

PO-CH/NL/0653

PART A

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1988 BUDGET
PAPERS ON
YUGOSLAVIA

16.6.88

DD's 25yrs NARS
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1988 Budget

Yogoslavia

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TO IMMEDIATE UKDEL/IBRD WASHINGTON
TELNO 46
OF 091700Z MARCH 88

IMF: EXTERNAL CONTINGENCY MECHANISMS IN FUND ARRANGEMENTS
- PRELIMINARY CONSIDERATIONS EBS/88/30

OVERVIEW

1. AT ANNUAL MEETINGS US PROPOSED ESTABLISHING EXTERNAL CONTINGENCY FACILITY (ECF) WHICH WOULD INCLUDE CFF AS ONE PART. LATEST REVIEW OF CFF (EBS/88/20) PROPOSED OPTION WHEREBY UPPER TRANCHES OF CFF WOULD BE AVAILABLE FOR MORE GENERAL EXTERNAL CONTINGENCIES. PRESENT PAPER RECONSIDERS THAT OPTION, AS WELL AS THE POSSIBILITIES OF EXTERNAL CONTINGENCY MECHANISMS WITHIN PROGRAMMES, OR A SEPARATE ECF.
2. MUCH OF PAPER CONCERNED WITH PROBLEMS OF IDENTIFICATION AND MEASUREMENT OF EXTERNAL DEVELOPMENTS (SEE LINE TO TAKE) AND WE RECOGNISE THAT FURTHER WORK WILL BE NEEDED ON THIS IF ANY SORT OF EXTERNAL CONTINGENCY ARRANGEMENTS ARE TO BE IMPLEMENTED.
3. OUR PREFERENCE IS FOR CONTINGENCY ARRANGEMENTS TO BE INTEGRATED INTO A NEW FACILITY, WITH SEPARATE WINDOWS PROVIDING CONTINGENT ACCESS ALONGSIDE THE EXISTING CFF FRAMEWORK.

OBJECTIVES

4. TO SEEK BROAD SUPPORT FOR:
 - I. EXTERNAL CONTINGENCY ARRANGEMENTS NOT TO OBVIATE THE NEED FOR ADDITIONAL ADJUSTMENT IN THE EVENT OF UNFORESEEN DEVELOPMENTS (IE THERE SHOULD BE NO QUESTION OF FUND FULLY FINANCING ADVERSE SHOCKS):
 - II. SYMMETRY:
 - III. PROVISION OF CONTINGENT FINANCE ONLY IF SHOCKS LARGELY BEYOND A MEMBER'S CONTROL.
5. TO OPPOSE TRIGGERS WITHIN FUND PROGRAMMES WHERE THEY IMPLY AUTOMATICITY OF EXTRA FINANCE. PREFER THAT EXTERNAL DEVELOPMENTS TRIGGER PROGRAMME REVIEW WHICH COULD CONSIDER THE MERITS OF EXTERNAL CONTINGENCY ARRANGEMENTS.
6. TO STRESS NEED FOR SAFETY MARGIN IN FUND PROGRAMMES (EG RESERVE ACCUMULATION) TO STRENGTHEN THE PROSPECT

OF CONTINUITY OF PROGRAMMES.

LINE TO TAKE

7. I. TO REITERATE SUPPORT FOR THE IDEA OF CONTINGENCY MECHANISMS AS A MEANS OF ENABLING MEMBERS TO SUSTAIN ADJUSTMENT PROCESS WITHIN FRAMEWORK OF FUND PROGRAMMES.
 - II. TO ARGUE FOR EXTERNAL CONTINGENCY ARRANGEMENTS TO BE INTEGRATED INTO THE CFF ON THE LINES OF THE STAFF FACILITY.
 - III. RECOGNISE THAT THE FUND HAS ALTERNATIVES TO EXTERNAL CONTINGENCY ARRANGEMENTS AT ITS DISPOSAL. BUT ALTHOUGH THE CFF PROVIDES CONTINGENT FINANCE IT ONLY COMPENSATES FOR EXPORT SHORTFALLS (AND CEREAL IMPORTS) AND DOES NOT PROVIDE FOR A STRENGTHENING OF PROGRAMMES.
8. PREPARED TO LOOK AT COMPENSATION FOR INTEREST RATE CHANGES IN CONTINGENCY MECHANISMS: BUT THIS NEEDS FURTHER CONSIDERATION.
9. BASIC FEATURES
- I. APPROPRIATE MIX OF ADJUSTMENT AND FINANCING
 - A. AGREE WITH STAFF ASSESSMENT THAT EXTERNAL CONTINGENCY MECHANISM SHOULD FOCUS ON A RANGE OF RELATIVELY MAJOR DISTURBANCES WHICH CAN ONLY BE CONSIDERED ON CASE-BY-CASE BASIS.
 - B. ECM SHOULD NOT FINANCE THE WHOLE OF THE EFFECT OF UNFORESEEN DEVELOPMENTS WHICH SHOULD BE EVALUATED ON A NET BASIS. NEED FOR APPROPRIATE MIX OF ADJUSTMENT AND FINANCING IN RESPONSE TO SHOCKS, WITH BALANCE SHIFTING TOWARDS ADJUSTMENT AS TIME PASSES.
 - C. CONTINGENT ACCESS SHOULD NOT BE EXCESSIVE IN RELATION TO AN ASSOCIATED ARRANGEMENT, ALTHOUGH IT MAY BE DIFFICULT TO QUANTIFY THIS. SUPPORT TRANCHING TO PREVENT OPEN QUOTES FRONTLOADING CLOSE QUOTES OF FUNDS WITHOUT ADEQUATE CONDITIONALITY.
 - D. ACTIVATION SHOULD BE THROUGH REVIEW OF PROGRAMMES. WOULD NOT SUPPORT QUASI-AUTOMATIC FINANCING.
 - E. IT WOULD BE FOR BANKS TO MAKE THEIR OWN DECISIONS ON PARALLEL CONTINGENCY FINANCING IN THE WAYS SUGGESTED ON PAGE 11.
 - F. SUPPORT IDEA OF THRESHOLD BELOW WHICH ECM WOULD NOT BE ACTIVATED - SHOULD BE ADEQUATE SAFETY MARGIN WITHIN PROGRAMME DESIGN.

- II. SYMMETRY IN APPLICATION - SUPPORT STAFF PROPOSAL TO ENCOURAGE STRENGTHENING OF RESERVES, REDUCE BORROWING, PREPAYMENT ETC FOLLOWING UNFORESEEN GAINS. STRONGLY SUPPORT VIEW THAT SYMMETRY SHOULD APPLY TO FUND LENDING TOO - PREFER STRONGER OPTION OF CLEAR PROVISION FOR REDUCED LENDING RATHER THAN JUST AN EXPECTATION. ALSO CLEAR PROVISION FOR EARLY REPURCHASE IF LATER FAVOURABLE DEVELOPMENTS.
- III. WOULD STRONGLY SUPPORT STAFF PROPOSAL THAT CONTINGENCIES MUST BE LARGELY BEYOND CONTROL OF MEMBER. RECOGNISE THAT IN PRACTICE THE INFLUENCE OF DOMESTIC POLICIES (EG ON EXCHANGE RATES) WILL BE DIFFICULT TO EXTRACT WHEN EVALUATING EXOGENOUS INFLUENCES.
10. TECHNICAL ISSUES -
- I. PREPARED TO SUPPORT USE OF WEO FOR BASELINE PROJECTIONS IN INTERESTS OF CONSISTENCY AND IN VIEW OF LACK OF PREFERABLE ALTERNATIVES, WHILE RECOGNISING DRAWBACKS (EG WEO ASSUMES CURRENT EXCHANGE AND INTEREST RATES).
- II. SEE MERIT IN APPROACH WHICH FOCUSES ON NET EFFECT OF UNANTICIPATED CHANGE FROM ASSUMED VALUES FOR EXOGENOUS COMPONENT OF KEY CURRENT ACCOUNT VARIABLES TO APPROACH BASED ON GLOBAL INDICATOR IN ORDER SUCCESSFULLY TO IDENTIFY EXOGENOUS FACTORS. BUT WOULD NOT RESIST SIMPLER GLOBAL INDICATOR.
- III. AGREE WITH STAFF THAT JUDGEMENTAL ESTIMATES LIKELY TO BE REQUIRED TO CALCULATE EXOGENOUS ELEMENTS EVEN IF FORMAL FRAMEWORK ADOPTED.
11. INTEREST PAYMENTS - RECOGNISE ARGUMENT FOR INCLUDING INTEREST PAYMENTS IN ECM SINCE THEY TOO CAN SEND PROGRAMME OFF TRACK. PARTIAL FINANCING (PARA 6) WOULD REDUCE THE EXTENT OF DILUTION OF INTEREST RATES AS TOOL OF MONETARY POLICY. PREFER THAT NOMINAL RATES BE USED IN INTERESTS OF TRANSPARENCY AND EASE OF MEASUREMENT. RECOGNISE THAT REAL RATES MAY GIVE BETTER INDICATION OF EFFECT OF CHANGE IN NOMINAL RATES ON MEMBER'S EXTERNAL POSITION, BUT THAT THE CHOICE OF DEFLATOR DIFFICULT AND UNLIKELY TO RESULT IN SATISFACTORY MEASURE. RISK PREMIA SHOULD NOT BE COVERED IN AN ECM, NOR SHOULD CHANGES IN THE REAL VALUE OF DEBT. ARGUMENTS ON P24 STRENGTHEN ARGUMENT FOR LIMITED CONTINGENT FINANCING.
12. OPERATIONAL STRUCTURES - WE WOULD PREFER

THE ECM TO BE INTEGRATED WITH CFF AS SET OUT IN CFF REVIEW (EBS/88/20 P26). IF THE TWO FACILITIES WERE COMBINED, DOUBLE COMPENSATION WOULD BE AVOIDED. WOULD NOT WISH TO SEE SEPARATE ECF INDEPENDENT OF CFF AS WISH TO AVOID PROLIFERATION OF SEPARATE FACILITIES. INTEGRATION OF ECM WITH PROGRAMMES WOULD IMPLY NO CONTINGENT FINANCING (BEYOND THE CFF) FOR COUNTRIES WITHOUT PROGRAMMES. EXPRESS INTEREST IN IDEA THAT CONTINGENT ACCESS COULD BE MADE AVAILABLE TO ALL MEMBERS (EG AS A BRIDGE TO AN SBA FOR THOSE WITHOUT PROGRAMMES).

13. LIQUIDITY - DRAW ASSURANCE FROM STAFF FIGURES THAT LIQUIDITY IMPLICATIONS OF ECM WOULD NOT POSE SERIOUS DIFFICULTIES IN THE SHORTER TERM, BUT NEED TO KEEP IMPLICATIONS UNDER REVIEW. NEED TO BEAR IN MIND THAT IF INTEREST RATES TO BE INCLUDED, IT COULD RESULT IN CONCENTRATION OF REQUESTS FOR CONTINGENCY FUNDS.

14. OTHER ISSUES - WOULD WANT LOW INCOME ESAF ELIGIBLE COUNTRIES TO BE ABLE TO DRAW ON CONTINGENT FINANCING, BUT THIS RAISES ISSUE THAT FINANCE IS ON NON-CONCESSIONAL TERMS AND SHORT MATURITIES. WOULD WELCOME FURTHER STAFF CONSIDERATION OF CONTINGENT FINANCING UNDER ESAF (P2). FOR EXAMPLE, SHOULD A PORTION OF ESAF FUNDS BE WITHHELD? SHOULD PROGRAMMES SET AMBITIOUS RESERVE TARGETS? ETC. OPPOSE FURTHER STAFF WORK ON GROWTH CONTINGENCIES.

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Courtesy Translation

Message

from

Herr Helmut Kohl, Federal Chancellor of the
Federal Republic of Germany

to

Her Excellency The Rt. Hon. Margaret Thatcher, MP
Prime Minister of the United Kingdom of Great Britain
and Northern Ireland

Dear Margaret,

On the 19th of this month I had a comprehensive discussion with Yugoslav Prime Minister Mikulic which was followed by contacts with Minister Makic. My impression is that the Yugoslav leadership, by implementing the reforms envisaged in the 1988 economic programme, now has a chance to avert a serious crisis with unforeseeable consequences. In my view Yugoslavia deserves support on grounds of foreign and economic policy. It is in the West's interest that Yugoslavia be enabled to return to the path of stability. There is a direct relationship between economic and political stability.

It is urgently necessary that the recovery programme negotiated between the International Monetary Fund and Yugoslavia be financed and implemented. In the opinion of the Yugoslav Government and the International Monetary Fund, however, the financing of the programme is not yet assured. I have therefore asked Dr. Lubbers, Prime Minister of The Netherlands, whose country leads the IMF voting group, to which Yugoslavia, too, belongs, to make a special effort to secure the programme's financial base. I have also informed him that the Federal Government will seek in the Club of Paris to achieve a generous

rescheduling arrangement including interest, and that it is prepared to assume a share of the preliminary financing of that interest.

Considering the political significance of this matter, joint action is in my view necessary, which is why I am approaching you and the Heads of State and Government of several other Western countries today. I do feel that comparable contributions from Western countries will facilitate a solution to Yugoslavia's current problems and would appreciate it if you, too, could likewise participate in the financing of the recovery programme worked out with the IMF.

Yours sincerely,
(sgd) Helmut Kohl
Chancellor of the
Federal Republic of Germany

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FM BELGRADE

TO DESKBY 081230Z FCO

TELNO 97

OF 081130Z APRIL 88

INFO PRIORITY UKDEL IMF/IBRD WASHINGTON

IMF TELNO 76: IMF/YUGOSLAVIA

SUMMARY

1. LONCAR ASKED ME ON 8 APRIL TO CONVEY TO YOU THE FEC'S VIEW OF THE POLITICAL CONTEXT IN WHICH THEY HAD TO DECIDE HOW MUCH TO DEVALUE THE DINAR. THE FUND WAS ASKING TOO MUCH, ESPECIALLY OF THE LESS-DEVELOPED. HE HOPED WE AND OTHERS COULD HELP THEM JUDGE BY CONVEYING THE FULLER BACKGROUND.

DETAIL

2. THE FOREIGN SECRETARY ASKED ME TO CALL ON 8 APRIL. HE WAS ALSO ARRANGING TO SEE THE US, FRG, ITALIAN AND FRENCH SEPARATELY. HE WANTED TO DISCUSS WHAT HE DESCRIBED AS THE LAST AND MOST DIFFICULT PROBLEM BETWEEN YUGOSLAVIA AND THE FUND, DEVALUATION, AND SET IT IN ITS POLITICAL CONTEXT.

3. LONCAR SAID THE YUGOSLAVS WANTED AGREEMENT ON AN SBA AS SOON AS POSSIBLE. DELAY HELD UP THEIR ECONOMIC PROGRAMME AS A WHOLE, THEY NEEDED TIME TO GO THROUGH THE POLITICAL AND LEGAL PROCEDURES CONSEQUENT UPON AGREEMENT WITH THE IMF, WHICH COULD WELL IN ANY CASE GIVE RISE TO DIFFICULTIES, AND FINALLY, A FINANCING GAP WAS CLEARLY ON THE HORIZON AND THEY WANTED TO CREATE THE RIGHT CONDITIONS FOR DISCUSSION OF BRIDGING FINANCE. THESE THREE FACTORS MEANT THAT DELAY WOULD AFFECT YUGOSLAVIA'S INTERNAL DEVELOPMENT AND HER EXTERNAL RELATIONSHIPS, WITH POLITICAL CONSEQUENCES WE SHOULD ALL TAKE INTO ACCOUNT. I WOULD KNOW, HE SAID, THE QUESTION OF RELATIONSHIPS WITH THE IMF WAS HIGHLY POLITICISED. IF PRESENT DIFFICULTIES COULD NOT BE RESOLVED, OPPOSITION TO THE FUND WOULD BE STRENGTHENED. IT WAS NOT A QUESTION OF DISAGREEMENT BETWEEN THE FUND AND YUGOSLAVS AS TO THE DIRECTION OF ECONOMIC POLICIES BUT ONE OF THE SPEED OF THEIR IMPLEMENTATION. IF DEVALUATION WERE PUSHED TOO FAR TOO SOON AND DESPITE ALL THE LONG TERM BENEFITS OF SUCH A MOVE THE FACT WAS THERE WOULD BE AN IMMEDIATE AND PROBLEMATIC IMPACT ON A NUMBER OF ENTERPRISES, BRANCHES OF THE ECONOMY, AND REGIONS OF THE COUNTRY. THE FOUR SOUTHERN FEDERAL UNITS WOULD BE PARTICUL-

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ARLY AFFECTED AND THAT HE FEARED WOULD EXACERBATE THE INTERNAL POLITICAL DIVISIONS TO WHICH HE HAD ALREADY REFERRED. IT WAS A FACT OF LIFE THAT YUGOSLAVIA'S FUTURE RELATIONSHIP WITH THE IMF WAS ONE WHICH HAD TO BE FITTED INTO THE WHOLE CONTEXT OF THE COUNTRY'S RELATIONSHIP WITH WESTERN CREDITORS.

4. LONCAR ASKED ME TO ENSURE THAT YOU WERE PERSONALLY AWARE OF THESE CONSIDERATIONS. IN ANSWER TO A COMMENT FROM ME THAT IT WOULD PERHAPS BE MISTAKEN FOR US TO INTERVENE ON ONE SIDE OR THE OTHER ON A TECHNICAL ISSUE IN THE NEGOTIATIONS HE EMPHASISED HE WAS NOT ASKING FOR US OR ANY OF THE OTHERS TO MEDIATE BETWEEN YUGOSLAVIA AND THE FUND, MERELY THAT WE SHOULD SOMEHOW MAKE THE IMF AWARE OF THE WIDER POLITICAL CONTEXT AND ENSURE THEY KNEW OF THE SOCIO-POLITICAL CONSIDERATIONS THE YUGOSLAV GOVERNMENT HAD TO WEIGH. BOTH THE SECRETARY FOR FINANCE AND THE GOVERNOR OF THE NATIONAL BANK WERE AT PRESENT IN WASHINGTON AND WOULD BE SEEING CAMDESSUS. THEY WOULD BE GIVING THE LATTER A "RATHER RESTRICTIVE" REPLY FROM MIKULIC TO THE QUESTIONS WHICH HAD BEEN LEFT OPEN FOLLOWING THE DEPARTURE OF THE STAFF MISSION.

5. I ASKED LONCAR WHETHER THE DIFFICULTY LAY IN THE INITIAL STEP DEVALUATION OR WHETHER THERE WERE ALSO PROBLEMS OVER THE INTRODUCTION OF A MORE FLEXIBLE MECHANISM FOR MANAGING THE DINAR FOLLOWING THAT FIRST STEP. HE SAID IT WAS THE FIRST PHASE THAT WAS THE PROBLEM (THOUGH I AM NOT SURE FROM HIS EXPRESSION WHETHER HE WAS FULLY BRIEFED ON THIS POINT). I ALSO TRIED TO ESTABLISH WHAT EXACTLY WAS THE GAP BETWEEN WHAT THE YUGOSLAVS THOUGHT ACCEPTABLE AND THE IMF DESIRABLE AS THE INITIAL STEPS. HIS ANSWER WAS COMPLICATED BY CONFUSION OVER THE METHOD OF CALCULATING PERCENTAGES BUT HE SAID THAT USING YUGOSLAV METHODOLOGY IT WAS HARD TO GO MUCH OVER 20 PER CENT. I UNDERTOOK TO PASS ON WHAT HE SAID, COMMENTING THAT THE RECENT DJURANOVIC VISIT WOULD HAVE GIVEN YOU AND THE PRIME MINISTER AN UP-TO-DATE FEEL FOR THE PRESENT POLITICAL SCENE HERE. HE SAID DJURANOVIC HAD BEEN WELL SATISFIED WITH HIS VISIT AND IMPRESSED BY THE EXTENT TO WHICH THOSE TO WHOM HE HAD TALKED WERE AU COURANT WITH YUGOSLAV AFFAIRS.

RECOMMENDATION

6. ALTHOUGH I DO NOT SUGGEST WE TAKE ANY POSITION ON THE SUBSTANCE OF THE ISSUE AS TO HOW MUCH THE DINAR SHOULD BE DEVALUED, SINCE THAT MUST CLEARLY BE A MATTER FOR THE FUND TO JUDGE AND NEGOTIATE WITH THE YUGOSLAVS, I HOPE WE CAN TELL THE IMF WHAT LONCAR HAS SAID TO ME (AND THE OTHERS) AND SUBSEQUENTLY LET THE YUGOSLAVS KNOW WE HAVE DONE SO. IT IS PROBABLY TRUE DEVALUATION

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WILL BEAR MORE HARDLY ON THE LESS-DEVELOPED AND THEREFORE PROVE MORE DIFFICULT DOMESTICALLY FOR THE GOVERNMENT TO NEGOTIATE. ON THE OTHER HAND, AS DJURANOVIC WAS TOLD LAST MONTH, NECESSARY MEDICINE IS BEST TAKEN IN ONE GULP.

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TO PRIORITY UKDEL IMF WASHINGTON

TELNO 63

OF 121100Z APRIL 88

INFO PRIORITY BELGRADE, PARIS, BONN, WASHINGTON, ROME

BELGRADE TELNO 97: YUGOSLAVIA/IMF

1. CALOVSKI (YUGOSLAV AMBASSADOR) CALLED ON SIR J FRETWELL ON INSTRUCTIONS ON 11 APRIL TO SEEK UK POLITICAL UNDERSTANDING AND SUPPORT IN HELPING TO SOLVE WHAT HE CLAIMED WAS THE FINAL POINT OF DIFFERENCE BETWEEN YUGOSLAVIA AND THE IMF STAFF, NAMELY THE PROBLEM OF DEVALUATION. SIMILAR APPROACHES ARE APPARENTLY BEING MADE IN THE OTHER MAJOR CREDITOR CAPITALS.
2. CALOVSKI ECHOED THE LINE TAKEN BY LONCAR (BELGRADE TUR) IN STRESSING IN PARTICULAR THE POLITICAL DIFFICULTIES WHICH WOULD RESULT FROM THE DEGREE OF DEVALUATION PROPOSED BY THE FUND (WHICH HE CLAIMED WAS 33 PERCENT). HE HOPED THE UK WOULD INTERVENE IN THIS SENSE WITH THE FUND TO SUPPORT THE REPRESENTATIONS CURRENTLY BEING MADE IN WASHINGTON BY RIKANOVIC AND VLATKOVIC AND TO INFLUENCE IMF THINKING AS THE STAFF PAPER WAS BEING PRODUCED. ONCE THE DEVALUATION ISSUE WAS RESOLVED CALOVSKI HOPED THAT THE FUND COULD COMPRESS THE TIME NEEDED BEFORE BOARD DISCUSSION AND APPROVAL, SINCE ANY DELAY COULD LEAD TO A FINANCING GAP. THIS WOULD EXACERBATE EXISTING PROBLEMS INCLUDING INFLATION.
3. CALOVSKI SET HIS APPROACH IN THE POLITICAL CONTEXT OF THE PRIME MINISTER'S RECENT TALKS WITH DJURANOVIC, AND ASKED THAT HIS REPRESENTATIONS BE BROUGHT TO THE ATTENTION OF THE PRIME MINISTER AND THE FOREIGN SECRETARY. (HE LATER TOLD LANCE THAT

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YUGOSLAV CONCESSIONS TO THE FUND OWED MUCH TO THE PRIME MINISTER'S DISCUSSION WITH DJURANOVIC: HE ALSO THOUGHT THERE MIGHT BE SCOPE FOR NEGOTIATING A FINAL COMPROMISE BETWEEN THE YUGOSLAV AND IMF POSITIONS).

4. IN REPLY, SIR J FRETWELL SAID WE WOULD TAKE YUGOSLAV VIEWS FULLY IN ACCOUNT, AND BEAR IN MIND THE POLITICAL CONTEXT. HE COULD MAKE NO COMMITMENT ON THE UK POSITION UNTIL WE HAD SEEN THE IMF STAFF PAPER. HE UNDERTOOK TO REPORT CALOVSKI'S APPROACH AT HIGH POLITICAL LEVEL.

5. SEE SEPARATE TELEGRAM TO BELGRADE IN RESPONSE TO THEIR TELNO 97. WE SHOULD BE GRATEFUL FOR YOUR COMMENTS ON THESE YUGOSLAV REPRESENTATIONS, IN THE LIGHT OF YOUR FURTHER DISCUSSIONS WITH THE IMF STAFF.

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TO PRIORITY BELGRADE

TELNO 60

OF 121030Z APRIL 88

INFO PRIORITY UKDEL IMF/IBRD WASHINGTON

YOUR TELNO 97: IMF/YUGOSLAVIA

WE ARE TELEGRAPHING SEPARATELY AN ACCOUNT OF A CALL YESTERDAY BY THE YUGOSLAV AMBASSADOR ON FRETWELL. CALOVSKI MADE MUCH THE SAME POINTS AS HAD BEEN MADE TO YOU BY LONCAR.

2. SINCE THE YUGOSLAVS HAVE MADE REPRESENTATIONS BOTH HERE AND IN BELGRADE, INCLUDING AT FOREIGN MINISTER LEVEL, IT SEEMS CLEAR THAT THEY ARE GENUINELY WORRIED THAT A STEP DEVALUATION OF THE SIZE CURRENTLY BEING SOUGHT BY THE IMF STAFF MAY PREJUDICE THE FEC'S ABILITY TO GET THE PROGRAMME AS A WHOLE APPROVED WITHIN YUGOSLAVIA, AT LEAST WITHOUT ADDING TO THE DELAY.

3. THEIR REASONS FOR WISHING TO KEEP DELAYS TO A MINIMUM, BEFORE BEFORE A SUITABLE PROGRAMME CAN BE PRESENTED TO THE EXECUTIVE BOARD AND ENTER INTO EFFECT, SEEM TO HAVE SOME VALIDITY. HOWEVER, THEIR REQUEST FOR US TO PASS ON THEIR REPRESENTATIONS TO THE IMF STAFF CAUSES DIFFICULTY. POLITICAL REPRESENTATIONS TO INDIVIDUAL EXECUTIVE BOARD MEMBERS BY COUNTRIES INVOLVED IN NEGOTIATIONS FOR AN IMF PROGRAMME ARE COMMON. ALL IMF MEMBERS OF COURSE HAVE THEIR OWN CHANNELS TO THE STAFF (INCLUDING IN THIS CASE THE YUGOSLAVS, AS YOU POINT OUT). IF WE WERE TO PASS ON THE YUGOSLAV REPRESENTATIONS, THE FUND STAFF WOULD TAKE THIS AS AN INDICATION THAT THE UK WISHED TO ASSOCIATE ITSELF WITH THE POINTS THE YUGOSLAVS HAVE MADE. AGAINST THE BACKGROUND IN UKDEL IMF TELNO 76, THIS MIGHT ALSO BE SEIZED ON BY THE FUND MANAGEMENT AS

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A REASON FOR WEAKENING THE STANCE CURRENTLY BEING TAKEN BY THE STAFF IN THE NEGOTIATIONS. OUR OBJECTIVE OF COURSE REMAINS A FIRM ADJUSTMENT PROGRAMME. WE NEED TO AVOID ANY ACTION WHICH MIGHT PREJUDICE OUR POSITION SUBSEQUENTLY, WHEN WE SHALL NEED TO ASSESS THE WHOLE MIX OF INTEREST RATES, FISCAL AND EXCHANGE RATE MEASURES ON OFFER. AND IT IS IMPORTANT NOT TO CUT ACROSS ANY COORDINATION BETWEEN G7 EXECUTIVE DIRECTORS.

4. FOR THE MOMENT, WE WOULD THEREFORE NOT WISH YOU TO GO BEYOND TELLING THE YUGOSLAVS, IN LINE WITH FRETWELL'S RESPONSE TO CALOVSKI, THAT WE HAVE TAKEN MOST CAREFUL NOTE OF YUGOSLAV VIEWS. WE WILL BEAR THESE IN MIND AS DISCUSSION OF A PROGRAMME MOVES FORWARD. WE AGREE THAT DELAY IN CONSIDERING A PROGRAMME SHOULD BE KEPT TO A MINIMUM. MEANWHILE, WE ASSUME THAT RIKANOVIC AND VLATKOVIC WILL BE SPELLING OUT THE YUGOSLAV POSITION IN DETAIL WHEN THEY SEE CAMDESSUS IN WASHINGTON THIS WEEK, INCLUDING THE IMPORTANT POLITICAL FACTORS TO WHICH LONCAR AND CALOVSKI HAVE DRAWN OUR ATTENTION.

5. FOR UKDEL IMF. YOU WILL NO DOUBT ASK THE IMF STAFF FOR AN EARLY ACCOUNT OF RIKANOVIC'S AND VLATKOVIC'S DISCUSSION WITH CAMDESSUS. IT WOULD BE USEFUL IF YOU COULD TELL THE STAFF, IN THE COURSE OF RECEIVING THIS ACCOUNT, THAT THE YUGOSLAVS HAVE BEEN LOBBYING HARD ON THE QUESTION OF DEVALUATION, AND ASK IN PARTICULAR HOW THAT ISSUE NOW STANDS. PLEASE ALSO ARRANGE FOR LITTLER TO SEE THIS TELEGRAM AND OUR TUR TO BELGRADE.

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FM BELGRADE

TO DESKBY 131000Z FCO

TELNO 99

OF 130820Z APRIL 88

INFO IMMEDIATE UKDEL IMF/IBRD WASHINGTON

INFO ROUTINE PARIS, BONN, WASHINGTON, ROME

YOUR TELNO 60 TO ME AND 63 TO UKDEL IMF: YUGOSLAVIA/IMF

SUMMARY

1. ACCORDING TO LONCAR AGREEMENT WITH THE FUND INCLUDING OVER DEVALUATION IS IMMINENT. THEREAFTER CAMDESSUS IS TO COORDINATE ACTION ON BRIDGING AND LONGER TERM FINANCIAL SUPPORT.

DETAIL

2. LONCAR TOLD EC AMBASSADORS OVER DINNER LAST NIGHT (MY TELNO 100, NOT TO ALL) HE EXPECTED FINAL AGREEMENT WITH THE IMF STAFF TO BE REACHED ON 13 APRIL. IT HAD NOW BEEN ACCEPTED THE INITIAL STEP DEVALUATION WOULD BE 23.9 PER CENT AGAINST THE DOLLAR WITH THE OPTION OF A FURTHER 10 PER CENT DEVALUATION OVER THE YEAR SHOULD THAT PROVE NECESSARY. HE ASKED FOR HIS CONFIDENCE TO BE RESPECTED. THE DINAR WOULD CONTINUE TO FLOAT AGAINST A BASKET OF CURRENCIES FOLLOWING THE INITIAL DEVALUATION. THE ONLY REMAINING ISSUE BETWEEN THE YUGOSLAVS AND THE STAFF CONCERNED THE PERCENTAGE BY WHICH INTEREST RATES SHOULD EXCEED THE RATE OF INFLATION. THE YUGOSLAVS WERE ARGUING FOR FOUR PERCENT, THE STAFF FOR FIVE PERCENT. HE WAS CONFIDENT THIS OBSTACLE WOULD BE OVERCOME. HE UNDERLINED THE SERIOUSNESS OF THE YUGOSLAV COMMITMENT TO REFORM AND THE WEIGHT OF THE OBLIGATIONS THEY WOULD BE ASSUMING UNDER AN SBA, INCLUDING OVER PRICE AND IMPORT LIBERALISATION.

3. LONCAR WENT ON TO SAY THE TOTAL FINANCING REQUIREMENT WOULD BE OF THE ORDER OF 1.4 BILLION DOLLARS, 500 MILLION OF WHICH THE

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/...YUGOSLAVS

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YUGOSLAVS TRUSTED WOULD BE FORTHCOMING FROM CREDITOR GOVERNMENTS. THERE WOULD BE AN EARLY REQUIREMENT FOR SHORT TERM BRIDGING FINANCE OF SOME 460 MILLION DOLLARS, WHICH WOULD BE REFUNDED ONCE LONGER TERM ARRANGEMENTS WERE IN PLACE. THE LATTER REQUIREMENT WOULD NEED RAPID AND EARLY ACTION. I ASKED HIM WHO WOULD BE TAKING THE INITIATIVE. HE SAID IT WOULD BE CAMDESSUS. I ALSO TOLD HIM IT SEEMED TO ME VERY GOOD NEWS INDEED THAT AGREEMENT WITH THE FUND WAS APPARENTLY SO CLOSE.

4. I DID NOT IN THE CIRCUMSTANCES THINK IT APPROPRIATE TO DRAW ON PARAGRAPH 4 OF YOUR TELNO 60 (NOT TO ALL). CALOVSKI WILL IN ANY CASE HAVE REPORTED WHAT SIR J FRETWELL HAD TO SAY TO HIM ON 11 APRIL.

COMMENT

5. WE SHALL OBVIOUSLY NEED TO PICK OVER THE BONES OF THE PROPOSED STANDBY VERY CAREFULLY AND KEEP A CLOSE WATCH ON YUGOSLAV IMPLEMENTATION OF ITS PROVISIONS. THAT SAID HOWEVER IT SEEMS ON THE FACE OF IT THAT THE YUGOSLAVS HAVE INDEED MADE SUBSTANTIAL CONCESSIONS AND AGREED TO CONDITIONS WHICH, IF FULFILLED, OUGHT GREATLY TO ADD TO THE PRESSURE ON THEM TO UNDERTAKE A REAL MEASURE OF ECONOMIC REFORM. IF THIS IS RIGHT, AND RECOGNISING THE CUP IS STILL SOME WAY FROM THE LIP, IT OWES A GREAT DEAL TO SUSTAINED PRESSURE FROM THE FINANCIAL INSTITUTIONS AND THE CREDITORS, WITH US AND THE AMERICANS TO THE FORE. CALOVSKI WAS ADDING HIS USUAL PERSONAL FLOURISH WHEN HE TOLD LANCE YUGOSLAV CONCESSIONS TO THE FUND OWED MUCH TO THE PRIME MINISTER'S DISCUSSION WITH DJURANOVIC (STRBAC TOLD ME THE DAY THE STAFF MISSION ARRIVED IN BELGRADE THE PRINCIPAL DIFFICULTY THIS TIME ROUND WOULD BE DEVALUATION, EVERYTHING ELSE HAVING BEEN PRETTY MUCH AGREED IN ADVANCE). BUT I HAVE NO DOUBT OUR EXCHANGES WITH THE YUGOSLAVS CULMINATING IN THE TALKS WITH DJURANOVIC PLAYED AN IMPORTANT PART IN PERSUADING THEM THEY HAD NO REAL ALTERNATIVE BUT TO COME TO TERMS WITH THE IMF AS BEST THEY COULD. THEY WILL ALSO HAVE TAKEN DUE NOTE OF OUR UNDERTAKINGS TO BE GENEROUS ONCE AN SBA IS ACHIEVED AND HAVE MADE THEIR HOPES OF FINANCIAL SUPPORT CLEAR ENOUGH IN THE COURSE OF THIS YEAR.

WOOD

NOTE FOR RECORD

Copies to PS/Chancellor
 The Governor
 Mr Loehnis
 Mr Cassell
 Mr Evans
 Mr Enoch

IMF: Yugoslavia

1. Following the news yesterday that the Yugoslavs had signed a Letter of Intent for a Stand-By Arrangement, Mr Loehnis and Mr Enoch spoke this morning with Duncan Ripley (leader of the staff mission to Yugoslavia).
2. The Stand-By is for 12 months and an amount of SDR 306 mn. (50% of quota). Agreement followed Yugoslav acquiescence in an initial step devaluation of 23.9% (compared to the 16.7% they originally proposed). We understand that a further 10.0% devaluation has been pencilled in over the rest of the Stand-By period. The Yugoslavs were finally able to move towards the Fund on devaluation once the latter lowered their figure below the 24.6% devaluation seen in November: anything above this level was seen as politically damaging (the Yugoslavs have been lobbying hard on this point - see FCO telno 63).
3. Ripley described the agreed programme as "draconian", at least on paper. As always with the Yugoslavs, the problem would be one of implementation. She was particularly worried that, as the foreign exchange situation eased with seasonal inflows during the summer, the Yugoslavs would become less inclined to undertake adjustment.
4. Ripley explained that the nominal limits - on public expenditure, wages and credit - which had been the keystone of the programme originally proposed by the staff remained in place but with allowance for a higher rate of inflation in 1988 following the failure of the price freeze. The structural measures which had been advanced in order to offset the easier macro-economic path included agreements on the exchange rate and foreign exchange allocation mechanism, and on interest rate determination, both of which Ripley saw as very significant.
5. On exchange determination and foreign exchange allocation, the Yugoslavs had agreed to move to an inter-bank system (which would be used as a means of reaching judgments on further adjustments against the basket of currencies to which the dinar is fixed). The new arrangement would be subject to fairly intense staff monitoring. The latter would involve monthly visits and a close examination of central bank directives to commercial banks. On interest rate determination, the present system - in which interest rates are fixed by reference to the rate of inflation in the last month but one - would be replaced by the indexation of principal with reference to the concurrent rate of inflation plus a margin of 5 percentage points.
6. The Yugoslavs remain obsessed with getting Fund Board approval of the Stand-By before the deadline of 15 May. In Ripley's opinion, this

reflected Mikulic's desire to anticipate his vote of confidence but also the probable turnover of economic officials at that time (including Zemljuric and possibly Rikanovic) and the expiration of the current intervention laws freezing prices and wages. However, neither the Yugoslavs nor the Fund staff apparently wish to go to the Board for approval of the Stand-By until adequate assurances had been obtained from creditors on filling Yugoslavia's estimated financing requirement.

7. Although the Yugoslavs were targetting financing from government and commercial bank creditors of \$1 bn. (ie in addition to the Fund and Bank), the Fund staff believed that \$800 mn. would be adequate and was a more feasible target. Bridging finance of some \$460 mn. is also being sought. Ripley and Russo (Director, European Dept.) are due in New York this afternoon to talk with the commercial banks. Ripley was not optimistic about the banks' response, noting that in previous discussions they had only envisaged new money of \$300 mn. Some \$200 mn. might be available from the roll-over of interest but Ripley was unsure whether the banks had included this in their original new money figure and whether they would be willing to continue to roll over this interest for more than one year. Ripley observed that the attitude of banks had hardened with concerns about the possible subordination of new money.

8. On new money from official creditors, Ripley identified \$200-300 mn. of official interest that could be capitalised in 1988. The Germans would be asked to take the lead here and an official request would be made by Mikulic when he visited Kohl on 19 April. Ripley expected Yugoslavia to be raised in the Paris Club tour d'horizon in April and to come to the Paris Club for formal consideration on 6 June.

9. Ripley was not hopeful that financing assurances could be put in place by the May deadline. In addition to likely delays with the commercial banks, the World Bank SAL was unlikely to be put into place as quickly as the Yugoslavs claimed.

10. A version of this note will be sent by telegram to London and Belgrade.

13 April 1988
Richard Comotto *RC*

Postscript: Reuters reported this morning that Cheysson (EC) had said that the EC could provide Yugoslavia with "several hundred" million dollars of assistance, mainly short term. Grant aid - as offered to several Mediterranean states - was ruled out because of objections to such assistance by Mrs Thatcher.

NOTE FOR RECORD

Copies to Mr Loehnis
Mr Cassell
Mr Evans
Mr Enoch
Mr Richardson

Yugoslavia

1. I saw Russo (European Dept.) this morning, shortly before he was due to depart for New York to talk to the commercial banks on their prospective lending to Yugoslavia. As the Managing Director told the Chancellor yesterday, an SBA has now been agreed with the Yugoslavs and Russo for one believes that it is certainly a good programme - on paper, that is. The crux, as always, will come with its implementation.
2. We did not discuss all the details, though one of the main features of the programme is a step devaluation of 20%, to be effected one week before the papers come to the Board for approval. In addition, the National Bank will be given authority for a further real devaluation of up to 10% if that subsequently proves necessary. If this 10% is fully used up, it will be open to the National Bank to go back to the government for authority for a further 10%. All this means that the level of the exchange rate should be kept at a reasonable level for the foreseeable future (the 20% step change will restore the level of the dinar to its 1983 level - a time when the Yugoslav balance of payments was in a reasonable position).
3. Russo confirmed that the total financing need is \$1 1/2 bn. \$500 mn. of this is to come from the Fund/World Bank, \$500 mn. from the commercial banks and the remaining \$500 mn. from governmental sources. As far as the latter is concerned, this means the Paris Club, export credit agencies (though here there is the problem that the Yugoslavs already have unused lines available) and bilateral sources. I asked Russo whether he included the EC in this but he said they had no money available and anything provided by the EIB was already factored into the figures which produced the financing gap. Russo was concerned that he would find it difficult to persuade the commercial banks that they needed to put up as much as \$500 mn. This was partly because he himself could not put his hand on his heart and say that this amount was needed. Of the \$1 bn. from governments and banks, he felt that perhaps only \$800 mn. was really required. The problem was that the Yugoslav technicians had sold the programme to their authorities on the basis of the full \$1 bn. As well as doubts over the need for the full \$500 mn., Russo was also concerned that the banks would argue that they were bailing out the Fund.
4. For the future, and if all went well, Russo mused on the possibility of a follow-on EFF. He also felt that the EIB might be able to play a role in providing the collateral for a debt buy-back arrangement a la Mexico. He felt it important that Europe should be seen to be helping one of its own in the same way that the Americans helped their clients.

13 April 1988
R G Ware

Sir G. Little

NOTE FOR RECORD

Copies to PS/Chancellor
 The Governor
 Mr Loehnis
 Mr Cassell
 Mr Evans
 Mr Enoch

1 Donat
2 prog

*4-4-85 pm Arts*IMF: Yugoslavia

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13 April 1988
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MDADAN 4279

RESTRICTED
FM BELGRADE
TO DESKBY 271030Z FCO
TELNO 108
OF 270915Z APRIL 88

ADVANCE COPY

INFO ROUTINE UKDEL IMF/IBRD WASHINGTON, PARIS, BONN, ROME
INFO ROUTINE WASHINGTON, UKREP BRUSSELS

YUGOSLAV FINANCIAL PROBLEMS

1. THE FSFA HAVE TOLD ME INSTRUCTIONS WERE SENT OFF TO THEIR EMBASSY IN LONDON THIS MORNING TO SEEK AN URGENT INTERVIEW WITH THE CHANCELLOR OF THE EXCHEQUER FOR RIKANOVIC WHO WILL BE IN LONDON ON 2 MAY. THEY SAY THE NEGOTIATIONS WITH THE CREDITORS ON RE-FINANCING ARE ENTERING THEIR FINAL PHASE AND WOULD LIKE TO TALK TO US DIRECTLY ABOUT THEIR ECONOMIC PROGRAMME AND THE LATEST DEVELOPMENTS IN THEIR CONTACTS WITH THEIR OTHER CREDITORS, TO WHOM THEY ALSO INTEND TO TALK. I HAVE TOLD THEM I AGREE CONTACTS OF THIS KIND WOULD BE USEFUL BUT THAT THEY HAVE NOT GIVEN US MUCH TIME IN WHICH TO ARRANGE ANYTHING AND 2 MAY IS IN ANY CASE A HOLIDAY IN THE UK. TRAJKOVSKI SAID HE NEVERTHELESS HOPED SOMETHING COULD BE ARRANGED, FOR TIME WAS PRESSING GIVEN THE IMF BOARD MEETING DUE ON 13 MAY AND THE FACT THAT PRESENT YUGOSLAV MEASURES ARE DUE TO EXPIRE ON 15 MAY. HE THEREFORE HOPED FOR A POSITIVE RESPONSE.

COMMENT

2. THIS IS HIGHLY INCONVENIENT, ESPECIALLY AS TO TIMING, BUT THERE IS AN OBVIOUS CASE FOR SOMEONE SENIOR TO SEE RIKANOVIC IF HUMANLY POSSIBLE. THE LESS GOOD ALTERNATIVE WOULD BE FOR INSTRUCTIONS TO BE SENT TO ME. WE SHOULD TAKE THE CHANCE IF WE CAN IN THE HOPE OF CUTTING THROUGH SOME OF THE FOG RAISED BY THE COMMISSION ON 25 APRIL (LUXEMBOURG TELNO 79).

WOOD

YYYY

ADVANCE

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197 Yugoslavia
of Spring 1988

HER MAJESTY'S TREASURY
INTERIM/DEVELOPMENT COMMITTEE MEETINGS
14-15 APRIL 1988

MAJOR DEBTORS - YUGOSLAVIA

Line to take

A rigorous IMF standby arrangement remains an essential precondition for debt relief from official creditors. Warn Camdessus against bringing inadequate programme to Fund board. A BIS bridging loan for Q2 could be considered but a strong Letter of Intent to the Fund would be needed and there could be problems with negative pledge on gold collateral.

Once a strong IMF programme is in place Paris Club rescheduling could proceed.

Background

Recent economic performance has been mixed. The current account outturn for last year was better than expected but reserves had to be reduced by \$0.75 billion. (Reserves stood at less than \$0.6 billion at end-January.) Inflation accelerated sharply last year. Temporary price regulation and a partial wage freeze introduced in November will not provide a lasting solution, and have been criticised by Croats and Slovenes who want fundamental reforms to introduce market forces, as also by the IMF and commercial banks. Nevertheless, some allies (Italy and possibly Germany) but also the Fund MD may be inclined to agree a weak IMF programme: the allies through fears that stringent economic measures might precipitate a collapse of the present regime, and Camdessus because of Yugoslavia's large obligation to the Fund. Both these fears are probably overstated.

Relations with IMF/IBRD

The Fund team has just returned from Belgrade. The Yugoslavs are resisting a step devaluation followed by flexible exchange rate mechanism. They have also increased their financing requirements. The Yugoslavs are seeking agreement before 15 May when the Government changes. Fund management (Camdessus/Russo) may be too ready to make concessions in these circumstances - agreeing a weak programme which the incoming team fails to implement. It might be better to conclude a firm programme with the new team. The earliest date for a Board discussion of an SBA would be 13 May and accumulation of arrears to creditors in the second quarter is inevitable unless bridging finance is arranged.

The World Bank has staff in Yugoslavia at present discussing conditions for a SAL but this would not go to the Board before December.

Relations with Paris Club

The Paris Club has refused to begin rescheduling negotiations before the implementation of an SBA but after discussion in March there was a consensus that if Yugoslavia did fall into arrears bridging finance through the BIS might be possible, provided a satisfactory Letter of Intent had been agreed. Yugoslavia would probably be required to pledge its gold reserves (\$0.9 billion at end-1987) as collateral. Yugoslavia had a BIS bridging loan in 1983 of \$0.5 billion, to which the UK contribution was \$25 million. Yugoslavia is reported to be looking for a bridging loan in the region of \$400 - 600 million.

Relations with commercial banks

In January the Yugoslavs rejected the banks' offer of an 18 year rescheduling of 100 per cent of all outstanding principal (\$6.9 billion) at LIBOR + 1 per cent because they are seeking a margin of only 0.5 per cent and up to \$0.7 billion new money. The banks continue to roll over principal payments due; the Yugoslavs remain current on interest. No date has been set for a further meeting.

Relations with UK

Relations with Yugoslavia are friendly. The UK's position on an appropriate SBA programme has been described by Rikanovic (Finance Minister) as "severe and lacking in warmth" but he acknowledged that we were not alone in our views. The Yugoslav Foreign Minister subsequently reported that during his recent visit to London, Djuranovic (Member of Yugoslav Presidency) had been exposed to some "tough but wise words". Djuranovic pressed the Prime Minister for resumption of ECGD cover, particularly in connection with the proposed leasing of three Airbus for Adria airways. FRG and France have agreed to provide cover before agreement of a Fund programme. ECGD is not in a position to offer cover until agreements with Fund and Paris Club have been reached.

Key Statistics

Real GSP/Growth in 1987 2.7 per cent

Inflation 116 per cent

External Debt \$20.3 billion (34 per cent GSP)

Financial Situation in Yugoslavia

This is covered in brief []

At the March ECOFIN meeting Delors drew attention at lunch to the serious external situation in Yugoslavia and appealed to Community Finance Ministers to show understanding. No one commented. The subject may be raised again at lunch. The Commission circulated a paper to the Monetary Committee on whether the Community should support the IMF in providing assistance to Yugoslavia. The paper got no support and we would not wish to support a Commission initiative. You will be familiar with any developments in the margins at the Interim Committee last week.

Mr Mountfield -

The proposal as agreed with EC.

ST
19/4

DRAFT BRIEF

H M TREASURY

ECOFIN MEETING 18 APRIL

SUBJECT: YUGOSLAVIA

UK Objectives

1. Squash any proposal that the EC should provide funding for Yugoslavia either in the form of bridging finance or in the form of funds linked to IMF money under a Fund programme or in the form of aid.
2. Convince other finance ministers that discussion on Yugoslavia is premature before the staff paper on the SBA has been produced.

Line to take

A rigorous IMF standby arrangement remains an essential precondition for debt relief. We need to see the staff paper before we can judge how adequate are the terms proposed. If bridging finance is needed to meet payments falling due in the next three months a BIS loan could be considered but a strong letter of intent to the Fund would be needed and there could be problems with negative pledge on gold collateral. No special need

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for EC assistance: satisfactory IMF programme would mean rescheduling in the Paris Club could proceed.

Background

A letter of intent for an SBA for 50% of quota (306 SDRs) was agreed with the IMF last week. We would like to reserve judgement on the terms until we have analysed the staff paper because of earlier reports of disagreement between Fund management and Staff on the measures necessary and because of some confusion on the exact figures for the devaluation proposed by the IMF staff. Any Yugoslav adjustment package must contain adequate measures both to restrain domestic demand via budgetary/interest rate policies and to switch resources into the balance of payments, and we wish to examine the total package proposed when the Fund has produced a paper. The Yugoslavs have been lobbying hard in Western Capitals and with EC Ambassadors in Belgrade for support for a speedy agreement with the Fund before the vote on May 15th on the confirmation of the present FEC for a further 2 year term. During a recent visit to Belgrade Cheysson reportedly declared that Yugoslavia would be eligible for large grants from the EC once agreement had been reached with the IMF. When certain that the proposed programme is adequate we could support a BIS bridging loan with appropriate safeguards, but there is no need for EC finance.

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142720
MDHIAN 7525

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FM BELGRADE

TO DESKBY 281430Z FCO

TELNO 111

OF 281200Z APRIL 88

INFO ROUTINE UKDEL IMF/IBRD WASHINGTON, PARIS, BONN, ROME

INFO ROUTINE WASHINGTON

MY TELS NOS 108 AND 110: IMF/YUGOSLAVIA

SUMMARY

1. THE YUGOSLAVS NEED AN EARLY INDICATION OF OUR VIEWS ON FINANCING THE PROPOSED IMF PROGRAMME.

DETAIL

2. WE HAVE RECEIVED AN ACCOUNT OF THE PARIS CLUB DISCUSSION ON 26 APRIL THROUGH THE US EMBASSY. CAMDESSUS WROTE TO TRICHET ON 18 APRIL, COMMENDING THE IMF PROGRAMME AND SEEKING ASSURANCES OF FINANCIAL ASSISTANCE. ACCORDING TO THE US ACCOUNT, THERE WAS GENERAL CONGRATULATION TO THE FUND FOR PUTTING TOGETHER A STRONG PROGRAMME. THE US REPRESENTATIVE STRESSED THAT HIS COUNTRY WAS PREPARED TO RESCHEDULE WHAT WAS NECESSARY TO SUPPORT IT. BUT TRICHET EXPRESSED SCEPTICISM ABOUT 'THE EFFORT BEING DEMANDED OF THE PARIS CLUB CREDITORS, AND WONDERED WHERE THE MONEY COULD BE FOUND. HE ADDED THAT, ALTHOUGH AN IMF BOARD MEETING IN MAY WAS ENVISAGED, IN HIS VIEW A JUNE MEETING WAS MORE LIKELY GIVEN EXPECTED DELAYS IN ASSEMBLING THE FINANCIAL PACKAGE.

3. DELAY UNTIL JUNE WOULD COMPLICATE NEGOTIATIONS. IF IT IS INEVITABLE, IT WILL THEREFORE REQUIRE CAREFUL HANDLING. PRESENT YUGOSLAV PERCEPTIONS OF THE NEED FOR A DECISION AT THE IMF BOARD MEETING ON 13 MAY STEM PARTLY FROM THE TIMING OF THE RENEWAL OF MIKULIC'S MANDATE ON 15 MAY (MY TELNO 110) AND EVEN MORE URGENTLY FROM THE NEED TO PUT SOMETHING IN PLACE OF CURRENT ARRANGEMENTS WHICH EXPIRE THE SAME DAY. THE YUGOSLAVS ARE SUPPOSED, MOREOVER, TO IMPLEMENT A NUMBER OF RADICAL MEASURES BEFORE THE BOARD DISCUSSION. BUT THE AGREEMENT WILL NOT BE PUT TO THE BOARD BEFORE FINANCE IS ASSURED, MAKING THE TIMETABLE EVEN TIGHTER. DISCUSSION OF FINANCING AMONG OFFICIAL CREDITORS STILL APPEARS AT AN EARLY STAGE. CONSIDERATION OF A BRIDGING LOAN AWAITS CONFIRMATION OF LONGER TERM FINANCING.

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4. THE KEY TO RESOLVING THESE DILEMMAS WOULD SEEM FROM HERE TO LIE IN CREDITOR HANDS, FOR WITHOUT SOME IDEA OF WHAT FINANCING ARRANGEMENTS ARE LIKELY TO BE AGREED (OR AT THE VERY LEAST IF AN EARLY BRIDGING LOAN IS IN PROSPECT) IT IS ASKING A LOT TO EXPECT THE YUGOSLAVS TO MAKE DECISIVE MOVES. ON THE OTHER HAND IT IS ASKING A LOT OF US TO MAKE DECISIONS WITHOUT KNOWING MORE PRECISELY WHAT IT IS WE WOULD BE PAYING FOR. THE VARIOUS QUESTIONS INVOLVED ARE BROUGHT INTO FOCUS FOR US BY RIKANOVIC'S REQUEST FOR A MEETING IN LONDON ON 2 MAY. SUCH A MEETING (OR DISCUSSION HERE ON INSTRUCTIONS) COULD BE USED TO EXPLORE THE YUGOSLAV POSITION, IN PARTICULAR THE QUESTION OF EXACTLY HOW MUCH FINANCE IS NEEDED AND WHY (I UNDERSTAND THAT, IN THE PARIS CLUB, MOUNTFIELD QUESTIONED SOME ASSUMPTIONS ABOUT PROJECTED RESERVE BUILD UP AND THE CURRENT SURPLUS). WE COULD ALSO ASK HOW THE YUGOSLAVS NOW SEE THE LIKELY PATTERN OF EVENTS, AND WHEN THEY PROPOSE TO IMPLEMENT THE VARIOUS MEASURES TO WHICH THEY ARE COMMITTED BY AGREEMENT WITH THE IMF. BUT THE MAIN POINT FOR THE YUGOSLAVS WILL BE TO GET AS BEST AN INDICATION AS THEY MAY OF WHAT WE ARE PREPARED TO DO TO HELP. IT WOULD SEEM UNFAIR AND PERHAPS UNWISE, TO BE TOO SECRETIVE IN RESPONSE.

5. WE AND OTHER WESTERN CREDITORS HAVE BEEN INSTRUMENTAL IN HELPING TO SET UP A STRONG IMF PROGRAMME (MY TELNO 99), AND IN FORCING THE YUGOSLAVS TO ACCEPT IT. IN DOING SO WE HAVE ALLOWED YUGOSLAV ASSUMPTIONS AS TO A SUPPORTING CREDITOR EFFORT TO GO UNCHALLENGED. WE NOW HAVE A REAL OPPORTUNITY TO PUT PRESSURE ON THE YUGOSLAVS TO IMPROVE THEIR ECONOMIC PERFORMANCE, AND THEREBY TO AFFECT THE POLITICAL EVOLUTION OF THIS COUNTRY. WE NEED AS SOON AS POSSIBLE TO DECIDE HOW BEST WE CAN HELP TO EXPLOIT THIS OPENING. IN PARTICULAR, DECISIONS ARE NEEDED ON HOW MUCH CONCRETE FINANCIAL ASSISTANCE WE ARE PREPARED TO GIVE, AND WHERE WESTERN DECISIONS SHOULD BE COORDINATED. IT WILL BE ALL THE HARDER TO MANAGE YUGOSLAV DISAPPOINTMENT AT ANY DELAY UNTIL JUNE, OR TO ASSUAGE THEIR FEARS OF THE CONSEQUENCES OF SUCH A POSSIBILITY, IF WE ARE UNABLE SOON TO GIVE THEM SOME CONCRETE INDICATION OF THE WAY OUR MINDS ARE TURNING.

6. I HAVE JUST SEEN BONN TELEGRAM NUMBER 396 WHICH ADDS FURTHER POINT TO THE ABOVE.

WOOD

YYYY

PAGE 2
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NNNN



I have provisionally
arranged for Mr Rikancic
to call on you at 4.00pm
on Wed 4 May. He will be
accompanied by the Yugoslav
Ambassador + one other.

Content?

I understand Mr Lancaster
is free & Mr Bethell. Mr
Mountfield is lecturing at
Sussex University at this time
& so would not be able to
attend.

Content with Mr Lancaster
& Mr Bethell?

Julia OK -
29/4.



Ch.

Rikanovic

Rikanovic has now scrubbed Monday. Unfortunately he has said that he would instead be available to see you on 3, 4, or 5 May! Difficult to refuse, + Mr Thompson + FCO think it would be worth seeing him. Shall we try to fix a time?

OK: half hour max.
JF
29/4

UNCLASSIFIED



FROM: J M G TAYLOR
DATE: 28 April 1988

Handwritten signature

MR MOUNTFIELD

cc Sir G Littler
Mr Lankester
Mr Evans
Mr Bottrill
Mrs Thomson

VISIT OF YUGOSLAV FINANCE MINISTER

The Chancellor has seen your minute of 27 April.

2. He will not be able to see Mr Rikanovic himself on Bank Holiday Monday. If you were able to see Rikanovic yourself without too much difficulty, he would be happy for you to do so.

Handwritten signature

J M G TAYLOR

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150672
MDHIAN 7780

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FM UKDEL IMF/IBRD WASHINGTON
TO DESKBY 020900Z FCO
TELNO 103
OF 292300Z APRIL 88
INFO ROUTINE BELGRADE

IMF: YUGOSLAVIA

SUMMARY

1. BOARD FORMALLY NOTIFIED OF SBA AND PRELIMINARY AGREEMENT WITH BANKS. CONFIRMATION THAT FINANCING GAP MAY BE LESS THAN DOLLARS 1 BN. DOUBT EXPRESSED ABOUT 13 MAY DEADLINE FOR BOARD DISCUSSION. PAPER EXPECTED EARLY NEXT WEEK.

DETAIL

2. THE MD ANNOUNCED TO THE BOARD THAT THERE WAS BASIC AGREEMENT ON AN SBA FOR YUGOSLAVIA. HE DESCRIBED THE PROGRAMME AS STRONG AND SAID THAT IT WOULD, IF FULLY IMPLEMENTED, BE THE MOST FAR-REACHING ADJUSTMENT EFFORT YET UNDERTAKEN BY THE YUGOSLAVS. HE OUTLINED THE MAJOR ELEMENTS OF THE PROGRAMME (PREVIOUSLY REPORTED), INCLUDING THE EXPECTED DEVALUATION, WHICH HE DESCRIBED AS SIGNIFICANT ALTHOUGH LESS THAN RECOMMENDED BY THE FUND. MD ALSO STRESSED THE FRONT-LOADING OF MEASURES.

3. THE MD NOTED THE SIGNIFICANT FINANCING THAT WOULD BE NEEDED TO SUPPORT YUGOSLAVIA'S SBA. HE MENTIONED THE FIGURE OF DOLLARS 1 BN BUT SAID THIS WAS A YUGOSLAV FIGURE AND THAT THE FINANCING REQUIREMENT WAS AGAIN BEING REVIEWED CAREFULLY WITH THE FUND. PRELIMINARY AGREEMENT WAS ANNOUNCED WITH THE BANKS ON NEW MONEY OF DOLLARS 300 MN. THE MD REFERRED TO THE NEED FOR SIGNIFICANT UP-FRONT FINANCING, PERHAPS THROUGH A BIS BRIDGING LOAN, TO SUPPORT THE FRONT-LOADING OF ACTIONS.

4. THE MD ADMITTED THAT THE STARTING POSITION FOR THE PROGRAMME WAS DIFFICULT IN BOTH POLITICAL AND ECONOMIC TERMS. HE ALSO SAID THAT YUGOSLAV IMPLEMENTATION HAD OFTEN BEEN WEAKER THAN EXPECTED, AS HAD THE FUND'S ABILITY TO MONITOR IMPLEMENTATION. HE HIGHLIGHTED THE RISK THAT THE PROGRAMME MIGHT IMPOSE STRAINS THAT COULD EXCEED THE SYSTEM'S ABSORPTIVE CAPACITY AND SAID THIS MIGHT RESULT IN AN ACCELERATION OF LIBERALISATION BUT COULD LEAD TO GREATER INTROSPECTION.

5. THE MD NOTED THAT THE YUGOSLAVS WANTED A BOARD MEETING ON 13 MAY BUT SAID THAT THIS WAS OBVIOUSLY VERY DIFFICULT AND

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IN HIS JUDGMENT UNREALISTIC. HE WOULD HOWEVER TRY FOR A BOARD MEETING AS CLOSE AS POSSIBLE TO THIS DATE. IN RESPONSE TO A QUESTION FROM TEMPLEMAN (US), THE MD SAID THE BOARD WOULD BE ASKED FOR OUTRIGHT APPROVAL OF THE YUGOSLAV PROGRAMME, FOR WHICH REASON, IT WOULD ONLY COME TO THE BOARD WHEN ADEQUATE FINANCING ASSURANCES (IE CRITICAL MASS OF BANK COMMITMENTS) HAD BEEN ACHIEVED. POSTHUMUS (NETHERLANDS, REPRESENTING YUGOSLAVIA) SUGGESTED THAT, IF THE STAFF REPORT WAS TO BE DELAYED MUCH LONGER, THE MANAGEMENT SHOULD CIRCULATE IN ADVANCE WHATEVER PAPERS THEY COULD, IN PARTICULAR, THE SUBMISSION OF THE YUGOSLAV GOVERNMENT. THE MD AGREED BUT ASSURED POSTHUMUS THAT THE STAFF REPORT WOULD BE ISSUED VERY SHORTLY.

6. FCO PLEASE ADVANCE TO BATT (HMT), FIGGIS (ERD) AND JAGGERS (BOE).

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YYYY

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MR WICKS NO 10 DOWNING ST.

NNNN



FROM: MRS JULIE THORPE

DATE: 3 May 1988

MR P MOUNTFIELD

cc Sir G Littler
Mr Lankester
Mr H P Evans
Mr Bottrill
Mrs Thomson

VISIT OF YUGOSLAV FINANCE MINISTER

Following your minute to PS/Chancellor of 27 April, I am now confirming that the Chancellor has agreed to see Mr Rikanovic on Wednesday, 4 May, at 4.00pm at No.11. I understand Mr Rikanovic will be accompanied by the Yugoslav Ambassador and by one other person.

2. I understand you are not free on Wednesday afternoon so the Chancellor has said he would like Mr Lankester and Mr Bottrill to attend the meeting as well.

3. I understand you are providing briefing.

Julie Thorpe.

MRS JULIE THORPE
Diary Secretary

FROM: P MOUNTFIELD
DATE: 4 May 1988

CHANCELLOR OF THE EXCHEQUER

cc Sir P Middleton
Sir G Littler
Mr Lankester
Mr H P Evans
Mr Bottrill
Mrs Thomson

Mr Cassell UKDEL

VISIT OF YUGOSLAV FINANCE MINISTER

This is a postscript to my brief dated 29 April.

2. Chancellor Kohl has now written to the Prime Minister, as threatened. I attach a copy of his letter. The Treasury has been asked for a draft reply, which we shall prepare after your meeting.

3. Kohl's letter raises two points: a medium-term rescheduling of Yugoslav official (Paris Club) debt; and an immediate short-term bridging loan.

4. On the Paris Club deal, he suggests that creditors should be prepared to reschedule interest. We expected this. It is in your brief (line to take, point vi., and para 9). It now looks as if we shall have to reschedule both previously-rescheduled debt and moratorium interest. Obviously, we need to examine the figures, when the IMF circulates its paper; but you can tell Rikanovic that the UK will not wish to block a consensus on the appropriate level of debt relief when that has been demonstrated.

5. The short-term problem is more difficult. We had hoped that Yugoslavia would go to the BIS for a bridging loan. But it has neither the collateral (most of its gold has been pledged) nor the firm ground at the other end of the bridge (the new IMF money will be needed to repay existing loans from the IMF). We understand that the Yugoslavs have just asked BIS for help, but

we do not yet know the response.[⊕] Meanwhile, the Germans have gone ahead with a different proposal: to give a Federal guarantee to a short-term loan raised by Yugoslavia from the German banks. This is a device the FRG used to help Hungary last year, which they have been anxious not to repeat. But it is the only instrument (my German colleague tells me) which they have available to implement Kohl's promise of short-term help. And they are hoping that other creditor countries will provide similar assistance. It is not clear that the UK can help, even if we wanted to. We do have powers to indemnify the Bank of England, if it chose to take part in a BIS operation. It is very doubtful if we have powers to give a guarantee for a short-term commercial bank loan. I am getting legal advice urgently. Meanwhile, I think you should tell Rikanovic that we will of course consider his request, but we cannot easily see a way to help.

6. We have also just received (since my brief was written) the text of the Yugoslav Letter of Intent. We have not yet received the accompanying IMF Staff analysis. You should therefore limit yourself, I suggest, to saying that we are studying it urgently. (At first sight, it doesn't look too bad. The question is whether an outgoing government can actually implement the promises it contains, in time for a Board meeting on 13 May - a deadline which Camdessus now says will probably slip anyway.) Meanwhile, you will want to avoid being drawn on the substance.

RM

P MOUNTFIELD

⊕ BIS has just telexed the Bank of England, inviting them to participate. The Bank know they must seek your approval before going ahead. You need not tell Rikanovic that the BIS request has arrived.

Courtesy Translation

Message

from

Herr Helmut Kohl, Federal Chancellor of the
Federal Republic of Germany

to

Her Excellency The Rt. Hon. Margaret Thatcher, MP
Prime Minister of the United Kingdom of Great Britain
and Northern Ireland

Dear Margaret,

On the 19th of this month I had a comprehensive discussion with Yugoslav Prime Minister Mikulic which was followed by contacts with Minister Makic. My impression is that the Yugoslav leadership, by implementing the reforms envisaged in the 1988 economic programme, now has a chance to avert a serious crisis with unforeseeable consequences. In my view Yugoslavia deserves support on grounds of foreign and economic policy. It is in the West's interest that Yugoslavia be enabled to return to the path of stability. There is a direct relationship between economic and political stability.

It is urgently necessary that the recovery programme negotiated between the International Monetary Fund and Yugoslavia be financed and implemented. In the opinion of the Yugoslav Government and the International Monetary Fund, however, the financing of the programme is not yet assured. I have therefore asked Dr. Lubbers, Prime Minister of The Netherlands, whose country leads the IMF voting group, to which Yugoslavia, too, belongs, to make a special effort to secure the programme's financial base. I have also informed him that the Federal Government will seek in the Club of Paris to achieve a generous

rescheduling arrangement including interest, and that it is prepared to assume a share of the preliminary financing of that interest.

Considering the political significance of this matter, joint action is in my view necessary, which is why I am approaching you and the Heads of State and Government of several other Western countries today. I do feel that comparable contributions from Western countries will facilitate a solution to Yugoslavia's current problems and would appreciate it if you, too, could likewise participate in the financing of the recovery programme worked out with the IMF.

Yours sincerely,
(sgd) Helmut Kohl
Chancellor of the
Federal Republic of Germany

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

Lyn Parker Esq
PS/Secretary of State
Foreign & Commonwealth Office
LONDON SW1

4 May 1988

Lyn Parker

[Handwritten signature]

cc: PS/EST
Sir 262
Mr Lankester
Mr AP Evans
Mr Hamfield
Mr Bottrill
Mr Walsh.

MEETING WITH YUGOSLAV FINANCE MINISTER

The Yugoslav Finance Minister, Mr Rikanovic, called on the Chancellor today. He was accompanied by the Yugoslav Ambassador, Mr Calovski, the Minister-Counsellor (Economic) at the Yugoslav Embassy, Mr Mitic, and an interpreter. Mr Lankester and Mr Bottrill (both Treasury) were also present.

Rikanovic recalled his last meeting with the Chancellor, on 19 October 1987. He had then discussed with the Chancellor the measures to be undertaken by Yugoslavia to secure a standby arrangement with the IMF. At that stage, neither side had a clear view as to how matters would turn out. Now Yugoslavia was on the eve of a high quality standby arrangement with the Fund, matched by an agreed high quality internal programme. He was conscious that Yugoslavia's creditors lacked confidence in its ability to achieve the objectives of the programme. This was unsurprising, given the recent decade of economic crisis in Yugoslavia. But Yugoslavia was encouraged by the United Kingdom's positive attitude. Fresh money was needed, and quickly!

The Chancellor said he was very glad indeed that Yugoslavia had been able to conclude an agreement with the IMF. He also admired the courage shown by the Yugoslav government in being prepared to undertake these difficult, though necessary, measures. But, to be frank, we did have doubts about Yugoslavia's ability to achieve the objectives set. These were based not only on Yugoslavia's economic record, but also on the additional difficulties imposed by the complications of the federal constitution. We understood Yugoslavia's need for more money: this pointed to an agreed rescheduling of debts in the Paris Club framework. The UK would contribute to a consensual agreement here. We would consider carefully what could be done. It was, however, difficult to think of ways in which it would be right to implement special arrangements for Yugoslavia.



Rikanovic said that Yugoslavia was on the eve of major, radical reforms. Constitutional changes were envisaged which would lead to a greater market orientation in the economy. The government had also set up a task force to promote the independence of enterprises in the market. In order to develop in this direction, the Yugoslav economy needed adequate support. Free price formation was required, which meant a liberalised import regime. But this, in turn, meant that additional support for Yugoslavia's foreign exchange reserves was required. It would be most undesirable to implement the new programme, only to have to halt it after a few months.

The Chancellor said he understood exactly what Rikanovic was saying. He asked Rikanovic about the forthcoming constitutional changes in Yugoslavia. Rikanovic said that there would be some reorganisation of the machinery of government. Three Ministries would be abolished, and two new Ministries set up. But there would be no essential changes. The Chancellor asked Rikhanovic whether he expected to remain Finance Minister. He hoped that he would. Rikanovic said that the Yugoslav Prime Minister had made no indication that he wished to give Rikanovic a new portfolio.

Rikanovic said that Yugoslavia wanted Germany to co-ordinate the activities of Yugoslavia's creditors. He knew that Kohl had recently written to his EC colleagues. Yugoslavia had agreed with the IMF that its programme could begin if the \$800 million financing gap for 1988 could be filled. The commercial banks had offered \$300 million this year, and \$200 million next year. So a further \$500 million in 1988 was now required from Governments.

The Chancellor said that the Prime Minister had indeed received a letter from Chancellor Kohl. We were considering our response but he had to say that we would have great difficulty in doing anything outside the normal Paris Club or BIS fora.

Rikanovic said that the Yugoslav Central Bank Governor had discussed the possibility of a bridging loan with his colleagues in Basle. The Chancellor said that we did understand the Yugoslav position, and would look at the options sympathetically in consultation with our colleagues in other creditor countries.

Rikanovic said that quick decisions were required, if the introduction of Yugoslavia's new economic measures was not to be postponed. The IMF Executive Board meeting to consider the standby arrangement would take place on 13 May. The Chancellor said he was not sure whether the IMF Executive Board itself would be able to meet this deadline. We recognised that early decisions were required. He could say nothing further at this meeting.



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

Yours truly

J M G Taylor

J M G TAYLOR
Private Secretary

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TO PRIORITY FCO

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OF 050930Z MAY 88

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INFO ROUTINE WASHINGTON, PARIS, BONN, ROME, UKREP BRUSSELS

YUGOSLAVIA: EDRC REVIEW 4 MAY

SUMMARY

1. YUGOSLAVS LEFT IN NO DOUBT OF OECD ENDORSEMENT OF NEED FOR STRONG MEDICINE. REFORM COMMITMENTS OFFERED BY YUGOSLAVS REASONABLY ENCOURAGING.

DETAIL

2. OECD'S ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE REVIEWED YUGOSLAVIA'S ECONOMIC PERFORMANCE AND POLICIES ON 4 MAY. EXAMINERS WERE AUSTRIA AND SWITZERLAND. UK WAS REPRESENTED BY MRS DARBY (FCO ECONOMIC ADVISERS) AND VERCNOCKE (BANK). YUGOSLAV TEAM WAS LED BY KOVAC (MEMBER OF THE FEDERAL EXECUTIVE COUNCIL).

3. SECRETARIAT'S DRAFT REVIEW WAS INEVITABLY PARTIALLY OVERTAKEN BY EVENTS. MUCH OF KOVAC'S EXTREMELY PROFESSIONAL PRESENTATION WAS GIVEN OVER TO DESCRIBING THE PROGRAMME AGREED WITH IMF.

4. MRS DARBY WILL REPORT. DISCUSSION REASONABLY SATISFACTORY FROM OUR POINT OF VIEW. SEVERAL DELEGATIONS WERE NOT AT FULL STRENGTH, BUT BOTH FRG AND FRANCE HAD SENT EXPERTS (NEITHER CONTRIBUTED MUCH). GENERAL TONE OF EXAMINATION WAS CRITICAL OF PAST, AND SCEPTICAL OF YUGOSLAV DETERMINATION TO STICK TO PROGRAMME. HUET (CHAIRMAN) DID NOT MINCE WORDS IN SUMMING UP. EACH SUCCEEDING EDRC, HE SAID, HAD BEEN FASCINATED AND DISAPPOINTED BY YUGOSLAVIA, FASCINATED BY THE PECULIARITIES OF THE SYSTEM, DISAPPOINTED BECAUSE THE PREVIOUS YEAR'S PROMISES OF PROGRESS HAD ALWAYS BEEN FORGOTTEN. IT WAS NOW URGENT TO BREAK THE OLD PATTERN. THE TURNAROUND NOW FORESEEN WAS BASED ON THE IMF PROGRAMME WHICH EDRC STRONGLY ENDORSED. A CHANGE OF MENTALITY WAS NECESSARY TO CONVINC

DOMESTIC AND EXTERNAL AUDIENCES. AND MUCH REMAINED TO BE DONE NOT SIMPLY IN 1988.

5. TO UNDERLINE EDCR'S CONTINUING MONITORING ROLE, DAVIES ASKED FOR CLOSE SECRETARIAT COORDINATION WITH DELEGATIONS OVER REDRAFT OF REVIEW TO TAKE ACCOUNT OF IMF PROGRAMME. HUET ENDORSED THIS.

6. SECRETARIAT HAVE TOLD US PRIVATELY THAT THEY WERE QUITE ENCOURAGED. FOR THE FIRST TIME THE YUGOSLAVS HAD GIVEN FIRM DEADLINES FOR INTRODUCTION OF REFORMS, (SUBJECT TO RECEIPT OF THE BRIDGING FINANCE). SECRETARIAT REMAIN CONCERNED HOWEVER THAT IMF PROGRAMME PAYS INSUFFICIENT ATTENTION TO NEED FOR TIGHT MONETARY TARGETS.

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cc: Chief Secretary
 Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Anson
 Mr Lankester
 Mr P Mountfield
 Mr H P Evans
 Mr Peretz
 Mrs Lomax
 Mr Turnbull
 Mr C D Butler
 Mr Beastall
 Mr Bottrill
 Mr Watts
 Mrs Thomson



Treasury Chambers, Parliament Street, SW1P
 01-270 3000

6 May 1988

C D Powell, Esq
 No.10 Downing Street
 London SW1

Mr Cassell
 Mr Enoch (Washington)
 Miss Wheldon (T/Sol)

Dear Charles

YUGOSLAVIA: ECONOMIC SUPPORT

Thank you for your letter of 29 April, forwarding a message from Chancellor Kohl to the Prime Minister.

Rikanovic, the Yugoslav Finance Minister, came to see the Chancellor at his own urgent request on 4 May. His requests boiled down to:

- a. UK support for his IMF programme;
- b. UK participation in a generous 'Paris Club' rescheduling; and
- c. (most urgently) a UK contribution to a bridging loan to get Yugoslavia through the next few months.

The Chancellor did not give him any specific promises, but indicated UK willingness to support a suitably firm adjustment programme. He has since decided that it would be right to let the Bank of England contribute up to \$40 million towards a BIS bridging loan, with a Treasury indemnity against loss should Yugoslavia fail to repay, provided all other major Western nations make adequate contributions, too. We are arranging for the Governor to confirm this at the BIS meeting in Basle this weekend.

We still lack any firm information about the Yugoslav economic recovery programme, and it is hard to be too confident about it given past failures and the need for the Yugoslav Federal administration to have its mandate renewed by the Federal Assembly on 15 May. So it is well to be cautious in our reply to Kohl. I ... attach a draft, which the Chancellor has approved.

I am sending copies of this letter to Lyn Parker (FCO), Stephen Ratcliffe (DTI) and John Footman (Bank).

Y.M.G. Taylor
J.M.G. Taylor

J M G TAYLOR
 Private Secretary

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DRAFT REPLY FROM PRIME MINISTER TO CHANCELLOR KOHL

Thank you for your message about financial support for Yugoslavia. I share your concern that the Yugoslav economic recovery programme should be successfully implemented.

It is unfortunate that despite much pressure from Western governments, Yugoslavia has only recently concluded an agreement with the staff of the International Monetary Fund and signed a Letter of Intent. In the circumstances I am sure we would all have preferred to reserve judgement until we had been able to review the plan.

But it is already clear that a substantial IMF Stand By Arrangement will be needed, supported by generous Paris Club rescheduling. I can assure you that the United Kingdom will do its part to secure the success of both operations, though we shall be seeking evidence of firm Yugoslav commitment to the necessary domestic economic reforms.

In your message you also raised the question of preliminary financing. Since you wrote, the Bank of International Settlements has invited the Bank of England and other participating banks to take part in a bridging loan. I can confirm that the Bank of England has the Government's agreement to join in this operation.

YUGOSLAVIA

FROM: MRS S THOMSON

DATE: 10 May 1988

MR LANKESTER

cc: Mr Mountfield o/r
Mr Bottrill
Mr Batt

YUGOSLAVIA

BIS BRIDGING LOAN

The Bank of England (Phil Compton) rang to report from the Governors' meeting at Basle. The Governors have offered a bridge to the Yugoslavs of \$250 million. The loan can be drawn down when Yugoslav reserves fall below \$500 million and is repayable when reserves rise above \$600. The facility terminates on 30th November 1988, and is repayable from drawings on the IMF SBA and IBRD SAL and 'any other inter Governmental loan'. The only express condition for the loan is that the IMF Board shall have approved the SBA in principle. There is no collateral. The loan will be handled through an account of the NBY at the Federal Reserve Bank.

2. The Bank of England's share in this offer is \$30 million, 12 per cent of total. At an interdepartmental meeting on Thursday it was agreed that despite the lack of adequate collateral and despite the fact that the sole possibility of the loan being repaid depended on the hope (never very strong) of the Yugoslavs faithfully filling the programme criteria for the SBA and SAL, the UK should participate on political grounds: because of the Prime Minister's words to Djuranovic and because other European countries were taking part. The meeting therefore recommended that the UK should make a 'proportionate contribution': the limits were set at \$40 million, thought to be 10 per cent of the total. In fact the sum now offered is \$10 million less but 2 per cent more of the total offered.

3. There is a question as to whether the Bank is indemnified for this 2 per cent (\$5 million). I have not seen the terms of the indemnity and cannot comment. However, the contribution seems to be 'proportionate': we understand that it is the same as France's, that Germany has contributed \$40 million (we do not yet know whether this is the Bundesbank or the large German banks) and the Fed \$50 million. The percentage shares were apparently based on banking exposure. The exposure of British owned banks in Yugoslavia is 15 per cent, and for banks in the UK the figure is 20 per cent. However, the share of the Germans and Italians has not lived up to our expectations: perhaps they are planning to contribute to the trade credits or medium term financing?

4. A note from the Bank giving further details of the loan is expected later today.

ST
W.S.
S THOMSON

CONFIDENTIAL

FROM: A BOTTRILL
 DATE: 13 MAY 1988



CHANCELLOR

cc: PS/CST
 Sir P Middleton
 Sir G Littler
 Mr Lankester
 Mr Mountfield (o.r)
 Mrs Thomson

(seen by UH) Eupm (HP)

INFORMAL ECOFIN: YUGOSLAVIA

We have just been warned via UKDEL/IMF overnight that Ruding will be seeking additional cash from governments or their export credit agencies for Yugoslavia at this weekend's informal ECOFIN. This is separate from and in addition to the combined BIS and US bridging facility of \$250 million which is being put together (UK contribution \$30 million).

2. The need for additional official credit stems from the financing gap which still remains to be filled to support the IMF programme. The main elements are shown in the attached table. The Fund is seeking a current surplus of \$0.5 billion but this is more than offset by the target increase in reserves of \$0.85 billion. The Fund itself is due to be repaid almost \$0.4 billion. The Yugoslavs, therefore, are looking to other creditors to fill the gap.

3. The multilateral agencies are expected to provide some \$0.15 billion net including project loans and a SAL from the World Bank and project loans from the IBRD. The commercial banks are expected to provide some \$0.3 billion net, and support for this is currently being marshalled.

4. The Fund, however, is looking to bilateral official creditors to provide a further net \$0.4 billion. Paris Club creditors are owed some \$1.6 billion in amortisation this year of which \$0.8 billion is on debt incurred since the 1982 cut-off date. Creditors are being asked to reschedule \$0.5 billion of the rest. The Fund is also expecting some \$0.79 billion to be disbursed under previous commitments and is seeking a further \$0.5 billion in new credits including rescheduling of interest.

5. ECGD is currently providing only short-term cover on confirmed letters of credit. It is off medium-term cover. ECGD would consider rescheduling 1988 maturities coming due and current interest (albeit reluctantly). It would be very reluctant to reschedule moratorium interest coming due, although the Yugoslavs are likely to ask for this. If this were to be granted at the Paris Club it would make Yugoslavia less credit-worthy and we should be reluctant to resume even DX cover quickly.

6. In the present circumstances, you will want to listen to Ruding's case, but express reservations about rescheduling moratorium interest or providing new credits. You have told Rikanovic that you will approach the Paris Club discussions sympathetically but you will want to see the figures.

ABRILL

A BOTTRILL

YUGOSLAVIA: EXTERNAL FINANCING 1988

(DOLLARS MN)

CURRENT ACCOUNT BALANCE	500	
ECAS, ETC, NET	<u>790</u>	Export credits.
SUPPLIERS' CREDITS, ETC, NET	20	
DISBURSEMENT		125
AMORTISATION		-105
OTHER SHORT-TERM CAPITAL, NET	90	
NET LENDING	-237	
MULTILATERAL, NET	155	
SAL II		150
OTHER LENDING		430
AMORTISATION		-425
BANKS, NET	300	
NEW LENDING		300
RESCHEDULING - '87 AGREEMENT		573
'88 PROPOSAL		309 PRD: '83
		416 PRD: '84
		347 '87 ROLL-OVER
AMORTISATION		-1298
		-347 '87 ROLL-OVER
OFFICIAL, NET	<u>-383</u>	
NEW LENDING		<u>500</u> New money (including rescheduled interest?)
RESCHEDULING - '87 AGREEMENT		145
'88 PROPOSAL		207 PRD
		329 PRE-DEC '82
AMORTISATION - BERNE '83		-187
GENEVA		-110
PRE-DEC '82		-474
POST-DEC '82		-793
- IMF, NET	-370	
		PURCHASES 269
		REPURCHASES -640
RESERVES	-854	

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FM UKDEL IMF/IBRD WASHINGTON
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TELNO 110
OF 122300Z MAY 88
INFO ROUTINE BELGRADE

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ATTENTION MR BOTTRILL
IMF: YUGOSLAVIA

1. I SPOKE TO DUNCAN RIPLEY (IMF MISSION CHIEF) AGAIN THIS EVENING.
2. TOTAL AMOUNT AVAILABLE FOR TAKE-OUT OF THE BRIDGE FROM THE SBA BY END-NOVEMBER 1988 WILL BE SDR 183.5 MN (3 TRANCHES OF SDR 61.5 MN).
3. RIPLEY STRESSED THAT THE YUGOSLAV PROGRAMME WILL NOT COME TO THE BOARD FOR APPROVAL IN PRINCIPLE UNTIL ALL ELEMENTS EXCEPT BANK FINANCE ARE CLEARLY IN SIGHT. THE FUND ITSELF IS SEEKING MORE DETAILS FROM THE PARIS CLUB AS WELL AS EXPORT CREDIT AGENCIES AS TO HOW THE DOLLARS 500 MN EARMARKED FOR THE OFFICIAL SIDE WILL BE DERIVED. RIPLEY NOTED THAT THE 'NEW' EXPORT CREDIT BEING SOUGHT WILL BE ADDITIONAL TO THE INCREASE IN CREDITS IN LINE WITH PROJECTED INCREASES IN IMPORTS ALREADY INCLUDED IN THE PROJECTIONS. SHE POINTED OUT ALSO THAT IF THIS 'NEW' CREDIT WERE TO BE LINKED TO ADDITIONAL IMPORTS (BEYOND THAT IN THE PROJECTIONS) THIS OF COURSE WOULD NOT HELP CLOSE THE FINANCING GAP. WHAT IS NEEDED IS CASH: RUDING WILL BE MAKING A BIG PLAY FOR THIS AT ECOFIN THIS WEEKEND.
4. ON THE BASIS OF THIS, I THINK THE BOARD MEETING MAY BE SLIGHTLY FURTHER OFF THAN WE HAD THOUGHT. (FUND MANAGEMENT CAN IN ANY CASE NOT BRING THE PROGRAMME TO THE BOARD UNTIL AT LEAST FIVE WORKING DAYS AFTER THE IMPLEMENTATION OF THE FOREIGN EXCHANGE LIBERALISATION - WHENEVER THAT OCCURS.) BUT IT SHOULD ALSO MEAN THAT THE BRIDGE LOAN'S LINKAGE TO FUND BOARD APPROVAL IN PRINCIPLE SHOULD GIVE SOME ASSURANCE ALSO THAT THE REQUIRED OFFICIAL FINANCE WILL BE AVAILABLE BY THE TIME IT COMES INTO EFFECT.
5. FCO PLEASE ADVANCE TO BOTTRILL AND WALSH (HMT), T RICHARDSON (ERD) AND WARE (BOE).

ENOCH

ADVANCE 11

. MONETARY
MR BRAITHWAITE
MR MAUD
HD/ERD
HD/ECD(E)
RESIDENT CLERK

MR LAVELLE CABINET OFFICE
MR MOUNTFIELD HM TREASURY
MR BOTTRILL HM TREASURY
MR WALSH HM TREASURY
MR WARE BANK OF ENGLAND

CONFIDENTIAL

4720

BF 6/20 20/5

Ch: Content with these atts., and for me to write (at the appropriate time) as at Annex C?

(Agreed with Bottrill that what is this in problem)

FROM: A BOTTRILL
DATE: 18 MAY 1988

- 1. MR LANKESTER
 - 2. SIR PETER MIDDLETON
 - 3. CHANCELLOR
- Copies for: Chief Secretary
Economic Secretary
Sir G Littler (o/r)
Mr Anson

- cc: Mr H P Evans
- Mr Peretz
- Mrs Lomax
- Mr Turnbull
- Mr C D Butler
- Mr Beastall
- Mr Mountfield (o.r)
- Mr R I G Allen
- Mr Watts
- Mrs Thomson
- Mr R Savage (Plty Sec)
- Mr Cassell (Washington)
- Mr Enoch (")
- Miss Wheldon (T/Sol)

Overl...
J

YUGOSLAVIA: BRIDGING LOAN

You will wish to have an update on the prospects for the IMF Executive Board's discussion of the Yugoslav programme and the related BIS bridging facility. We also have to prepare to notify Parliament as well as be ready to answer any Press queries in due course.

IMF Executive Board

2. No date has been set for the Executive Board discussion. The Yugoslavs have to take three prior actions before the Board can approve their programme. These are the liberalisations of prices, imports and the foreign exchange market. The extension by 10 days of the price and wage freeze which was due to end on 15 May, suggests that 25 May may be the earliest date for a Board meeting. The relaxation of imports can take place at any day before the Board meets. The foreign exchange liberalisation however, which involves a significant dinar depreciation, must take place five working days before the IMF meeting.

3. The argument is apparently that the Yugoslavs can only finance the expected increase in demand for foreign exchange for a week before they will need the bridging loan. We expect that this would be triggered by IMF approval in principle of their programme - although the form of the Board resolution has not been published. This is all very tight and interlocked.

4. As far as the Board discussion itself is concerned, we can support the measures to which the Yugoslavs are committed. You are aware, however, about the IMF Staff's difficulties in identifying financing for the programme. The amounts sought from Paris Club creditors look particularly large. Trichet has now unofficially suggested that the Paris Club might provide \$300 million in rescheduled interest over the period of the SBA. The Fund is also counting on a \$150 million SAL being agreed and disbursed by the IBRD this year - although this is not assured.

5. Closing the financing gap is likely to take time. The commercial banks do not expect to reach their critical mass of 85 per cent until the first half of June. The Paris Club is unlikely to discuss Yugoslavia until July. It is possible, therefore, that the BIS will be asked to make the bridging facility available once the IMF programme is approved in principle but the Fund itself will not disburse until the financing package is assured.

BIS facility

6. We have received from Lamfalussy the draft text relating to the BIS facility. The draft provides for:

(i) A \$200 million dollar guarantee to the BIS by 11 central banks, together with \$50 million from the United States. The UK share is confirmed at \$30 million, equivalent to 12½ per cent. Other countries' shares are at Annex A. We have told the BIS via the Bank of England that the UK's participation is contingent on all others agreeing.

(ii) Yugoslav drawings on the BIS facility depend only on the

IMF agreeing 'in principle' to the SBA, ie ahead of full agreement on the overall financing of the programme by banks and official creditors. This implies that the BIS and its guarantors will be exposed.

- (iii) Yugoslav drawings are also constrained by the amount by which their reserves fall below \$500 million.
- (iv) Repayments of the loan by 30 November are to be from disbursements under the SBA which will be made directly into an account at the New York Fed. The Yugoslavs are due to receive three disbursements of approximately \$87 million each, the first on the coming into operation of the programme, the second on 15 August and the third on 30 November. These will be sufficient to meet the bridge. Disbursements under the World Bank SAL do not seem likely to be available. The Yugoslavs, however, will also be committed to make repayments of the BIS loan whenever their reserves exceed \$600 million.
- (v) The interest rate on the loan will be one-month LIBOR plus $\frac{1}{2}$ per cent. The BIS will receive a one-eighth per cent fee and the participating central banks three-eighths per cent.

7. The terms of the BIS facility leave the guarantors particularly exposed in the period between the IMF Board's approval in principle and the completion of the financing package. The disbursements in August and September will require Yugoslavia to meet its performance targets. Repayment of the bridge, therefore, seems likely to depend heavily on Yugoslav performance, although there will of course be pressure on creditor governments to agree a waiver, if necessary, in order to be repaid.

Bank of England indemnity

8. The Treasury will need to provide an indemnity to the Bank of England. A draft letter which would have to be approved by Sir Peter Middleton as Accounting Officer for the Consolidated

Fund has been provided by the Bank and is at Annex B. It can be signed by Sir Geoffrey Littler or in his absence Mr Lankester. It follows exactly the form of that used for the Mexico bridging loan. It guarantees the Bank for principal, interest and costs in dollars. You will note that the Bank does not need to provide cash since it is a Substitution Agreement. You will also note that the Treasury will receive three-quarters of the commission. This will have to be sent to the Bank of England once the BIS documentation is cleared.

9. The indemnity is granted under the International Monetary Arrangements Act 1983. If the loan were to go wrong, it would represent at current exchange rates a charge of £16 million together with any unpaid interest and costs on public expenditure. The Chief Secretary and Mr Anson will want to note this, and Mr Butler will wish to note the Treasury's contingent liability.

Notification of No 10

10. No 10 have already been informed of the bridging facility and the Prime Minister confirmed to Chancellor Kohl the UK's readiness to participate. We shall need to tell No 10 of the arrangements being made to inform Parliament. A draft private secretary letter to No 10 is attached at Annex C.

Notification of Parliament

11. Under the terms of the 1983 Act, the Treasury is obliged to notify each House of Parliament immediately after any indemnity of this kind is undertaken. This might best be done the day after the BIS announces that the arrangements are complete. If Parliament is sitting, this should be by a Paper under Act presented by the Economic Secretary. If Parliament is not sitting (eg during the Whitsun Recess) a Command Paper needs to be presented to Parliament but not printed. Alternative drafts are attached at Annexes D and E.

The letter
to No 10
should
go after
we have
learned
that the
BIS facility
has been
finalised.
R.

Publicity

12. The Bank of England does not intend to issue a Press notice, and I do not recommend that the Treasury issues one. Nevertheless, we will provide briefing for the Press Office immediately prior to the date of announcement.

Overseas posts

13. We shall also need to inform overseas posts and will liaise with the Foreign Office. The main sensitivity will be to avoid requests for other debtor countries for a similar bridging facility, notably Nigeria. The key difference, of course, is that Yugoslavia has agreed a firm IMF programme. Nigeria is far from this.

A Bottrill

A BOTTRILL

THE FIRST SCHEDULE
(Text of the BIS Facility)

THE SECOND SCHEDULE

	Proportions	Maximum amounts of principal (in millions of US dlrs)
Banque Nationale de Belgique	5/200	5
Bank of Canada	10/200	10
Deutsche Bundesbank	40/200	40
Bank of England	30/200	30
Banque de France	30/200	30
Banca d'Italia	25/200	25
Bank of Japan	30/200	30
De Nederlandsche Bank N.V.	5/200	5
Oesterreichische Nationalbank	10/200	10
Schweizerische Nationalbank	10/200	10
Sveriges Riksbank	5/200	5
Total	<u>200/200</u>	<u>200</u>

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

ANNEX B

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 \$30 million participation in the credit facility to be granted by the Bank for International Settlements to the National Bank of Yugoslavia.

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 Peter Middleton

Geoff Butler

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 Whip Lords
Chief Press Officer No.10
PS/Governor of Bank of
England

YUGOSLAVIA: BIS BRIDGING LOAN

As the Prime Minister confirmed to Chancellor Kohl in her letter of 9 May, the Bank of England is participating in a bridging loan which is being arranged by the Bank for International Settlements to support a Yugoslav IMF programme. The loan is intended to support the dinar during the first months of economic reform until Yugoslavia can make a drawing from the IMF. The Board of the International Monetary Fund is expected to approve a Stand By Arrangement in principle later this month. Drawings on the Fund will become available once all the financing elements for the programme are in place.

2. The bridging loan is for \$250 million, of which \$50 million is from the US and \$200 million from other Central Banks. Of this \$30 million is from the Bank of England. Yugoslavia can draw on the facility if reserves fall below \$500 million. The facility terminates on 30 November 1988 and will be repaid by drawings on the IMF Stand By Arrangement [and from a Structural Adjustment Loan from the World Bank].

3. The Chancellor has authorised the Bank of England to take part in the operation. The Treasury will give the Bank an indemnity on lines similar to that given in 1986 for Mexico. We expect that the loan will be finalised [in Basle] in the next few days.

4. Under the terms of the International Monetary Arrangements Act, 1983 we are required "immediately after giving any undertaking under this section, to lay a statement of the undertaking before each House of Parliament".

5. The Chancellor proposes to do this on []. I attach a draft. I should be glad to hear that the Prime Minister sees no objection.

6. The Chancellor does not think it will be necessary to make a separate announcement, by way of arranged Question or otherwise. But the announcement will have been made in [Basle] on [] so we shall let you have suitable language for the Prime Minister's use at Question Time on [], and will provide speaking notes for the Adjournment Debates in both Houses in case points are raised then. However, our view is that the operation will be uncontroversial and is unlikely to provoke much comment in Parliament.

7. The FCO has arranged to send an appropriate briefing to Belgrade and other concerned posts. Press Officers at the Treasury, FCO and Bank have question and answer briefing.

8. As a matter of courtesy, we are notifying the Public Accounts Committee and the Treasury and Civil Service Select Committee.

ANNEX D

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ANNEX D

INTERNATIONAL MONETARY ARRANGEMENTS ACT 1983

STATEMENT of Indemnity given by the Treasury to the Bank of England on [May 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 Yugoslavia.

Treasury Chambers)
[May 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 [May 1988]
for commitment by the Bank of England to the
Bank for International Settlements in respect
of a loan to the National Bank of Yugoslavia to an
amount not exceeding 30,000,000

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

ANNEX E

ANNEX E

**INDEMNITY TO THE BANK OF ENGLAND
COVERING THEIR COMMITMENT TO
THE BANK FOR INTERNATIONAL SETTLEMENTS
IN RESPECT OF A LOAN TO YUGOSLAVIA**

Presented to Parliament
by the Chancellor of the Exchequer
by Command of Her Majesty
[] May 1988

**LONDON
HER MAJESTY'S TREASURY**

Not to be Printed

INDEMNITY TO THE BANK OF ENGLAND COVERING THEIR COMMITMENT TO THE BANK FOR INTERNATIONAL SETTLEMENTS IN RESPECT OF A LOAN TO YUGOSLAVIA

Section 2(1) of the International Monetary Arrangements Act 1983 empowers the Treasury to undertake to indemnify the Bank of England in respect of financial assistance given by the Bank to the central bank or other monetary authority of a foreign country, in co-operation with the Bank for International Settlements or any central bank or other monetary authority. Section 2(3) of the Act requires the Treasury to lay a statement of the undertaking before both Houses of Parliament immediately after giving the undertaking. This paper fulfils that requirement.

International assistance to Yugoslavia

2. The Yugoslav Government is seeking medium-term financial support through an application to the International Monetary Fund for a Stand-By Arrangement, in respect of which a Letter of Intent has been agreed; [through an application to the International Bank for Reconstruction and Development for a Structural Adjustment Loan] and through negotiation with commercial banks of many countries which have provided loans to Yugoslavia. In anticipation of such support, the National Bank of Yugoslavia sought short-term assistance from the Bank for International Settlements and the United States monetary authorities. The BIS facility will provide for \$200 million for a period ending on 30 November 1988. An additional facility for \$50 million will be provided by the United States. The BIS loan will be financed from its own resources, but it has a right of recourse to participating member central banks. The Bank of England's contingent liability under this arrangement is for a principal amount of \$30 million plus any unpaid accrued interest and costs. The Treasury has agreed to give the Bank an indemnity in respect of this contingent liability.

3. Any sums required to meet this indemnity would be charged on and issued out of the Consolidated Fund.

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FM UKDEL IMF/IBRD WASHINGTON
TO ROUTINE FCO
TELNO 113
OF 192300Z MAY 88
INFO ROUTINE BELGRADE

*A note per
IMB state of
as Yugoslavia.*

IMF: YUGOSLAVIA

SUMMARY

1. FUND SEE LINK BETWEEN BIS LOAN AND YUGOSLAV RESERVES AS IMPRACTICAL AND UNHELPFUL. STAFF BELIEVE RELEASE OF BIS LOAN AND COMMERCIAL BANK CRITICAL MASS COULD ALLOW PROGRAMME TO BE STARTED. FUND DIRECTOR RESPONSIBLE FOR YUGOSLAVIA BELIEVES PROGRAMME MAY COME TO BOARD LATE NEXT WEEK (27 MAY), ALTHOUGH OTHERS THINK FOLLOWING WEEK MORE LIKELY. DECISION RESTS WITH YUGOSLAVS.

DETAIL

2. FUND STAFF HAVE CONFIRMED THAT THE GERMANS, DUTCH, AUSTRIANS AND POSSIBLY THE SWISS HAVE AGREED TO PROVIDE A DOLLAR 136 MN BRIDGE TO OFFICIAL INTEREST RESCHEDULING OVERLAPPING INTO 1989. TOGETHER WITH THE RESCHEDULING OF OFFICIAL INTEREST FALLING WITHIN 1988 AND THE CRITICAL MASS OF COMMERCIAL BANK NEW MONEY (WHICH HAS NOT BEEN FIXED BUT IS EXPECTED TO BE 90 PER CENT), THIS COULD, IN THE STAFF'S OPINION, PROVIDE SUFFICIENT ASSURANCES OF FINANCING FOR 1988 TO BRING THE YUGOSLAV SBA TO THE BOARD FOR FULL APPROVAL, DESPITE SHORTFALL OF AT LEAST DOLLARS 100 MN FROM FINANCING TARGET OF DOLLARS 800 MN.

3. THE STAFF ARE HOPEFUL, AFTER THE ROADSHOW LAST WEEK, THAT COMMERCIAL BANKS WILL REACH THE CRITICAL MASS OF COMMITMENTS BY THE 'EARLY BIRD' DEADLINE OF 6 JUNE, ALTHOUGH THEY EXPECTED THE SMALLER US BANKS AND THE CANADIANS TO BE DIFFICULT AND FOUND IT DIFFICULT TO GAUGE THE JAPANESE REACTION.

4. THE REAL PROBLEM, IN THE STAFF'S OPINION, IS WITH THE BIS BRIDGING LOAN. THEY REGARD THE LINKAGE TO THE LEVEL OF YUGOSLAV RESERVES AS UNREALISTIC GIVEN THE ILLIQUIDITY OF THESE RESERVES AND THE FACT THAT A RUNDOWN TO THE TRIGGER LEVELS SPECIFIED BY THE BIS WOULD, AMONG OTHER THINGS, BREACH THE PERFORMANCE CRITERIA ON NET FOREIGN ASSETS. THE FUND STAFF HOPE THE BIS CAN BE PERSUADED TO RELAX ITS CONDITIONS

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AND RELEASE THE LOAN IN TIME TO SUPPORT THE PRIOR ACTIONS - SPECIFICALLY, FOREIGN EXCHANGE LIBERALISATION - WHICH MUST BE TAKEN FIVE WORKING DAYS BEFORE THE SBA COMES TO THE BOARD. STAFF STRESS THAT THE MONEY DOES NOT HAVE TO PRECISELY PRECEDE THESE PRIOR ACTIONS.

5. POSTHUMUS (THE DUTCH ED WHO REPRESENTS YUGOSLAVIA) STRESSED THAT BOTH THE BIS' LINKAGE TO APPROVAL IN PRINCIPLE AND TO MINIMUM RESERVE LEVELS ARE SEEN AS UNHELPFUL. THE YUGOSLAVS SOUGHT POSTPONEMENT OF BOARD MEETING SCHEDULED EARLY THIS WEEK ON GROUNDS OF INADEQUATE FINANCING TO INTRODUCE PRIOR ACTIONS SAFELY. THE GERMAN/DUTCH ETC LOAN, NOT DEPENDENT ON THESE LINKAGES, WILL PROVIDE SOME CUSHION, BUT THE YUGOSLAVS MAY ASK THE FUND TO MODIFY THE FIVE WORKING DAY LEAD TIME BETWEEN FOREIGN EXCHANGE LIBERALISATION AND BOARD APPROVAL. POSTHUMUS THINKS THE YUGOSLAVS ARE NOW AIMING FOR A BOARD MEEING MAY 27 (WHICH PRESUMABLY COULD ONLY BE APPROVAL IN PRINCIPLE), BUT OTHERS THINK SLIPPAGE OF A FURTHER WEEK OR MORE (WHICH WOULD MAKE FULL APPROVAL PERHAPS POSSIBLE) IS MUCH MORE LIKELY.

6. THE INITIATIVE TO SCHEDULE THE BOARD MEETING NOW RESTS ENTIRELY WITH THE YUGOSLAVS.

7. FCO PLEASE PASS TO BOTTRILL AND WALSH (HMT), T RICHARDSON (ERD) AND WARE (BOE).

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FM BELGRADE

TO DESKBY 200830Z FCO

TELNO 124

OF 200630Z MAY 88

INFO ROUTINE UKDEL IMF/IBRD WASHINGTON

CORRECTED VERSION

MY TELNO 121: IMF/YUGOSLAVIA: FINANCING

SUMMARY

1. URGENT NEED FOR DECISIONS BY OFFICIAL CREDITORS ON FINANCING IMF AGREEMENT. POLITICAL, ECONOMIC AND COMMERCIAL CASE FOR NEW UK MONEY, IN FORM OF EXPORT CREDIT UNDER DX COVER.

DETAIL

2. THE OUTCOME OF YUGOSLAVIA'S DISCUSSIONS WITH THE IMF, AND OF THE DEBATE IN THE ASSEMBLY ON 14-15 MAY, LEAVES MATTERS EFFECTIVELY IN THE HANDS OF THE CREDITORS. THE YUGOSLAVS HAVE TO TAKE THE AGREED LIBERALISATION MEASURES FIVE DAYS BEFORE THE SBA IS PUT TO THE IMF BOARD, BUT ARE NOT PREPARED TO MOVE BEFORE ADEQUATE FINANCING IS ASSURED. IN PARTICULAR, THEY AND THE IMF SEE THE NEED FOR A CUSHION OF RESERVES TO FINANCE EXCHANGE PRESSURES. THE TOTAL SUM OF NEW MONEY REQUESTED FROM OFFICIAL CREDITORS IS DOLLARS 500 MILLION. HALF OF THIS COULD BE MET FROM CAPITALISING INTEREST PAYMENTS DUE, LEAVING SOME DOLLARS 250 MILLION OF NEW MONEY.

3. THIS QUESTION IS INCREASINGLY URGENT. THE SBA WAS AGREED IN PRINCIPLE AT THE BEGINNING OF APRIL. UNLESS IT IS IMPLEMENTED SOON, THERE IS A DANGER THAT FEARS OF THE POSSIBLE SOCIAL CONSEQUENCES OF SUCH TOUGH MEDICINE MAY GROW, OPPOSITION DEVELOP, THE FEC'S RESOLUTION FALTER, MOMENTUM BE LOST AND THE PACKET BEGIN TO FALL APART. IT TOOK PRESSURE FROM THE IMF AND CREDITORS, AS WELL AS TIME AND PATIENCE, TO PUT IT TOGETHER. THE PRESSURE NEEDS TO BE KEPT UP, AND WOULD BECOME LESS EFFECTIVE AND CREDIBLE IF CREDITORS FAIL TO DEMONSTRATE SUPPORT FOR WHAT HAS BEEN AGREED.

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4. THE IMF ARE LIKELY TO APPROACH THE UK SOON FOR AN INDICATION OF WHETHER WE ARE PREPARED TO CONTRIBUTE NEW MONEY. THEY MAY HAVE IN MIND A PROPORTIONATE CONTRIBUTION TO THE TUNE OF SOME DOLLARS 20-25 MILLION. THERE IS A GOOD CASE FOR US TO RESPOND POSITIVELY:

A) THE IMF DESCRIBE THE AGREEMENT AS RIGOROUS. THEY HAVE SAID THAT, IF IT IS FULLY IMPLEMENTED, IT WOULD BE THE MOST FAR REACHING ADJUSTMENT EFFORT YET UNDERTAKEN BY THE YUGOSLAVS (UKDEL IMF TELNO 103). TO HELP IMPROVE IMPLEMENTATION (AN ACHILLES HEEL IN THE PAST) THEY HAVE INCLUDED SPECIFIC TARGETS AND PERFORMANCE CRITERIA, AND QUOTE FRONT LOADED UNQUOTE THE ARRANGEMENT IN PARTICULAR BY MAKING IT CONDITIONAL ON INTRODUCTION OF THE LIBERALISING MEASURES. THE AGREEMENT PROVIDES AN OPPORTUNITY FOR ECONOMIC IMPROVEMENT AND REFLECTS OUR OBJECTIVE OF ENCOURAGING YUGOSLAVIA'S DEVELOPMENT IN A MARKET ORIENTED DIRECTION (WITH ALL THAT THAT IMPLIES FOR POLITICAL DEVELOPMENT).

B) WE HAVE BEEN INSTRUMENTAL IN HELPING TO SET UP THE ARRANGEMENT. IT WOULD BE INCONSISTENT NOT TO PARTICIPATE IN THE FINANCING ARRANGEMENTS NECESSARY TO SECURE THE SBA. THE PRIME MINISTER TOLD DJURANOVIC DURING HIS VISIT TO LONDON IN MARCH THAT QUOTE ONCE AGREEMENT HAD BEEN REACHED WITH THE IMF ON AN SBA, THE DOORS WOULD BE UNLOCKED TO A GOOD DEAL OF EXTRA HELP UNQUOTE (YOUR TELNO 55).

C) ONE WAY OF PROVIDING NEW MONEY WOULD BE IN THE FORM OF NEW OFFICIAL BILATERAL CREDITS UNDER DX COVER. AS POINTED OUT BY MISS RIPLEY (UKDEL IMF TELNO 110), NEW CREDITS COULD BE CONSIDERED NEW MONEY ONLY IF THEY WERE USED TO FINANCE EXISTING (NOT ADDITIONAL) IMPORTS - AND QUICK-DISPERSING. THEY COULD BE APPLIED TO RAW AND REPRO MATERIAL IMPORTS. 'SUCH CREDITS WOULD HAVE OBVIOUS COMMERCIAL BENEFIT TO US. THEY WOULD ALSO CONTRIBUTE TO YUGOSLAV EXPORT PERFORMANCE AND IMPROVE OUR CHANCES FOR DEBT RECOVERY.

D) THE PROPOSED FINANCING ARRANGEMENTS WILL REQUIRE THE PARTICIPATION OF OTHER MAJOR CREDITORS. THE FRG AND US IN PARTICULAR HAVE INDICATED THEIR WISH TO HELP.

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THERE ARE GOOD ARGUMENTS FOR ACTING IN CONCERT WITH OUR PARIS CLUB PARTNERS, AND PRESERVING THE CONSENSUS ON HANDLING YUGOSLAV DEBT.

5. ALTHOUGH NEW IMF MONEY WILL BE MADE AVAILABLE UNDER THE SBA, THE YUGOSLAVS ARE DUE TO MAKE NET REPAYMENTS TO THE IMF OF SOME DOLLARS 370 MILLION IN 1988 AND PERHAPS DOLLARS 335 MILLION NEXT YEAR. THERE SEEMS A GOOD CASE TO TRY TO PERSUADE THE IMF TO REDUCE THEIR DEMANDS AND NOT TO RETREAT SO RAPIDLY. THIS WOULD REDUCE THE AMOUNT OF FRESH MONEY WHICH NEEDS TO BE FOUND, AND HENCE ENHANCE THE PROSPECTS FOR AGREEMENT ON THE PACKAGE. OUR POSITION FOR ARGUING THIS CASE WILL BE STRONGER IF WE INDICATE THAT WE ARE PREPARED TO MAKE A PROPORTIONAL CONTRIBUTION. PRESSURE ON THE FUND COULD REDUCE THE SIZE OF THAT CONTRIBUTION.

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FM UKDEL IMF/IBRD WASHINGTON
TO ROUTINE FCO
TELNO 115
OF 202300Z MAY 88
INFO ROUTINE BELGRADE

IMF: YUGOSLAVIA - FCO TELNO 46 AND BELGRADE'S TELNO 124

SUMMARY

1. US CONTRIBUTION TO BIS BRIDGE LOAN - WHICH IS FROM US TREASURY AND DOES NOT INVOLVE FEDERAL RESERVE - AWAITS BIS REPLY TO US PROPOSALS ON BIS LOAN. POSSIBILITY OF MORE IMF MONEY RAISES WIDER POLICY ISSUES AND IS LIKELY TO MEET OPPOSITION FROM SOME OTHER CREDITORS, INCLUDING THE US.

DETAIL

2. IN RESPONSE TO FCO'S TUR, WE CHECKED WITH THE US OFFICE HERE ON THE STATUS OF US PARTICIPATION IN THE BIS BRIDGE LOAN TO YUGOSLAVIA. MULFORD AND DALLARA ARE ONLY DUE BACK IN WASHINGTON TODAY BUT WE TALKED TO TEMPLEMAN (ADVISOR IN THE US OFFICE). HE TOLD US THAT THE US OFFER OF DOLLARS 50 MN WAS DIRECT FROM THE TREASURY'S EXCHANGE STABILISATION FUND AND THERE WAS NO FEDERAL RESERVE PARTICIPATION. FINAL COMMITMENT OF THE US OFFER WAS AWAITING A RESPONSE FROM THE BIS TO THE US PROPOSALS ON HOW THE OVERALL BIS LOAN SHOULD BE LINKED TO THE YUGOSLAV PROGRAMME. THE US HAD PROPOSED DISBURSEMENT AND REPAYMENT IN THREE TRanches: THE FIRST ON APPROVAL IN PRINCIPLE OF THE SBA TO BE REPAID ON FULL APPROVAL OF THE SBA AND FIRST DISBURSEMENT: THE SECOND UPON ASSURANCE BY THE MD THAT THE END-JUNE PERFORMANCE CRITERIA HAD BEEN MET TO BE REPAID UPON DEFINITIVE CONFIRMATION AND THE SECOND SBA DISBURSEMENT: AND, THIRD, UPON A GREEN LIGHT FROM THE WORLD BANK PRESIDENT ON THE EXPECTED SAL TO BE REPAID ON SAL DISBURSEMENT. TEMPLEMAN HAD NOT YET SPOKEN WITH MULFORD OR DALLARA BUT THOUGHT THAT THE PROPOSAL, WHICH WAS PUT TO LAMFALUSSY IN THE MARGINS OF THE OECD MEETING IN PARIS, MAY NOT YET HAVE BEEN PASSED ON TO OTHER CREDITORS.

3. WITH RESPECT TO SUGGESTIONS IN TURS THAT THE FUND MIGHT INCREASE ITS GROSS DISBURSEMENTS TO REDUCE NET REPAYMENTS, WE UNDERSTAND THAT THIS IDEA HAS ALSO BEEN PROMOTED BY THE FRENCH. THE FRENCH OFFICE HERE WOULD NOT GIVE US A PRECISE INDICATION OF THE INCREASED ACCESS BEING SOUGHT TO FUND RESOURCES BUT ADMITTED IT WAS 'SIGNIFICANT'. WE SUSPECT THEREFORE THAT THE FRENCH ARE AT LEAST THINKING

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OF AN INCREASE IN ACCESS FROM THE CURRENT 50 PER CENT OF QUOTA TO SOMEWHERE CLOSE TO, IF NOT AT, THE CURRENT 90 PER CENT LIMIT ON ANNUAL ACCESS (90 PER CENT OF YUGOSLAVIA'S QUOTA IS EQUIVALENT TO JUST OVER SDR 550 MN - ABOUT DOLLARS 450 MN IN 1988, IE A NET REPURCHASE OF DOLLARS 190 MN CF DOLLARS 370 MN CURRENTLY ENVISAGED).

4. THIS SUGGESTION WILL RAISE CONSIDERABLE DIFFICULTIES FOR THE FUND AND MAY ANYWAY BE IMPRACTICAL IN THE FACE OF LIKELY OPPOSITION FROM OTHER CREDITORS, INCLUDING THE US. ENLARGING ACCESS FOR YUGOSLAVIA, PARTICULARLY AS THIS INVOLVES A PUBLIC REVISION OF THE FUND ARRANGEMENT, WOULD JEOPARDISE THE FUND'S ABILITY TO MAINTAIN GENERAL DISCIPLINE ON ACCESS TO ITS RESOURCES. THE UK, IN CONCERT WITH OTHER CREDITORS, HAS SOUGHT TO MODERATE ACCESS TO AROUND CURRENT LEVELS IN ORDER TO SECURE THE FUND'S RESOURCES AND REINFORCE THE CONDITIONALITY. THE CONCEPT OF THE FUND SEEKING TO AVOID OR MINIMISE NET REFLOWS WAS, OF COURSE, REJECTED BY THE CHANCELLOR AT THE INTERIM COMMITTEE, AND THIS REJECTION HAS BEEN REPEATED MORE RECENTLY BY CAMDESSUS, FOLLOWING UK LEAD. A PUBLIC RETREAT ON YUGOSLAVIA WOULD ALSO MAKE IT DIFFICULT FOR THE FUND TO RESIST CLAIMS FOR SIMILAR TREATMENT BY OTHER COUNTRIES. THIS IS OF COURSE SOMETHING WHICH THE FRENCH WOULD WELCOME AND, INDEED, HAVE BEEN PROMOTING AT EVERY OPPORTUNITY.

5. FCO PLEASE PASS TO BOTTRILL AND WALSH (HMT),
T RICHARDSON (ERD) AND WARE (BOE).

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FROM: J M G TAYLOR
DATE: 23 May 1988

bf. 27/5
pmf
bf 25/5

MR BOTTRILL

cc Sir G Littler
Mr Lankester
Mr H P Evans
Mr Mountfield

IMF: YUGOSLAVIA

... The Chancellor has seen UKDEL TelNo.113 (attached). He would be grateful for a note on the latest state of play in relation to Yugoslavia.

JMGT

J M G TAYLOR

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FM UKDEL IMF/IBRD WASHINGTON
TO ROUTINE FCO
TELNO 113
OF 192300Z MAY 88
INFO ROUTINE BELGRADE

IMF: YUGOSLAVIA

SUMMARY

1. FUND SEE LINK BETWEEN BIS LOAN AND YUGOSLAV RESERVES AS IMPRACTICAL AND UNHELPFUL. STAFF BELIEVE RELEASE OF BIS LOAN AND COMMERCIAL BANK CRITICAL MASS COULD ALLOW PROGRAMME TO BE STARTED. FUND DIRECTOR RESPONSIBLE FOR YUGOSLAVIA BELIEVES PROGRAMME MAY COME TO BOARD LATE NEXT WEEK (27 MAY), ALTHOUGH OTHERS THINK FOLLOWING WEEK MORE LIKELY. DECISION RESTS WITH YUGOSLAVS.

DETAIL

2. FUND STAFF HAVE CONFIRMED THAT THE GERMANS, DUTCH, AUSTRIANS AND POSSIBLY THE SWISS HAVE AGREED TO PROVIDE A DOLLAR 136 MN BRIDGE TO OFFICIAL INTEREST RESCHEDULING OVERLAPPING INTO 1989. TOGETHER WITH THE RESCHEDULING OF OFFICIAL INTEREST FALLING WITHIN 1988 AND THE CRITICAL MASS OF COMMERCIAL BANK NEW MONEY (WHICH HAS NOT BEEN FIXED BUT IS EXPECTED TO BE 90 PER CENT), THIS COULD, IN THE STAFF'S OPINION, PROVIDE SUFFICIENT ASSURANCES OF FINANCING FOR 1988 TO BRING THE YUGOSLAV SBA TO THE BOARD FOR FULL APPROVAL, DESPITE SHORTFALL OF AT LEAST DOLLARS 100 MN FROM FINANCING TARGET OF DOLLARS 800 MN.

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4. THE REAL PROBLEM, IN THE STAFF'S OPINION, IS WITH THE BIS BRIDGING LOAN. THEY REGARD THE LINKAGE TO THE LEVEL OF YUGOSLAV RESERVES AS UNREALISTIC GIVEN THE ILLIQUIDITY OF THESE RESERVES AND THE FACT THAT A RUNDOWN TO THE TRIGGER LEVELS SPECIFIED BY THE BIS WOULD, AMONG OTHER THINGS, BREACH THE PERFORMANCE CRITERIA ON NET FOREIGN ASSETS. THE FUND STAFF HOPE THE BIS CAN BE PERSUADED TO RELAX ITS CONDITIONS

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AND RELEASE THE LOAN IN TIME TO SUPPORT THE PRIOR ACTIONS - SPECIFICALLY, FOREIGN EXCHANGE LIBERALISATION - WHICH MUST BE TAKEN FIVE WORKING DAYS BEFORE THE SBA COMES TO THE BOARD. STAFF STRESS THAT THE MONEY DOES NOT HAVE TO PRECISELY PRECEDE THESE PRIOR ACTIONS.

5. POSTHUMUS (THE DUTCH ED WHO REPRESENTS YUGOSLAVIA) STRESSED THAT BOTH THE BIS' LINKAGE TO APPROVAL IN PRINCIPLE AND TO MINIMUM RESERVE LEVELS ARE SEEN AS UNHELPFUL. THE YUGOSLAVS SOUGHT POSTPONEMENT OF BOARD MEETING SCHEDULED EARLY THIS WEEK ON GROUNDS OF INADEQUATE FINANCING TO INTRODUCE PRIOR ACTIONS SAFELY. THE GERMAN/DUTCH ETC LOAN, NOT DEPENDENT ON THESE LINKAGES, WILL PROVIDE SOME CUSHION, BUT THE YUGOSLAVS MAY ASK THE FUND TO MODIFY THE FIVE WORKING DAY LEAD TIME BETWEEN FOREIGN EXCHANGE LIBERALISATION AND BOARD APPROVAL. POSTHUMUS THINKS THE YUGOSLAVS ARE NOW AIMING FOR A BOARD MEEING MAY 27 (WHICH PRESUMABLY COULD ONLY BE APPROVAL IN PRINCIPLE), BUT OTHERS THINK SLIPPAGE OF A FURTHER WEEK OR MORE (WHICH WOULD MAKE FULL APPROVAL PERHAPS POSSIBLE) IS MUCH MORE LIKELY.

6. THE INITIATIVE TO SCHEDULE THE BOARD MEETING NOW RESTS ENTIRELY WITH THE YUGOSLAVS.

7. FCO PLEASE PASS TO BOTTRILL AND WALSH (HMT), T RICHARDSON (ERD) AND WARE (BOE).

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MR WICKS NO 10 DOWNING ST
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WALSH TREASURY
WARE B/ENGLAND

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CONFIDENTIAL (AMENDED DIST 25/5/88)
FM UKDEL IMF/IBRD WASHINGTON
TO ROUTINE FCO
TELNO 116
OF 232300Z MAY 88
INFO ROUTINE BELGRADE

IMF: YUGOSLAVIA

SUMMARY

1. YUGOSLAV PROGRAMME LIKELY TO COME TO BOARD JUNE 1.
SUBSTANTIAL OFFICIAL FINANCING REQUIREMENT REMAINS TO BE PUT
TOGETHER.

DETAIL

2. RIPLEY (FUND MISSION CHIEF) GAVE US THE LATEST
POSITION ON YUGOSLAVIA AS SEEN FROM THE FUND.
3. AS BRIDGE FINANCING NOW LOOKS LIKELY TO BE MUCH LESS
THAN ASKED FOR, THE YUGOSLAVS ARE SEEKING TO HAVE THE FUND
AGREE TO REDUCE FROM FIVE DAYS TO TWO THE LENGTH OF TIME THE
EXCHANGE MARKET LIBERALISATION HAS TO BE IN PLACE BEFORE THE
BOARD APPROVES THE SBA. IF FUND MANAGEMENT AGREE,
EXPECTATIONS ARE THAT THE PROGRAMME WILL COME TO THE BOARD
WEDNESDAY, JUNE 1. THIS WOULD REQUIRE THE BOARD AGREEING BY
FRIDAY, MAY 27 TO TAKE IT THEN (TWO WORKING DAYS' NOTICE IS
REQUIRED FOR TAKING A SUBJECT AT THE BOARD: MONDAY IS A
HOLIDAY HERE). THE EXCHANGE MARKET LIBERALISATION WOULD
HAVE TO BE INTRODUCED THIS WEEKEND.
4. RIPLEY IS CONCERNED ABOUT THE US PROPOSAL TO BRIDGE IN
THREE ARCHES, RATHER THAN OVER THE ENTIRE PERIOD TO END-
NOVEMBER. EVEN IF THE US ALONE ADOPTED THIS APPROACH, THE
EFFECTIVE SIZE OF THE BRIDGE WOULD SEEM TO FALL FROM DOLLARS
250 MN TO DOLLARS 217 MN. IF THIS WERE IMPLEMENTED BY ALL,
THIS WOULD EFFECTIVELY CUT THE BRIDGE TO DOLLARS 87 MN.
RIPLEY WAS NOT SURE THE YUGOSLAVS COULD GO AHEAD ON THIS
BASIS. IN ANY CASE, DELAYS IN PUTTING THE BRIDGE TOGETHER
MAY BE PLACING THE OVERALL PACKAGE IN SOME JEOPARDY.
(RIPLEY IS LARGELY UNSIGHTED ON DEVELOPMENTS REGARDING THE
BRIDGE: ANY EARLY INFORMATION WE COULD HAVE TO PASS ON TO
HER WOULD BE EXTREMELY HELPFUL.)
5. RIPLEY CONTINUES TO BE SCEPTICAL OF THE BRIDGE LOAN
LINK TO RESERVES. ORIGINALLY SHE HAD THOUGHT THE CONDITION
WOULD ENSURE THAT THE YUGOSLAVS WOULD BE UNABLE TO ACCESS THE
BRIDGE: HAVING CONSIDERED THIS FURTHER (AND SPOKEN TO THE
YUGOSLAVS) SHE THINKS THE YUGOSLAVS CAN SHIFT RESERVES INTO

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AND OUT OF THE CENTRAL BANK SO THAT THEY CAN (AT SOME COST) ACHIEVE WHATEVER RESERVE LEVEL THEY NEED. THE LINK TO THE RESERVES WOULD THUS BE MEANINGLESS.

6. REGARDING THE POSSIBILITY OF INCREASING FUND ACCESS, WHICH IS BEING SUGGESTED BY THE FRENCH AND JAPANESE, SHE THINKS THIS WOULD BE DISASTROUS. BOTH CAMDESSUS (FUND MD) AND RUSSO (HEAD OF EUROPEAN DEPT) WOULD RESIST THIS PROPOSAL STRONGLY. HIGHER FUND ACCESS WAS CONSIDERED A FEW MONTHS AGO, BUT CAMDESSUS HAD NOT WANTED A LARGER PROGRAMME. TO AGREE IT NOW WOULD BE TO PUT THE FUND IN THE POSITION OF RESIDUAL LENDER, AND WOULD HAVE A VERY NEGATIVE DEMONSTRATION EFFECT ON BOTH CREDITORS AND DEBTORS.

7. RIPLEY PUTS THE REMAINING FINANCING NEEDED FROM OFFICIAL SOURCES NOW AT ABOUT DOLLARS 900 MN. THIS COMPRISES THE DOLLARS 790 MN EARLIER IDENTIFIED, PLUS ABOUT DOLLARS 100 MN WHICH THE GERMANS, AND OTHERS, CLAIM IS EXCLUDED FROM THE ASSUMED PARIS CLUB RESCHEDULING. THE FUND IS NOT (NOT) TAKING THE LEAD IN CO-ORDINATING FILLING THIS GAP. (RIPLEY THEREFORE CONTRADICTS THE SUGGESTION IN BELGRADE'S TELNO 124 THAT THE UK IS ABOUT TO BE CONTACTED BY THE FUND TO ASK WHAT OUR CONTRIBUTION WILL BE.) THE EFFORTS OF MAAS DURING ECOFIN WERE DESIGNED TO ACHIEVE EUROPEAN CO-ORDINATION, AND HE ALSO SPOKE TO THE JAPANESE. MIKULIC IS SHORTLY TO VISIT JAPAN, AND WILL DOUBTLESS SEEK ASSISTANCE THERE. (SO FAR THERE IS APPARENTLY NO EXTRA JAPANESE MONEY IN PLACE.)

8. IF THE REMAINING FINANCE IS NOT AVAILABLE, THE YUGOSLAVS MAY HAVE TO DO MORE, EITHER ON THE EXCHANGE RATE OR DEMAND MANAGEMENT. THE FUND WILL BE VERY CAREFUL TO ENSURE THAT THERE IS NO BACKTRACKING ON THE LIBERALISATIONS. BUT RIPLEY POINTED OUT THAT NOT EVERYTHING IS WORKING AGAINST YUGOSLAVIA. EXPORTS HAVE PERFORMED WELL THIS YEAR AND, WITH THE DELAYS IN THE START OF THE PROGRAMME, IMPORT COMPRESSION HAS LASTED LONGER THAN EXPECTED (A 1 PER CENT CUT IN IMPORTS OVER A YEAR WOULD SAVE YUGOSLAVIA DOLLARS 100 MN), SO OVERALL FINANCING NEEDS MIGHT IN THE END BE SOMEWHAT LESS THAN CALCULATED.

9. FCO PLEASE PASS TO BOTTRILL AND WALSH (HMT), T RICHARDSON (ERD) AND JAGGERS AND WARE (BOE).

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FM UKDEL IMF/IBRD WASHINGTON
TO DESKBY 260800Z FCO
TELNO 118
OF 252300Z MAY 88
AND TO PRIORITY BELGRADE

IMF: YUGOSLAVIA

1. RIPLEY (IMF MISSION CHIEF) STILL THINKS JUNE 1 BOARD DISCUSSION POSSIBLE, BUT THIS IS LARGELY CONTINGENT ON YUGOSLAV WILLINGNESS TO GO AHEAD WHILST THE BIS LOAN MAY NOT YET BE FULLY IN PLACE. IT WOULD REQUIRE YUGOSLAVIA TAKING THE FOREIGN EXCHANGE LIBERALISATION COB FRIDAY, SO FUND BOARD COULD BE INFORMED FRIDAY AND SUPPLEMENTARY PAPER ISSUED POSSIBLY OVER THE WEEKEND.
2. RIPLEY STATED (PLEASE PROTECT) THAT SHE WOULD BE MORE RELAXED THAN RUSSO (DIRECTOR, EUROPEAN DEPARTMENT) ABOUT SOME SLIPPAGE IN THIS TIMETABLE. THE REAL DEADLINE IS THE PARIS CLUB MEETING OF 6 - 11 JUNE. IF THE YUGOSLAVS TAKE THE FOREIGN EXCHANGE LIBERALISATION ON THE WEEKEND OF JUNE 4 - 5, THE FUND BOARD COULD TAKE THE PROGRAMME (WHICH IS TO BE APPROVED IN PRINCIPLE ONLY AT THIS STAGE) AROUND JUNE 7, WHICH SHOULD STILL MEET THIS DEADLINE.
3. FCO PLEASE PASS TO BOTTRILL AND WALSH (HMT), T RICHARDSON (ERD) AND JAGGERS AND WARE (BOE).

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JAGGFERS BANK OF ENGLAND
WARE BANK OF ENGLAND

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Belmont to my book

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MDHIAN 0911

CONFIDENTIAL
FM BELGRADE
TO DESKBY 261200Z FCO
TELNO 126
OF 261015Z MAY 88
INFO ROUTINE UKDEL IMF/IBRD WASHINGTON

Handwritten notes in red ink:
If I could who
has taken the loan as
this, both in letters
with the Yugoslavs
& with the
← accounts
C. ... What is
done??

PERSONAL FOR RATFORD AND HEAD OF EED

MY TELNO 125 AND TELECON OF 26 MAY, MADDEN/LANCE:
YUGOSLAV FINANCIAL ARRANGEMENTS.

1. I UNDERSTAND YESTERDAY'S MEETING AT THE TREASURY CONCLUDED WE SHOULD MAINTAIN OUR SHARE OF THE BIS BRIDGING LOAN FOR YUGOSLAVIA AT US DOLLARS 25 MILLION AND TAKE A FULL PART IN RESCHEDULING, INCLUDING RESCHEDULING OF INTEREST PAYMENTS IN COMPANY WITH OTHER PARIS CLUB MEMBERS BUT THAT WE SHOULD NOT PROVIDE FRESH FINANCE.

2. I HOPE THIS WILL NOT BE OUR FINAL WORD. WE HAVE HAD PLENTY OF WARNING OVER SEVERAL MONTHS THE YUGOSLAVS WOULD BE ASKING FOR FRESH FUNDS AS WELL AS REFINANCING, AND WE HAVE ALSO KNOWN FOR SOME TIME THE IMF PROGRAMME WOULD BE PREDICATED ON THE ASSUMPTION THEY WOULD GET SUCH FUNDS. WE HAVE THROUGHOUT TAKEN A FIRM AND LEADING POSITION AMONG THE CREDITORS IN URGING THE YUGOSLAVS TO COME TO A RIGOROUS AGREEMENT WITH THE IMF. NOW THEY HAVE DONE SO. WE HAVE SAID NOTHING TO DISABUSE THEM OF THE IDEA THAT SUCH AN AGREEMENT WOULD OPEN THE WAY TO FRESH CAPITAL INJECTIONS FROM THE CREDITORS OVER AND ABOVE WHAT MIGHT BE RELEASED THROUGH RESCHEDULING. ON THE CONTRARY. THE YUGOSLAVS CERTAINLY INTERPRETED THE PRIME MINISTER'S COMMENTS TO DJURANOVIC IN MARCH AS MEANING BRITAIN, TOO, WOULD CONTRIBUTE, AN UNDERSTANDING WHICH IS NOT ONLY COMMENSURATE WITH THE WORDS SHE USED BUT ALSO IN LINE WITH OUR POSITION AS A MAJOR CREDITOR AND ONE OF THE PRINCIPAL ACTORS IN THE STORY SO FAR. WITHOUT IN ANY WAY WISHING TO UNDERESTIMATE THE VALUE OF RESCHEDULING, INCLUDING RESCHEDULING OF INTEREST PAYMENTS, OR THE WORTH OF OUR CONTRIBUTION TO THE BRIDGING LOAN, IT WOULD BE HARD TO ARGUE THAT THIS ALONE WOULD MAKE OUR DEEDS MATCH OUR WORDS.

3. THERE ARE GOOD ARGUMENTS OF SELF-INTEREST FOR US TO CONSIDER AS WELL AS THE PERHAPS MORE SENTIMENTAL AND THEREFORE LESS COMPELLING ARGUMENTS BASED ON PAST FRIENDSHIP AND CONTINUED INTEREST IN THE RELATIONSHIP.

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(A) NO-ONE CAN SAY THE PRESENT IMF SPONSORED PROGRAMME WILL WORK. BUT IT JUST MIGHT. IF IT DID WE SHOULD STAND SOME CHANCE OF GETTING OUR MONEY BACK EVENTUALLY AND WOULD CERTAINLY BENEFIT FROM THE RESULTING BOOST TO ANGLO-YUGOSLAV TRADE (WHICH IS ALREADY HIGHER IN VALUE THAN THAT WITH ANY OF THE EAST EUROPEAN COUNTRIES). VIEWED IN THIS LIGHT, APPROPRIATE ENCOURAGEMENT AT THIS POINT WOULD SEEM MONEY WELL SPENT, AND NOT JUST THE FULFILLMENT OF A MORAL OBLIGATION.

(B) IN THE RATHER MORE LIKELY EVENT OF PRESENT EFFORTS COMING TO GRIEF AND FURTHER PRESSURE ON YUGOSLAVIA PROVING NECESSARY (MY DESPATCH OF 23 MAY) WE WOULD BE FAR BETTER PLACED TO PLAY A ROLE WHICH WOULD BE ADEQUATE TO THE SCALE OF OUR INTEREST IN THIS COUNTRY AND ITS FINANCIAL PROBLEMS IF WE HAD BEEN SEEN TO TAKE A HELPFUL LINE NOW. NOT TO CONTRIBUTE FRESH MONEY AT THIS STAGE IS LIKELY TO LEAVE US EXPOSED AMONG THE CREDITORS, AND THEREFORE LESS ABLE TO INFLUENCE THEIR POLICY-MAKING IN FUTURE. IT WOULD ALSO INEVITABLY DECREASE OUR INFLUENCE ON FUTURE YUGOSLAV POLICY-MAKING.

4. THE MOST IMPORTANT IMMEDIATE ISSUE IS LIKELY TO PROVE OUR ATTITUDE TOWARDS BRIDGING FINANCE. IF WE WERE ABLE TO JOIN THE GERMANS AND A NUMBER OF THE SMALLER EUROPEAN COUNTRIES (MY TEL UNDER REF) IN PRE-FINANCING THE CAPITALISATION OF INTEREST PAYMENTS WE SHOULD BE MAKING AN IMMEDIATE GESTURE WHICH WOULD PERHAPS NOT BE TOO EXPENSIVE. THE BIS LOAN IS ONLY HALF WHAT THE YUGOSLAVS ARE ASKING FOR, ON IMF ADVICE. WHILE THEREFORE A CONTRIBUTION OF 10 PER CENT OF THE BIS LOAN IS PROPORTIONATE TO OUR EXPOSURE IT IS NOT PROPORTIONATE TO THE APPARENT REQUIREMENT. BY ITSELF, IT MAY ALSO TEND TO GET LOST SIGHT OF.

5. LONGER TERM FINANCING ARRANGEMENTS ARE HOWEVER OF GREATER IMPORTANCE, AND IF IMMEDIATE REQUIREMENTS CAN BE MET WITHOUT FURTHER RECOURSE TO US, THE STING WOULD BE DRAWN FROM ANY FEELING WE HAD BEEN LESS THAN GENEROUS (A FEELING WHICH EXISTS ALREADY) BY APPROPRIATE ACTION HERE. THE OBVIOUS CASE IS TO WORK THROUGH ECGD. THE YUGOSLAVS WOULD OF COURSE PREFER UNTIED LOANS AND IF THAT WERE IN PROSPECT I WOULD NATURALLY MUCH WELCOME IT TOO. BUT PROVISION OF SOME DEGREE OF ECGD COVER WOULD HELP THEM BOTH MATERIALLY AND PSYCHOLOGICALLY. AGAIN, WHAT DJURANOVIC AND THE PRIME MINISTER SAID TO EACH OTHER IS RELEVANT.

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MR WICKS NO 10 DOWNING ST

EASTERN EUROPEAN ECONOMIC

NNNN

FROM: P MOUNTFIELD
DATE: 26 MAY 1988

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Economic 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 Bottrill
Mrs Thomas
Mr Savage, Parliamentary
Section
Mr Cassell
Mr Enoch, Washington
Miss Wheldon, T/Sol

Handwritten notes in red ink:
The
Agree
man
wsh.
Agree recommendations
(para. 11); + that I should
write to No 10 re at Annex C?
(Same background
tels. behind).
26/5

YUGOSLAVIA: IMF, PARIS CLUB, BRIDGING LOAN, ETC

This submission seeks your agreement:

- (a) to the line to take at the IMF Board;
- (b) of the UK position in the Paris Club;
- (c) to confirm your approval of UK participation in the bridging loan, in slightly different circumstances (and to the administrative/publicity arrangements for the UK share);
- (d) to confirm that the UK should not put up any further "new money".

2. I discussed all these points with the other departments concerned, and with the Bank, at a meeting yesterday: there was complete agreement.

3. Since then, the situation has got considerably worse, because of problems over the bridging loan (see below). We and the Bank still feel we should go ahead if the BIS can patch together the loan agreement - provided the UK share is not increased and that the Bank of England is still satisfied as to security and take-out.

The Fund Programme: adjustment

4. Camdessus has described this as a very strong programme. Even on paper, we do not think it is as good as this. The mix of fiscal and monetary policies, the structural reforms in the socialised sector, the exchange rate devaluation and associated liberalisation of foreign exchange are all necessary moves. But to do them all at once and successfully will require great skill. There are doubts about the ability of the Yugoslav administration to deliver, even after the vote of confidence which Mikulic won on 15 May. (Rikanovic, whom you met last month, has been retained in office, at least for the moment). Nevertheless, we think this is the strongest programme we are likely to get and, if implemented, marking a considerable improvement in internal and external policies.

IMF programme: financing

5. However, it is not yet fully-financed, and at the Board meeting on 1 June the MD may (and in our view should) seek only approval in principle. One issue is the size of the IMF's own contribution: the programme assumes 50 per cent of the quota, but France and Japan are both suggesting an increase, perhaps to 66 per cent. This would do little to close the financing gap in calendar 1988. More important, it would breach the general UK line (which you reaffirmed to Camdessus) of not requiring the Fund to increase its exposure in such cases, and relying on the Fund's catalytic role, rather than looking to it to provide significant finance in its own right. 'Approval in principle' means that the Board will have to confirm its agreement at a later stage when the final position on financing is known. If (unexpectedly) the commercial banks fail to come up with the full \$300 million new money; or if (improbably) the Paris Club cannot provide its share of debt

relief; or if (a rather more serious risk) the government creditors do not provide the further new credits assumed, the package could still fall apart. Agreement in principle therefore carries a slight risk: it would trigger the bridging loan before the takeout assumed by the Fund disbursement was assured. We think this is a risk we have to carry.

6. We therefore propose to brief Mr Cassell to support approval of the programme in principle while criticising a number of elements in the adjustment package; to agree to 50 per cent of quota; but to give him discretion to fall in with a move to increase this up to 66 per cent if this is necessary to achieve a consensus.

Paris Club

7. Yugoslavia has now had 4 Paris Club agreements, and has managed to avoid rescheduling interest or reopening earlier deals. Indeed, the percentage of new principal to be rescheduled has fallen in successive agreements. Now, however, Yugoslavia is asking for rescheduling of 100 per cent of all principal and interest falling due for the first time in the period covered by the SBA (to June 1989) and also of the principal and interest now falling due under earlier rescheduling agreements. Normally, except in the case of poorest African countries, we try to avoid inclusion of "previously rescheduled debt". But in the present case it seems inevitable, even though this will lead to a net increase in the exposure of creditor governments (collectively) of about 6/7 per cent (compared to an increase in banking exposure of about 4 per cent). Although I have formally reserved your position on this, I think we have little option but to agree. The total amount foregone up to June 1989 is \$228 million - say £125 million, much of which is already allowed for in ECGD's financial forecasts. I recommend that we agree.

Bridging loans

8. You have already agreed in principle to UK participation, on condition that other countries joined in. The detailed arrangements, including the indemnity to the Bank of England,

notification to No 10 and to Parliament etc, are set out in the attached appendix. The terms of the indemnity have been approved by Sir Peter Middleton as Accounting Officer for the Consolidated Fund. The BIS draft memorandum provides for a \$200 million guarantee to the BIS by 11 central banks, together with \$50 million from the United States. The UK share is confirmed at \$30 million, equivalent to 12½ per cent. Yugoslavia's ability to draw on the BIS depends on the IMF agreeing in principle to the SBA. Repayments are to be from disbursements of the first three tranches of the SBA. The US is still holding out and its conditions for participation effectively reduce the value of the loan to less than \$250 million. Yugoslavia is now saying that it cannot go ahead with the IMF programme unless the BIS loan is increased to something nearer the original \$400 million. At present it is not clear how this will be resolved. We are working on the assumption that the Germans will, by one means or another, provide the balance of the bridge. In that case, we assume that the UK can still go ahead and put in \$30 million. This may need to be disbursed immediately after the weekend and announced next week while Parliament is in Recess: in the documentation we have followed the precedent of the Mexican loan which was also issued during a recess. May we proceed on this basis please - both in substance and on presentation?

I spoke to Mr M. about this. The US are insisting that they pay in 3 separate tranches, with only 1/3 paid up front. They are not, however, refusing to participate - I made clear to Mr M. that if they did so refuse, we would want to, too.

New money

9. The IMF arithmetic for closing the financing gap also assumes that new credits will be available from an unspecified number of other creditors. You may recall that in 1983, when a rather panicky Yugoslav rescue package was put together under American pressure, there were direct financing loans from the FCO, as well as Paris Club rescheduling. The FCO is certainly not prepared to put up any more money, even if we let it. Nor is ECGD prepared, given the recent Yugoslav record, to offer any new credits. So the UK has nothing to contribute under this heading. In practice, I believe the IMF will look to the FRG, Austria, Italy, etc rather than to us. We have agreed with the FCO and ECGD that the UK will likely refuse to join in. I assume you would support this.

Tactics

10. The FRG, and the Netherlands (with Yugoslavia in its IMF constituency) are taking the lead in organising support for this package. There are no political reasons why the UK should take a particularly forward position. So, despite the usual FCO wish to be seen to be helpful, I have agreed with them that we shall stay in the middle of the pack, undertake to do our bit (apart from new money) but not be especially helpful or officious in working for a solution. We need to keep our powder dry for Nigeria, where I fear we shall have to take a more active role.

Recommendation

11. I therefore propose:

- (a) that we instruct Mr Cassell to support the Fund Programme, subject to the points about financing noted above;
- (b) that at the Paris Club, I should be authorised to agree to 100 per cent rescheduling of principle and interest, including PRD;
- (c) that we continue to take our share of the bridging loan, up to a maximum of \$30 million;
- (d) that we provide no new money;
- (e) that generally, we maintain a low profile.

RM

P MOUNTFIELD

Arrangements for BIS bridging loan

Country Shares

Central banks' contributions to the BIS facility are an Annex A.

Bank of England indemnity

The Treasury will need to give an indemnity to the Bank of England. A draft letter has been provided by the Bank and approved by Sir Peter Middleton. See Annex B. It can be signed by Sir Geoffrey Littler. It follows exactly the form of that used for the Mexico bridging loan. It guarantees the Bank for principal, interest and costs in dollars. The Bank does not need to provide cash since it is a Substitution Agreement. The Treasury will receive three-quarters of the commission. This will have to be sent to the Bank of England once the BIS documentation is cleared. The indemnity is granted under the International Monetary Arrangements Act 1983. If the loan were to go wrong, it would represent at current exchange rates a charge of £16 million together with any unpaid interest and costs on public expenditure.

Notification of No 10

No 10 has already been informed of the bridging facility and the Prime Minister confirmed to Chancellor Kohl the UK's readiness to participate. We shall need to tell No 10 of the arrangements being made to inform Parliament. A draft private secretary letter to No 10 is attached at Annex C.

Notification of Parliament

Under the terms of the 1983 Act, the Treasury is obliged to notify each House of Parliament immediately after any indemnity of this kind is undertaken. This might best be done the day after the BIS announces that the arrangements are complete. If Parliament is sitting, this would be by a Paper under Act presented by the Economic Secretary. If Parliament is not sitting (eg during the Whitsun Recess) a Command Paper needs to be presented to

Parliament but not printed. Alternative drafts are attached at Annexes D and E.

Publicity

The Bank of England does not intend to issue a Press notice, and it is not intended that the Treasury issues one. Nevertheless, we will provide briefing for the Press Office immediately prior to the date of announcement.

Overseas posts

We shall also need to inform overseas posts and will liaise with the Foreign Office.

THE FIRST SCHEDULE
(Text of the BIS Facility)

THE SECOND SCHEDULE

	Proportions	Maximum amounts of principal (in millions of US dls)
	<hr/>	<hr/>
Banque Nationale de Belgique	5/200	5
Bank of Canada	10/200	10
Deutsche Bundesbank	40/200	40
Bank of England	30/200	30
Banque de France	30/200	30
Banca d'Italia	25/200	25
Bank of Japan	30/200	30
De Nederlandsche Bank N.V.	5/200	5
Oesterreichische Nationalbank	10/200	10
Schweizerische Nationalbank	10/200	10
Sveriges Riksbank	5/200	5
Total	<u>200/200</u>	<u>200</u>

ANNEX B
LETTER TO
BANK

0018 1011

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

ANNEX B

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 \$30 million participation in the credit facility to be granted by the Bank for International Settlements to the National Bank of Yugoslavia.

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 Peter Middleton/Sir Geoffrey Littler

ANNEX L
LETTER TO
NO 10

28/3

ANNEX C

DRAFT LETTER FROM PS/CHANCELLOR TO NO.10

CD Patten, Esq.
No 10 Downing St
London SW1.

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

YUGOSLAVIA: BIS BRIDGING LOAN

As the Prime Minister confirmed to Chancellor Kohl in her letter of 9 May, the Bank of England is participating in a bridging loan which is being arranged by the Bank for International Settlements to support a Yugoslav IMF programme. The loan is intended to support the dinar during the first months of economic reform. The IMF Board is expected to approve a Stand By Arrangement in principle on 1 June. Drawings on the IMF will become available once all the financing elements for the programme are in place.

2. The bridging loan is for \$250 million, of which \$50 million is from the US and \$200 million from other Central Banks. Of this \$30 million is from the Bank of England. The facility terminates on 30 November 1988 and will be repaid by drawings on the IMF Stand By Arrangement.

3. The Chancellor has authorised the Bank of England to take part in the operation. The Treasury will give the Bank an indemnity on lines similar to that given in 1986 for Mexico. We expect that the loan will be finalised in Basle early next week.

4. Under the terms of the International Monetary Arrangements Act, 1983 we are required "immediately after giving any undertaking under this section, to lay a statement of the undertaking before each House of Parliament". Since Parliament will be in recess, this will take the form of a Command Paper.

5. The Chancellor proposes to do this on [Wednesday]. I attach a draft. 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.

7. The FCO has arranged to send an appropriate briefing to Belgrade and other concerned posts. Press Officers at the Treasury, FCO and Bank have question and answer briefing.

8. As a matter of courtesy, we are notifying the Public Accounts Committee and the Treasury and Civil Service Select Committee.

9. I am copying this letter to ~~the~~ ^{the} Private Secretaries to the ^{5th} Foreign Secretary, ~~the~~ ^{the} Lord President, ~~the~~ ^{the} Lord Privy Seal, ~~the~~ ^{the} Chief Whips in the Commons and the Lords, ~~the~~ ^{the} Governor of the Bank of England, and to Bernard Ingham.

JMG T

P-5-

ANNEX D
INDEMNITY

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ANNEX D

INTERNATIONAL MONETARY ARRANGEMENTS ACT 1983

STATEMENT of Indemnity given by the Treasury to the Bank of England on [May 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 Yugoslavia.

Treasury Chambers)
[May 1988]) **PETER LILLEY**

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

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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 [May 1988]
for commitment by the Bank of England to the
Bank for International Settlements in respect
of a loan to the National Bank of Yugoslavia to an
amount not exceeding 30,000,000

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

ANNEX E:
INDEMNITY
(contd.)

ANNEX E

INDEMNITY TO THE BANK OF ENGLAND
COVERING THEIR COMMITMENT TO
THE BANK FOR INTERNATIONAL SETTLEMENTS
IN RESPECT OF A LOAN TO YUGOSLAVIA

Presented to Parliament
by the Chancellor of the Exchequer
by Command of Her Majesty
[] May 1988

LONDON
HER MAJESTY'S TREASURY

Not to be Printed

INDEMNITY TO THE BANK OF ENGLAND COVERING THEIR COMMITMENT TO
THE BANK FOR INTERNATIONAL SETTLEMENTS IN RESPECT OF A LOAN TO
YUGOSLAVIA

Section 2(1) of the International Monetary Arrangements Act 1983 empowers the Treasury to undertake to indemnify the Bank of England in respect of financial assistance given by the Bank to the central bank or other monetary authority of a foreign country, in co-operation with the Bank for International Settlements or any central bank or other monetary authority. Section 2(3) of the Act requires the Treasury to lay a statement of the undertaking before both Houses of Parliament immediately after giving the undertaking. This paper fulfils that requirement.

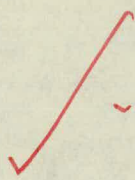
International assistance to Yugoslavia

2. The Yugoslav Government is seeking medium-term financial support through an application to the International Monetary Fund for a Stand-By Arrangement, in respect of which a Letter of Intent has been agreed; [through an application to the International Bank for Reconstruction and Development for a Structural Adjustment Loan] and through negotiation with commercial banks of many countries which have provided loans to Yugoslavia. In anticipation of such support, the National Bank of Yugoslavia sought short-term assistance from the Bank for International Settlements and the United States monetary authorities. The BIS facility will provide for \$200 million for a period ending on 30 November 1988. An additional facility for \$50 million will be provided by the United States. The BIS loan will be financed from its own resources, but it has a right of recourse to participating member central banks. The Bank of England's contingent liability under this arrangement is for a principal amount of \$30 million plus any unpaid accrued interest and costs. The Treasury has agreed to give the Bank an indemnity in respect of this contingent liability.

3. Any sums required to meet this indemnity would be charged on and issued out of the Consolidated Fund.

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FM UKDEL IMF/IBRD WASHINGTON
TO PRIORITY FCO
TELNO 121
OF 272300Z MAY 88
AND TO PRIORITY BELGRADE



ppp

IMF: YUGOSLAVIA

1. AT END OF BOARD MEETING TODAY, POSTHUMUS (THE DUTCH ED, WHO REPRESENTS YUGOSLAVIA) ASKED FOR, AND OBTAINED, BOARD AGREEMENT TO TAKE THE YUGOSLAV SBA REQUEST AT THE BOARD NEXT WEDNESDAY, JUNE 1.
2. POSTHUMUS GAVE NO FURTHER DETAILS, BUT SAID THE LIBERALISATIONS WERE BEING INTRODUCED AS FROM TODAY. A SUPPLEMENTARY STAFF PAPER WILL PROBABLY BE ISSUED TOMORROW (SATURDAY). WE WILL FAX IT TO YOU TUESDAY.
3. SEPARATELY, WE HEARD FROM THE FUND STAFF THAT THE YUGOSLAVS CLAIM DOLLARS 400 MN OF THE REQUIRED DOLLARS 500 MN FROM OFFICIAL CREDITORS IS NOW ASSURED (DOLLARS 200 MN RESCHEDULING OF INTEREST TO OFFICIAL CREDITORS DUE IN 1988, DOLLARS 136 MN IN THE GERMAN ETC BRIDGE TO THE 1989 INTEREST RESCHEDULINGS AND DOLLARS 64 MN ITALIAN CREDITS). IN ADDITION, WE WERE TOLD THERE IS TO BE DOLLARS 70 MN FROM THE US COMMODITY CO-OPERATION FUND.
3. FCO PLEASE PASS TO BOTTRILL AND WALSH (HMT), T RICHARDSON (ERD) AND JAGGERS AND WARE (BOE).

CASSELL

YYYY

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ADDITIONAL 6

MR WICKS NO 10 DOWNING ST

MR RICHARDSON ERD, FCO

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MR BOTTRILL H M TREASURY
MR WALSH H M TREASURY

MR JAGGERS BANK OF ENGLAND
MR WARE BANK OF ENGLAND

NNNN

PAGE 2
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Chief Secretary
 Economic 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

Treasury Chambers, Parliament Street, SW1P
 01-270 3000

27 May 1988

C D Powell Esq
 10 Downing Street
 LONDON
 SW1

Mr Bottrill
 Mrs Thomas
 Mr Savage - Parly Sect
 Mr Cassell - Washingto
 Mr Enoch - Washington
 Miss Wheldon - T.Sol.

Dear Charles

YUGOSLAVIA: BIS BRIDGING LOAN

The Prime Minister confirmed to Chancellor Kohl in her letter of 9 May that the Bank of England is prepared to participate in a bridging loan which the Bank for International Settlements is seeking to arrange in support of a Yugoslav IMF programme.

Implementation of the BIS loan has been delayed by problems with a parallel United States loan since central banks participating in the BIS operation have said they will not proceed without the US. On the assumption that the US difficulties are overcome, however, the BIS loan could be finalised in Basle early next week which would clear the way for an IMF Board meeting perhaps almost immediately. The loan is intended to support the dinar during the first months of economic reform. Drawings on it will become available once the IMF Board approves a Stand By Arrangement for Yugoslavia in principle. Drawings on the IMF itself will become available once all the financing elements for the programme are in place - including contributions from the commercial banks.

The bridging loan is for \$250 million, of which \$50 million is from the US and \$200 million from other Central Banks. Of this \$30 million is from the Bank of England. The facility terminates on 30 November 1988 and will be repaid by drawings on the IMF Stand By Arrangement.

The Chancellor has authorised the Bank of England to take part in the operation. The Treasury will give the Bank an indemnity on lines similar to that given in 1986 for Mexico.

Under the terms of the International Monetary Arrangements Act 1983, we are required "immediately" after giving any undertaking under this section, to lay a statement of the undertaking before



each House of Parliament". Since Parliament will be in recess, this will take the form of a Command Paper.

... The Chancellor proposes to do this on Wednesday or as soon after that as the BIS loan is announced. I attach a draft. 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.

The FCO will send appropriate briefing to Belgrade and other concerned 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 Lord President, the Lord Privy Seal, the Chief Whips in the Commons and the Lords, the Governor of the Bank of England, and to Bernard Ingham.

Yours sincerely

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

J M G TAYLOR

INDEMNITY TO THE BANK OF ENGLAND
COVERING THEIR COMMITMENT TO
THE BANK FOR INTERNATIONAL SETTLEMENTS
IN RESPECT OF A LOAN TO YUGOSLAVIA

Presented to Parliament
by the Chancellor of the Exchequer
by Command of Her Majesty
[] June 1988

LONDON
HER MAJESTY'S TREASURY

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INDEMNITY TO THE BANK OF ENGLAND COVERING THEIR COMMITMENT TO
THE BANK FOR INTERNATIONAL SETTLEMENTS IN RESPECT OF A LOAN TO
YUGOSLAVIA

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International assistance to Yugoslavia

2. The Yugoslav Government is seeking medium-term financial support through an application to the International Monetary Fund for a Stand-By Arrangement, in respect of which a Letter of Intent has been agreed; [through an application to the International Bank for Reconstruction and Development for a Structural Adjustment Loan] and through negotiation with commercial banks of many countries which have provided loans to Yugoslavia. In anticipation of such support, the National Bank of Yugoslavia sought short-term assistance from the Bank for International Settlements and the United States monetary authorities. The BIS facility will provide for \$200 million for a period ending on 30 November 1988. An additional facility for \$50 million will be provided by the United States. The BIS loan will be financed from its own resources, but it has a right of recourse to participating member central banks. The Bank of England's contingent liability under this arrangement is for a principal amount of \$30 million plus any unpaid accrued interest and costs. The Treasury has agreed to give the Bank an indemnity in respect of this contingent liability.

3. Any sums required to meet this indemnity would be charged on and issued out of the Consolidated Fund.

FROM: A BOTTRILL
DATE: 27 MAY 1988

MR J M G TAYLOR

Done

cc: Sir P Middleton
Sir G Littler
Mr Lankester
Mr Mountfield
Mr Savage
(Parliamentary
Section)
Mr Allan

YUGOSLAVIA: BRIDGING LOAN

We agreed that in view of the uncertain timing of any BIS announcement about the bridging loan and in view of the coming holiday weekend, it would be advisable to let No 10 at least have a letter setting out the state of play. I attach a draft.

AB Bill

A BOTTRILL

~~DRAFT LETTER FROM PS/CHANCELLOR TO NO.10~~

CD Powell, Esq
No 10 Downing Street
LONDON SW1

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

YUGOSLAVIA: BIS BRIDGING LOAN

The Prime Minister confirmed to Chancellor Kohl in her letter of 9 May, that the Bank of England is prepared to participate in a bridging loan which the Bank for International Settlements is seeking to arrange in support of a Yugoslav IMF programme.

2. Implementation of the BIS loan has been delayed by problems with a parallel United States loan since central banks participating in the BIS operation have said they will not proceed without the US. On the assumption that the US difficulties are overcome, however, the BIS loan could be finalised in Basle early next week which would clear the way for an IMF Board meeting perhaps almost immediately. The loan is intended to support the dinar during the first months of economic reform. Drawings on it will become available once the IMF Board approves a Stand By Arrangement for Yugoslavia in principle. Drawings on the IMF itself will become available once all the financing elements for the programme are in place - including contributions from the commercial banks.

3. The bridging loan is for \$250 million, of which \$50 million is from the US and \$200 million from other Central Banks. Of this \$30 million is from the Bank of England. The facility terminates on 30 November 1988 and will be repaid by drawings on the IMF Stand By Arrangement.

4. The Chancellor has authorised the Bank of England to take part in the operation. The Treasury will give the Bank an indemnity on lines similar to that given in 1986 for Mexico.

5. Under the terms of the International Monetary Arrangements Act, 1983 we are required "immediately after giving any undertaking under this section, to lay a statement of the undertaking before each House of Parliament". Since Parliament will be in recess, this will take the form of a Command Paper.

6. The Chancellor proposes to do this on Wednesday or as soon after that as the BIS loan is announced. I attach a draft. 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.

7. The FCO will send appropriate briefing to Belgrade and other concerned posts. Press Officers at the Treasury, FCO and Bank will have question and answer briefing.

8. As a matter of courtesy, we shall notify the Public Accounts Committee and the Treasury and Civil Service Select Committee.

CONFIDENTIAL



FROM: J M G TAYLOR

DATE: 27 May 1988

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

MR MOUNTFIELD

cc Chief Secretary
Economic 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 Bottrill
Mrs Thomas
Mr Savage - Parly Section
Mr Cassell - Washington
Mr Enoch - Washington
Miss Wheldon - T.Sol.

YUGOSLAVIA: IMF, PARIS CLUB, BRIDGING LOAN, ETC.

The Chancellor was grateful for your minute of 26 May. He agrees with your proposed line throughout (subject, of course, to the overriding provision that if the US end up not participating, we should pull out too).

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

J M G TAYLOR



10 DOWNING STREET
LONDON SW1A 2AA

CH/EXCHEQUER	
REC.	01 JUN 1988
ACTION	Mr MOUNTFIELD
COPIES TO	EST. SIR G. LITTLER,
	Mr LANKESTER,
	Mr A.J.C. EDWARDS,
	Mr H.P. EVANS

1/6

From the Private Secretary

31 May 1988

PWP

Dear Alex,

YUGOSLAVIA: BIS BRIDGING LOAN

Thank you for your letter of 27 May about the Chancellor's intention to present a Command Paper on 1 June (or shortly thereafter) on the proposed indemnity to the Bank of England covering their commitment to the BIS in respect of a loan to Yugoslavia. The Prime Minister is content with this.

I am copying this letter to the Private Secretaries to the Foreign Secretary, the Lord President, the Lord Privy Seal, the Chief Whips in the Commons and the Lords and the Governor of the Bank of England.

Yours sincerely,

Charles Powell

A.C.S. Allan, Esq.,
HM Treasury.

PWP

INDEMNITY TO THE BANK OF ENGLAND
COVERING THEIR COMMITMENT TO
THE BANK FOR INTERNATIONAL SETTLEMENTS
IN RESPECT OF A LOAN TO YUGOSLAVIA

Presented to Parliament
by the Chancellor of the Exchequer
by Command of Her Majesty
[] June 1988

LONDON
HER MAJESTY'S TREASURY

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INDEMNITY TO THE BANK OF ENGLAND COVERING THEIR COMMITMENT TO
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International assistance to Yugoslavia

2. The Yugoslav Government is seeking medium-term financial support through an application to the International Monetary Fund for a Stand-By Arrangement, in respect of which a Letter of Intent has been agreed; [through an application to the International Bank for Reconstruction and Development for a Structural Adjustment Loan] and through negotiation with commercial banks of many countries which have provided loans to Yugoslavia. In anticipation of such support, the National Bank of Yugoslavia sought short-term assistance from the Bank for International Settlements and the United States monetary authorities. The BIS facility will provide for \$200 million for a period ending on 30 November 1988. An additional facility for \$50 million will be provided by the United States. The BIS loan will be financed from its own resources, but it has a right of recourse to participating member central banks. The Bank of England's contingent liability under this arrangement is for a principal amount of \$30 million plus any unpaid accrued interest and costs. The Treasury has agreed to give the Bank an indemnity in respect of this contingent liability.

3. Any sums required to meet this indemnity would be charged on and issued out of the Consolidated Fund.

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MDHIAN 1578

MOST DIRECTORS ALSO IDENTIFIED THE NEED FOR A FURTHER BROADENING OF THE STRUCTURAL ADJUSTMENT EFFORT; IN PARTICULAR, ATTENTION WAS FOCUSED ON EFFICIENCY AT THE LEVEL OF THE FIRM, EG IN TERMS OF ENTERPRISE AUTONOMY AND DISCIPLINE. IT WAS NOTED HOWEVER THAT SUCH MEASURES WOULD REQUIRE CONSTITUTIONAL AMENDMENTS.

4. ON THE MACRO-ECONOMIC SIDE, INFLATION WAS SEEN AS THE FOCUS OF CURRENT DIFFICULTIES. SOME DIRECTORS WONDERED IF THE PROJECTED REDUCTION IN INFLATION WAS SUFFICIENT TO ALLOW AN EARLY ENOUGH RECOVERY OF CONFIDENCE. WORRIES ABOUT INFLATIONARY PRESSURES LED MANY DIRECTORS TO QUESTION THE ADEQUACY OF FISCAL AND MONETARY POLICIES. A NUMBER OF DIRECTORS ALSO EXPRESSED CONCERN ABOUT THE CONTINUED RELIANCE ON INTERVENTION MEASURES, SUCH AS INCOMES POLICY, INDEXATION OF DEPOSIT PRINCIPAL AND THE THREAT TO RE-INTRODUCE CREDIT CEILINGS. IT WAS EMPHASISED THAT SUCH MEASURES WERE ONLY ACCEPTABLE AS A TEMPORARY EXPEDIENT.

5. LIMITED REFERENCE WAS MADE TO THE FINANCING SIDE OF THE SBA. GENERAL PROMISES OF EXTERNAL ASSISTANCE WERE OFFERED BY GOOS (GERMANY), DALLARA (US) AND ZECCHINI (ITALY) (ALTHOUGH THE LAST QUERIED THE STAFF ABOUT THE IMPORT PROPENSITIES OF THE YUGOSLAV ECONOMY AND THE RESULTING ESTIMATE OF THE FINANCING GAP). LDC DIRECTORS CALLED ON CREDITORS TO PROVIDE YUGOSLAVIA WITH ADEQUATE EXTERNAL ASSISTANCE, NOT LEAST BECAUSE OF THE LARGE AMORTISATION PAYMENTS BEING MADE. FELDMAN AND FERNANDO QUERIED THE ADEQUACY OF FUND FINANCING. THE FRENCH DID NOT, AS EXPECTED, RAISE THIS SUBJECT - WE LEARNED SUBSEQUENTLY THAT THE IDEA WAS SHELVED IN PARIS BUT WAS ORIGINALLY A PROPOSAL FOR ACCESS OF 100 PER CENT OF QUOTA, IN LINE WITH THAT PROVIDED TO ARGENTINA. FOGELHOLM (NORDICS) CRITICISED THE LINKAGE IMPOSED BY THE BIS BETWEEN ITS BRIDGING LOAN AND THE FUND'S APPROVAL IN PRINCIPLE OF THE SBA.

6. ZECCHINI QUESTIONED WHETHER ENHANCED SURVEILLANCE SHOULD BE SUSPENDED OR TERMINATED. STAFF WILL PREPARE A PAPER ON THIS ISSUE.

UK INTERVENTION

7. ENOCH DREW ON YOUR TELNO 92. HE ALSO NOTED THAT FINANCING ARRANGEMENTS HAD TAKEN TIME TO CONCLUDE AND

PAGE 2
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UKDEL
TELNO 122

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071524
MDHIAN 1578

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FM UKDEL IMF/IBRD WASHINGTON
TO DESKBY 020900Z FCO
TELNO 122
OF 012300Z JUNE 88
AND TO PRIORITY BELGRADE

IMF: YUGOSLAVIA - 1987 ARTICLE IV CONSULTATION AND REQUEST
FOR STAND-BY ARRANGEMENT (EBS/88/89 AND SUPPLEMENTS 1 AND 2
AND SM/88/109)

SUMMARY

1. SBA APPROVED IN PRINCIPLE. PROGRAMME COMMENDED BUT
NEED POINTED UP FOR STRICT IMPLEMENTATION AND FURTHER
BROADENING OF ADJUSTMENT EFFORT.

DETAIL

2. THE BOARD TODAY CONCLUDED YUGOSLAVIA'S 1987 ARTICLE IV
CONSULTATION AND APPROVED IN PRINCIPLE ITS REQUEST FOR AN
SBA. OUTRIGHT APPROVAL WILL FOLLOW AS SOON AS COMMERCIAL
BANK COMMITMENTS TO THE DOLLARS 300 MN FACILITY REACHES
CRITICAL MASS (DEFINED AS 90 PER CENT). BEFORE THE MEETING,
POSTHUMUS CIRCULATED 88/103. FIFTEEN DIRECTORS SPOKE.
ENOCH SPOKE SIXTH.

3. THE BOARD DISCUSSION REVEALED A GENERAL DESIRE BY
DIRECTORS NOT TO CAUSE DIFFICULTIES. ALL WELCOMED THE
YUGOSLAV DECISION TO ENTE AN SBA AND COMMENDED THE STRENGTH
OF THE PROGRAMME, PARTICULARLY THE PRIOR ACTIONS AND GENERAL
FRONT-LOADING OF POLICY MEASURES. ONLY FELDMAN (ARGENTINA)
AND FERNANDO (INDIA) DISSENTED ON THE PACE OF ADJUSTMENT
(CONSIDERING IT TOO STRONG) BUT NEITHER QUESTIONED THE NEED
FOR THE SBA. MOST DIRECTORS EMPHASISED THE IMPORTANCE OF
PRIOR ACTIONS IN VIEW OF THE LOW CREDIBILITY OF THE
AUTHORITIES. DIRECTORS ALSO WELCOMED THE STRUCTURAL
MEASURES UNDER THE SBA, GIVEN WHAT WAS SEEN AS FUNDAMENTAL
DISTORTIONS IN THE ALLOCATION OF RESOURCES IN THE YUGOSLAV
ECONOMY. THE DIFFICULTY OF TRANSFORMING FROM A CENTRALLY-
PLANNED TO A MARKET-BASED ECONOMY WAS RECOGNISED BUT A NUMBER
OF DIRECTORS STRESSED THE NEED TO ACHIEVE A CRITICAL MASS OF
STRUCTURAL ADJUSTMENT FOR REFORM TO BE PROPERLY SEEDED.

SUGGESTED THERE WERE LESSONS TO BE LEARNT FOR FUTURE CASES WHERE BRIDGLNG FINANCE WAS REQUESTED, NOT LEAST, IN RESPECT OF PROVISION OF FINANCING INFORMATION BY DEBTORS.

STAFF RESPONSE

8. RUSSO (DIRECTOR, EUROPEAN DEPARTMENT) TOLD THE BOARD THAT A CRITICAL MASS OF COMMERCIAL BANK FINANCING WAS EXPECTED BY THE ICC BY END-JUNE. THE YUGOSLAV ROADSHOW WOULD VISIT THE MIDDLE EAST NEXT WEEK. HE WAS CONFIDENT THAT NEW OFFICIAL MONEY WOULD TURN OUT AT AROUND DOLLARS 500 MN. HE AND POSTHUMUS REVEALED THAT THE AUSTRIANS AND DUTCH HAD DISBURSED THEIR BRIDGE MONEY ON MONDAY, THE SWISS ARE DUE TO DO SO TOMORROW AND THE GERMANS EARLY NEXT WEEK. RUSSO NOTED THE ITALIAN MONEY WAS TIED. THE YUGOSLAVS HAD BEEN DUE TO REPLY TO THE BIS ON ITS BRIDGE LOAN OFFER BY THE START OF THE BOARD BUT RUSSO HAD NO NEWS. BRAU (ETR) PUT ARREARS AT DOLLARS 500-600 MN TO THE BANKS, DOLLARS 100 MN TO OFFICIAL CREDITORS AND DOLLARS 150-200 AGAINST UNCOVERED LETTERS OF CREDIT BUT THE LAST WAS EXPECTED TO BE CLEARED WITH FREE ACCESS TO FOREIGN EXCHANGE. BRAU SAID THE FUND HAD CONSIDERED HIGHER ACCESS FOR YUGOSLAVIA BUT HAD TO BE UNIFORM IN ITS TREATMENT (IN FACT 50 PER CENT OF QUOTA WAS ABOVE THE RECENT AVERAGE) AND HAD TO LEAVE ROOM FOR A FOLLOW-ON ARRANGEMENT. IF ADEQUATE FINANCING TO COVER THE WHOLE PROGRAMME PERIOD FAILED TO MATERIALISE AFTER THE SBA WAS TRIGGERED BY A CRITICAL MASS OF BANK MONEY, THE PROGRAMME WOULD HAVE TO BE REVISED AT THE MID-TERM REVIEW.

9. FCO PLEASE PASS TO BOTTRILL AND WALSH (HMT),
T RICHARDSON (ERD) AND JAGGERS AND WARE (BOE).

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YYYY

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MR WICKS NO 10 DOWNING ST
BOTTRILL, H M TREASURY
WALSH, H M TREASURY

T RICHARDSON, ERD
JAGGERS, BANK OF ENGLAND
WARE, BANK OF ENGLAND

NNNN

PAGE 4
CONFIDENTIAL

FROM: P MOUNTFIELD
DATE: 3 JUNE 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Economic 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 Bottrill
Mrs Thomson
Mr Savage, parliamentary
Section
Mr Cassell
Mr Enoch, Washington
Miss Wheldon, T/Sol

Ch. Agree Paris Club line?
3/6
Y.M.

YUGOSLAVIA: IMF, PARIS CLUB, BRIDGING LOAN, ETC

This submission outlines further developments since my submission of 26 May and seeks your agreement to discretion in the Paris Club to extend the consolidation period to the end of 1989.

IMF Programme - financing

2. The Board approved the Standby Arrangement in principle on 1 June. It will become effective on the date the Fund finds that satisfactory arrangements have been made for Yugoslavia's 1988 financing needs, which must be not later than 30 June. The critical mass for the commercial banks' new money package has been set at 90 per cent and while we do not expect this to be achieved by the early bird date of 6 June (\$150 million has been raised to date) the banks seem confident that they will meet the 30 June deadline.

3. During the Board discussion general promises of external assistance were offered by Germany, US and Italy but we have had no indication that these countries will go further than the amounts then on offer. These comprise \$136m from Germany, Austria and Switzerland (from early capitalisation of 1989 interest) \$64m in tied credits from Italy and \$70m from the US Commodity Co-operation Fund. Press reports on Mikulic's return from Japan suggested that he had negotiated a loan of \$100m to be given directly to Yugoslav commercial banks. So far, therefore, \$370m of the \$500 new money sought from Official Creditors has been found. The remainder will come from rescheduling through the Paris Club next week.

Paris Club

4. Yugoslavia is on the Paris Club Agenda next Thursday and Friday. A formal rescheduling request has still not been received, but it seems likely to include current and moratorium interest and principal. This involves \$228 million for the UK.

5. It is also likely that the Yugoslavs will ask for the consolidation period to be extended to the ^{mid-}end of 1989 and not just until mid-1988 - the end of the Stand-by Arrangement - as envisaged in my minute of 26 May. If we agree to this it will increase the cost to us to \$321 million. We should therefore only agree if it were necessary to go along with the general consensus. The US are likely to insist that any consolidation beyond the period of the SBA is linked to and triggered by a further SBA, and we would support this condition. Subject to this, may we proceed in the Paris Club on this basis?

Bridging Facilities including BIS Loan

6. The Yugoslavs went ahead with the programme preconditions before the BIS bridge had been agreed. These included a 19.3 per cent depreciation of the dinar. It was reported that the Austrians and Dutch have disbursed their bridge money on 30 May, and that the Germans will do so next week. (These bridging loans are in addition to the BIS loan, though they are an advance payment of the 'new money' referred to above.)

7. Progress on the BIS bridging loan has been tortuous but it now seems close to fruition. The BIS has asked central banks to consent as soon as possible to its \$200 million facility alongside \$50 million provided by the United States. The BIS bridge terms are now slightly better than those previously discussed.

8. Yugoslavia will be able to draw down the loan in three \$67 million tranches triggered essentially by the IMF Executive Board's approval in principle of the Standby Arrangement - given this week - and the IMF Managing Director's assurances in due course that Yugoslavia will be eligible to draw the second and third tranches of the SBA in August and November. The Yugoslavs, however, will have an alternative possibility to draw the second tranche ahead of IMF approval as long as they place a reserve deposit of a similar amount with the BIS. The three tranches of the bridge are to be repaid from disbursements under the SBA and under a Structural Adjustment Loan from IBRD.

9. The security of the bridge still depends on Yugoslavia's economic performance, but we judge it to be a little more secure than the earlier version that you approved. The Bank of England, therefore, is tonight telexing its approval of the terms to the BIS in Basle. We expect confirmation from the BIS on either Tuesday or Wednesday that the Yugoslavs have accepted the terms. The bridge can then be activated within a few days. The BIS will give this no publicity and neither will we, but we shall prepare a short statement to be issued if there are press enquiries. We will arrange for Parliament to be informed by a Paper under Act since the Whitsun recess will be over when the BIS facility is confirmed.

RM

P MOUNTFIELD



Handwritten initials in blue ink, possibly 'RW'.

Handwritten initials in red ink, possibly 'AW'.

Ch.
Your note behind.

2. The Germans (along with the Austrians + Swiss) are providing some hard money. There is no pressure on us to do this; indeed, the FCO recognize that the Ambassador is way out of line here.
3. See UKDEL telex. 122 (flagged) for latest developments. I have asked AEF to provide a sitrep for the weekend box.

Handwritten initials and date: 2/3/6



pmg

FROM: J M G TAYLOR

DATE: 6 June 1988

MR MOUNTFIELD

cc PS/Chief Secretary
PS/Economic 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 Bottrill
Mrs Thomson
Mr Savage - Parly Section
Mr Cassell - Washington
Mr Enoch - Washington
Miss Wheldon - T.Sol.

YUGOSLAVIA: IMF, PARIS CLUB, BRIDGING LOAN, ETC.

The Chancellor has seen your minute of 3 June. He is content with the line for the Paris Club that we should agree to the extension of the consolidation period, but only if it were necessary to go along with the general consensus.

JTG

J M G TAYLOR

*Tony D
Please minute
thanks*

FROM: A R BOTTRILL

DATE: 10 JUNE 1988

CHANCELLOR

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

YUGOSLAVIA: IMF, PARIS CLUB, BRIDGING LOAN, ETC

The Bank of England has informed us that the Yugoslavs have now agreed to the terms for the \$200 million BIS bridging facility and the US \$50 million loan. Confirmation and final documents will arrive on Monday. If this goes according to schedule, we should be able to notify Parliament on Tuesday. The loan will come into effect on Wednesday.

2. Latest reports from the Paris Club meeting, however, are that after two days negotiations no agreement has yet been reached on the terms of the rescheduling with the Yugoslavs still seeking new money.

ABM

A R BOTTRILL

FROM: A R BOTTRILL
 DATE: 10 JUNE 1988

CHANCELLOR

cc: PS/Chief Secretary
 PS/Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Lankester
 Mr Mountfield
 Mr Peretz
 Mrs Lomax
 Mr Turnbull
 Mr C D Butler
 Mr Beastall
 Mr R I G Allen
 Mr Watts
 Mr Walsh
 Mr Bottrill
 Mr J Taylor - 2nd
 Mrs Thomson
 Mr Savage - Parly Section
 Mr Cassell, Washington
 Mr Enoch, Washington
 Miss Wheldon, T/Sol

YUGOSLAVIA: IMF, PARIS CLUB, BRIDGING LOAN, ETC

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2. Latest reports from the Paris Club meeting, however, are that after two days negotiations no agreement has yet been reached on the terms of the rescheduling with the Yugoslavs still seeking new money.

AR Bottrill

A R BOTTRILL

CONFIDENTIAL

126220
MDHOAN 7965

CONFIDENTIAL
FM FCO
TO IMMEDIATE BELGRADE
TELNO 81
OF 111230Z JUNE 88
INFO IMMEDIATE UKDEL IMF/IBRD WASHINGTON
INFO ROUTINE PARIS

YUGOSLAV DEBT

1. PARIS CLUB HAS AGREED GENERAL TERMS OF RESCHEDULING, BUT SIGNATURE OF TEXT POSTPONED UNTIL JULY.
2. NEGOTIATIONS TOOK 33 HOURS AND ENDED AT 0330 SATURDAY. RIKANVOIC WAS CHARMING BUT OBSTINATE THROUGHOUT. POOR PREPARATION BY FRENCH CHAIR AND PERHAPS BY IMF CONTRIBUTED TO DELAY.
3. AGREEMENT COVERS 100 PERCENT OF ALL PRINCIPAL AND INTEREST FALLING DUE BETWEEN 1 APRIL 1988 AND 30 JULY 1989, I.E. UNTIL END OF CURRENT STANDBY. THIS INCLUDES PAYMENTS DUE ON PREVIOUSLY RESCHEDULED DEBT. A GOODWILL CLAUSE WILL PROVIDE FOR FURTHER AGREEMENTS BASED ON NEW ARRANGEMENTS WITH THE FUND IN LATER YEARS.
4. THIS WAS THE MOST GENEROUS AGREEMENT THE CLUB COULD POSSIBLY HAVE MADE UNDER ITS NORMAL RULES. (THE CLUB CANNOT PROVIDE NEW MONEY, AND WILL NOT RESCHEDULE WITHOUT A STANDBY.) IT FALLS FAR SHORT OF RIKANOVIC'S OBJECTIVE, WHICH ALSO INCLUDED DOLLARS 500 MILLION OF 'NEW MONEY' IN CALENDAR 1988, ON TOP OF THE RESCHEDULING OF PRINCIPAL. HE EVENTUALLY ACCEPTED RESCHEDULING OF ALL INTEREST, WHICH YIELDS ABOUT DOLLARS 193 MILLION IN 1988. TO COVER THE BALANCE, HE ASKED FOR ALL INTEREST TO BE RESCHEDULED UP TO END OF 1989, HOPING ON THE STRENGTH OF THIS DEBT RELIEF TO BORROW SHORT-TERM FINANCE FROM BANKS OR GOVERNMENTS TO FILL THE 1988 GAP. THE CLUB WAS READY TO CONCEDE THIS, AT LEAST UP TO SEPTEMBER 1989, PROVIDED THERE WAS A FRESH STANDBY AGREEMENT AFTER JUNE 1989. BUT HE WRECKED HIS CHANCES BY INSISTING ON AN UNCONDITIONAL EXTENSION. HE WAS APPARENTLY RELUCTANT TO COMMIT HIS GOVERNMENT TO A FURTHER STANDBY WITHOUT SPECIFIC PARLIAMENTARY AUTHORITY, AND BELIEVED THE BANKS WOULD NOT PROVIDE TEMPORARY LOANS WITHOUT AN UNCONDITIONAL ASSURANCE OF RESCHEDULING IN 1989H2. CREDITORS, LED BY USA, REFUSED TO RESCHEDULE THIS WITHOUT A FIRM COMMITMENT TO A NEW STANDBY IN 1989. AFTER HOURS OF ARGUMENT HE DROPPED THIS DEMAND COMPLETELY. IT IS NOT CLEAR WHERE HE WILL GET THE EXTRA MONEY

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MDHOAN 7965

FROM NOW. HE MAY APPROACH CREDITOR GOVERNMENTS DIRECTLY FOR FINANCIAL LOANS (NOT NEW EXPORT CREDITS). THE SHORTFALL TECHNICALLY BREACHES THE AGREEMENT WITH THE COMMERCIAL BANKS. BUT IMF SAY IT DOES NOT IMPERIL THE SBA. IT THEREFORE DOES NOT AFFECT THE BIS BRIDGE LOAN EITHER.

5. RIKANOVIC ALSO DROPPED HIS DEMANDS FOR MULTI-YEAR RESCHEDULING OF ALL MATURITIES UP TO 1992 ON THE BASIS OF ENHANCED MONITORING BY THE IMF: FOR EXCEPTIONALLY LONG REPAYMENT PERIODS OF UP TO EIGHTEEN YEARS: AND FOR PLEDGES OF NEW UNTIED MONEY AND THE RESUMPTION OF EXPORT CREDIT COVER. BOTH IMF AND FRENCH HAD WARNED HIM EARLIER THAT THESE DEMANDS WERE NON-NEGOTIABLE. CREDITORS ALSO INSISTED ON EXCLUDING FROM THE AGREEMENT THOSE REPAYMENTS DUE UNDER THE 1983 BERNE AGREEMENT, WHICH YUGOSLAVIA PROMISED AT THE TIME NEVER TO RESCHEDULE. (ALL THOSE DUE TO UK HAVE ALREADY BEEN REPAID.)

6. TALKS DRAGGED ON SO LONG THAT IT WAS IMPOSSIBLE TO NEGOTIATE A COMPLETE TEXT BEFORE THE WEEKEND. THE MAIN TERMS WERE THEREFORE EMBODIED IN AN EXCHANGE OF LETTERS, AND WILL BE TURNED INTO AN AGREED MINUTE AT A SPECIAL MEETING IN PARIS ON 13 JULY. TEXT OF LETTERS AND FULL RECORD FOLLOWS BY BAG TO BELGRADE ONLY.

7. RIKANOVIC WILL MAKE A STATEMENT ON RETURN TO BELGRADE. THERE WILL BE NO PRESS COMMUNIQUE IN PARIS. BELGRADE NEED NOT VOLUNTEER COMMENT. BUT IF PRESSED YOU SHOULD STRESS THE EXCEPTIONALLY GENEROUS NATURE OF THE AGREEMENT. CREDITORS CANNOT RESCHEDULE MORE THAN 100 PER CENT.

HOWE

YYYY

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ADDITIONAL 2

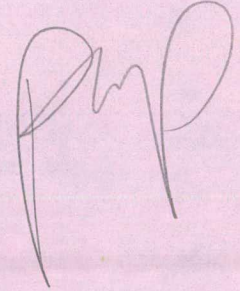
MR WICKS NO 10 DOWNING ST

P MOUNTFIELD, H M TREASURY

NNNN

CONFIDENTIAL

131532
MDHOAN 8034



CONFIDENTIAL
FM FCO
TO DESKBY 140800Z BELGRADE
TELNO 82
OF 131400Z JUNE 88
INFO PRIORITY UKDEL IMF/IBRD WASHINGTON
INFO ROUTINE PARIS

MY TELNO 81: YUGOSLAV DEBT
1. AGREEMENT COVERS PAYMENTS FALLING DUE BETWEEN 1 APRIL 1988
AND 30 JUNE 1989, NOT (NOT) JULY AS INDICATED IN PARAGRAPH 3
OF TUR.
2. ERROR REGRETTED.

HOWE

YYYY

DISTRIBUTION

154

MAIN 153

.MONETARY

EED

ADDITIONAL 1

MR WICKS NO 10 DOWNING ST

NNNN



H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000
Direct Dialling 01-270 4360

Sir Peter Middleton KCB
Permanent Secretary

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

Dear Anthony,

YUGOSLAVIA: BIS BRIDGING LOAN

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 \$30 million participation in the credit facility to be granted by the Bank for International Settlements to the National Bank of Yugoslavia.

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 required 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.

*Yours sincerely,
Peter*

SIR PETER MIDDLETON

cc Chancellor
Chief Secretary
Economic Secretary
Sir G Littler
Mr Lankester
Mr Peretz
Mrs Lomax
Mr Turnbull
Mr C D Butler
Mr Beastall
Mr R I G Allen
Mr Walsh
Mr Watts
Mr Mountfield
Mr Bottrill
Mrs Thomas
Mr R Savage

Miss Wheldon - Tsy Sol

13 June 1988

Mr Cassell - Washington
Mr Enoch - Washington

FROM: A BOTTRILL**DATE: 13 JUNE 1988****ECONOMIC SECRETARY****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 Thomas
Mr Savage Parly Section
Mr Cassell - Washington
Mr Enoch - Washington
Miss Wheldon - T.Sol**YUGOSLAVIA: BIS BRIDGING LOAN**

The Bank of England has now agreed to participate in the BIS bridging loan for Yugoslavia, and the Treasury has given 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***A BOTTRILL**

INTERNATIONAL MONETARY ARRANGEMENT ACT 1983

STATEMENT of Indemnity given by the Treasury to the Bank of England on 13 June 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 Yugoslavia.

Treasury Chambers)
14 June 1988) **PETER LILLEY**

Printed 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 13 June 1988 for commitment by the Bank of England to the Bank for International Settlements in respect of a loan to the National Bank of Yugoslavia to an amount not exceeding 30,000,000

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

FROM: A BOTTRILL**DATE: 13 JUNE 1988****SIR PETER MIDDLETON****cc:** Chancellor
Chief Secretary
Economic Secretary
Sir G Littler (o.r)
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 Thomas
Mr Savage Parly Section
Mr Cassell - Washington
Mr Enoch - Washington
Miss Wheldon - T.Sol**YUGOSLAVIA: 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 Yugoslavia. The BIS has now sent a formal offer to Belgrade which the Yugoslavs have accepted. The Bank of England is therefore committed to the loan and it would be appropriate now to issue the Treasury indemnity. As Accounting Officer of the Consolidated Fund you have already agreed this. Normally Sir Geoffrey Littler would have sent it to the Bank but in his absence in Luxembourg, 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 \$30 million participation in the credit facility to be granted by the Bank for International Settlements to the National Bank of Yugoslavia.

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 required 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 Peter Middleton

FROM: A BOTTRILL

DATE: 13 JUNE 1988

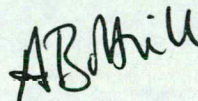
MR GIEVE

cc: Chancellor
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Mountfield
Mrs Thomson**YUGOSLAVIA: BIS BRIDGING LOAN**

The Bank for International Settlements has now agreed terms for a \$200 million bridging loan to Yugoslavia in support of its economic adjustment programme. The BIS facility will be alongside a similar \$50 million loan made available by the United States.

2. The Bank of England is participating in the BIS facility to the extent of \$30 million, and the Treasury has given the Bank an indemnity under the International Monetary Arrangements Act 1983. The BIS loan is to be repaid by 30 November from the proceeds of an IMF Standby Arrangement and an IBRD Structural Adjustment Loan to Yugoslavia.

3. We do not expect many Press queries but if you receive any, it might be helpful to outline the basic facts as set out above. Detailed queries should be referred to the Bank of England.



A BOTTRILL

FROM: A BOTTRILL

DATE: 13 JUNE 1988

PS/CHANCELLOR

cc: Chief Secretary
 Economic 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 Thomas
 Mr Savage Parly Section
 Mr Cassell - Washington
 Mr Enoch - Washington
 Miss Wheldon - T.Sol

YUGOSLAVIA: BRIDGING LOAN

We have now received the revised terms of the \$200 billion BTS facility. There are no major changes to the conditions.

2. Sir Peter Middleton is sending a letter of indemnity to the Bank of England. The Economic Secretary is being asked to lay a Paper under Act before both Houses of Parliament tomorrow. The PAC and TCSC are being informed. The Press Office has briefing.

3. A draft Private Secretary letter to No 10 is attached confirming that the loan has now been agreed.

A BOTTRILL

PS LETTER TO NO 10

YUGOSLAVIA: BRIDGING LOAN

Further to my letter of 27 May, the IMF Executive Board has approved in principle a Standby Arrangement with Yugoslavia, and the arrangements for the BIS \$200 million bridging facility have now been concluded. The United States have also agreed their similar \$50 million loan facility.

2. The Treasury has given the Bank of England an indemnity in respect of the Bank's \$30 million participation in the BIS facility. A Paper Under Act will be laid before both Houses of Parliament tomorrow.



FROM: A A DIGHT
DATE: 13 June 1988

MR A R BOTTRILL

YUGOSLAVIA: IMF, PARIS CLUB, BRIDGING LOAN, ETC.

The Chancellor has seen and was grateful for your minute of 10 June.

A handwritten signature in black ink, appearing to read "A A Dight".

A A DIGHT

P. Mountfield

FROM: P MOUNTFIELD

DATE: 13 JUNE 1988

CHANCELLOR

cc: Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Evans
Mr Bottrill
Mrs ThomsonYUGOSLAVIA: PARIS CLUB

Last week's meeting reached agreement on the general terms of a rescheduling for 1988-89. I attach my reporting telegram.

2. This settlement was well within the limits you approved (my minutes of 26 May and 3 June).

3. As you will see, it does not completely solve the problem. My guess is that Rickanovic will be round again with the begging-bowl very quickly. He will be seeking new financial credits (ie direct loans, not export credit). I have told him politely but firmly, in the corridors, that there was no question of the UK contributing again as we did in 1983. But I do not think this will stop him asking. We may need to ask you to receive him (or the Economic Secretary to receive the Yugoslavia Ambassador) if he comes round again. But the message will be the same.

R1

P MOUNTFIELD

BANK OF ENGLAND
LONDON EC2R 8AH

14 June 1988

Sir Peter Middleton KCB
Permanent Secretary
HM Treasury
Parliament Street
London
SW1P 3AG

PERM. SEC'S. OFFICE	
RECEIVED	
15 JUN 1988	
Action	Mr Bot Mill
Copies	Chancellor ✓
To	Chief Secretary
	Economic Secretary

Dear Peter,

INDEMNITY RE YUGOSLAVIAN LOAN

Thank you for your letter of 13 June which sets out the terms of the Treasury's indemnity in respect of the Bank's \$30 million participation in the BIS credit facility granted to the National Bank of Yugoslavia. I take it, however, that the Treasury undertakes to reimburse the Bank for any unrequited interest cost borne by the Bank (see line 5 of paragraph 2 of your letter).

I am pleased to confirm that, subject to this one amendment, these terms are acceptable to the Bank.

*Yours ever
Anthony*

A D Loehnis

Mr Cassell }
Mr Enoch }
Washin- }
gton }
Sir G. Lillier }
Mr Leakester }
Mr Penzance }
Mrs. Lomax }
Mr Turnbull }
Mr C. D. Butler }
Mr Boustead }
Mr R. Allen }
Mr Walsh }
Mr Watts }
Mr Mountfield }
Mrs. Thomas }
Mr R. Savage }
Miss W. H. ... }

77-14-6

FROM: G R WESTHEAD *GRW*
 DATE: 14 June 1988

MR BOTTRILL

cc PS/Chancellor *Z*
 PS/Chief Secretary
 PS/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 Thomas
 Mr Savage - Parly Section
 Miss Wheldon - Tsy Sol

YUGOSLAVIA : BIS BRIDGING LOAN

As I told you over the telephone, the Economic Secretary is content to present a Paper under the 1983 International monetary Arrangements Act to both Houses of Parliament about the indemnity approved by the Chancellor and Sir Peter Middleton.

2. I attach the top copy of the paper (not to copy recipients). The Economic Secretary has signed the document, although I understand there is no formal requirement for him to do so. It might therefore be best for you to have the first page retyped.

Guy Westhead

GUY WESTHEAD
 Assistant Private Secretary



Php

FROM: J M G TAYLOR

DATE: 14 June 1988

MR MOUNTFIELD

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

YUGOSLAVIA: PARIS CLUB

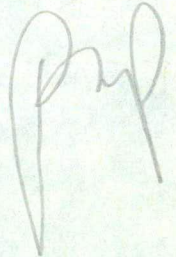
The Chancellor was grateful for your minute of 13 June.

JMGT

J M G TAYLOR

FROM: A BOTTRILL

DATE: 16 JUNE 1988

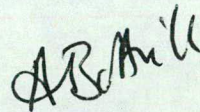


SIR PETER MIDDLETON

c: PS/Chancellor

YUGOSLAVIA: BRIDGING LOAN

Mr Loehnis is correct. Apologies for the typographical error.
A reply is attached.



A BOTTRILL

~~DR~~ DIRECT REPLY TO MR LOEHNIS

INDEMNITY RE YUGOSLAVIAN LOAN

You are of course correct to point out this typographical error. The Treasury will reimburse the Bank for any unrequited interest cost.

PETER MIDDLETON

CONFIDENTIAL

150307
MDHOAN 8486

CONFIDENTIAL

FM FCO

TO IMMEDIATE BELGRADE

TELNO 88

OF 171700Z JUNE 88

AND TO PRIORITY PARIS, BONN, ROME, WASHINGTON, OTTAWA, TOKYO
AND TO PRIORITY MEXICO CITY, LAGOS, BRASILIA, BISBA, CAIRO
AND TO PRIORITY ABIDJAN, NAIROBI, DAR ES SALAAM, KAMPALA
AND TO PRIORITY KINSHASA, LUSAKA

YUGOSLAVIA: BIS BRIDGING LOAN

1. THE CHANCELLOR OF THE EXCHEQUER HAS AUTHORISED THE BANK OF ENGLAND TO TAKE PART IN A BRIDGING LOAN WHICH THE BANK FOR INTERNATIONAL SETTLEMENTS (BIS) HAS ARRANGED IN SUPPORT OF YUGOSLAVIA'S IMF PROGRAMME.

2. THE BIS BRIDGING LOAN, WHICH BECAME EFFECTIVE ON 15 JUNE, IS FOR 200 MILLION DOLLARS, OF WHICH THE BANK OF ENGLAND'S SHARE IS 30 MILLION DOLLARS (15 PER CENT). THE US TREASURY IS MAKING AVAILABLE A PARALLEL FACILITY OF 50 MILLION DOLLARS. THE BIS/US FACILITIES TERMINATE ON 30 NOVEMBER 1988 AND WILL BE AVAILABLE IN THREE TRANCHES, LINKED TO DISBURSEMENTS WITHIN THE IMF STANDBY ARRANGEMENT (SBA) AND THE FIRST INSTALMENT OF AN IBRD STRUCTURAL ADJUSTMENT LOAN. THE BIS LOAN IS PART OF A WIDER FINANCING PACKAGE ACCOMPANYING THE SBA. IT IS DESIGNED TO CUSHION YUGOSLAV RESERVES AGAINST PRESSURES WHICH MAY ARISE FROM STRUCTURAL MEASURES ALREADY TAKEN BY THE YUGOSLAV AUTHORITIES TO LIBERALISE PRICES, IMPORTS AND FOREIGN EXCHANGE.

3. SHOULD OTHER ADDRESSEES BE APPROACHED WITH REQUESTS TO CONSIDER SIMILAR ARRANGEMENTS FOR OTHER DEBTOR COUNTRIES, YOU SHOULD DRAW ON THE FOLLOWING DEFENSIVE LINE TO TAKE:

UK PARTICIPATION IN THE YUGOSLAVIAN BRIDGING LOAN DOES NOT SIGNIFY A CHANGE IN BRITISH POLICY ON INTERNATIONAL DEBT. THE CIRCUMSTANCES ARE EXCEPTIONAL. (IF PRESSED) YUGOSLAVIA IS ABOUT TO ADOPT A STRONG, NEW IMF PROGRAMME WHICH WILL ONLY WORK IF THERE IS SUBSTANTIAL FINANCING. THESE FUNDS ARE BEING SOUGHT FROM VARIOUS SOURCES, BUT THE PACKAGE WILL TAKE SOME TIME TO PUT TOGETHER. RESERVES ARE AT LOW LEVELS AS THE BULK OF FOREIGN EXCHANGE EARNINGS IS TRADITIONALLY NOT RECEIVED UNTIL THE THIRD QUARTER. A BRIDGING LOAN IS THEREFORE ESSENTIAL TO THE SUCCESSFUL IMPLEMENTATION OF THE PROGRAMME.

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MDHOAN 8486

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ADDITIONAL 1

MR WICKS NO 10 DOWNING ST

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