FILE NUMBER

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DESTROY AFTER YEARS

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FILE TITLE

IMF / IBRD

SPRING MEETINGS 1989

BRIEFS

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HER MAJESTY'S TREASURY
SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

Briefing List

GENERAL

1. World economic outlook (incorporating US economy)

2. Middle income debtors (including debt reduction and burden sharing)

3. Debt issues affecting the poorest countries (including ESAF, Chancellor's initiative (covering Toronto terms and Paris Club) and World Bank special programme for Africa)

4. Major debtors (Algeria, Argentina, Brazil, Egypt, Mexico, Nigeria, Poland, Venezuela and Yugoslavia)

5. Roles of the Fund and Bank

6. Arrears at the Fund and Bank (including the role of Support Groups) with annexes on the Guyana Support Group and burden sharing

7. Aid, including global aid flows and UK aid programme, private direct investment flows and bank flows (including statistics on percentage of GDP) and annex on western credits to eastern Europe

8. Trade and agriculture, GATT and commodities

9. Staff compensation (Kafka II)

IMF

10. Recent developments

11. Ninth quota review

12. Other fund issues (access limits and admission of USSR)

IBRD

13. Financial management including exposure trends, reserves, provisioning and currency management)

14. Lending to Development Finance Corporations; division of lending (problem debtors and others)

15. IDA9

16. Private sector developments eg MIGA and IFC

17. Guarantees and credit enhancement

18. Environment: World Bank role, environmental conditionality and debt for nature swaps.

19. Poverty

20. Structural adjustment

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BRIEF NO:1

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

WORLD ECONOMIC OUTLOOK

Objectives

1. i. Secure recognition of the exceptional performance of the world economy in recent years, culminating in strong growth and low inflation in 1988.

   ii. Identify inflationary pressures as chief threat to continued expansion. Make clear that monetary authorities right to tighten policy to counter this threat and that US pressure on surplus countries to relax fiscal policy is unwarranted.

   iii. Stress urgent need for implementation of US Administration commitment to reduce US budget deficit.

   iv. To resist proposals to expand the scope of the indicators exercise, including the use of indicators as performance targets or as triggers for "remedial action" or special consultations.

   v. Reaffirm commitment to G7 Agreements (including promotion of greater stability of exchange rates).

   vi. Press importance of structural reform for improving economic performance.

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Line to Take

2. Broadly agree with IMF staff assessment of world economy. Most likely outcome is that economic growth in industrial countries will moderate to a rate closer to growth of potential, and the rise in inflation will be limited.

3. Recognise appropriateness of increases in interest rates since last Spring. Defeat of inflation, pursued by firm monetary policy, must continue to be top priority.

4. A reduction in the US budget deficit would lighten considerably the burden on monetary policy in containing inflation in the US and allow lower interest rates world wide.

5. Agree that process of adjustment of current account surpluses and deficits seems to have slowed or stopped. But, as proportions of GDP, US current account deficit and Japanese current account surplus considerably lower than in 1986. Once appropriate domestic policies are in place, the surpluses and deficit should continue to be financially for some time.

6. While firm monetary policies are needed to prevent inflation, it is structural policies that are key to increasing capacity for growth, improving economic performance, and reducing unemployment. Greatly improved UK performance in recent years shows the benefits of such policies.

7. Toronto Summit welcomed progress in refining analytical use of indicators (following Tokyo and Venice summits) including the development of a commodity price indicator. Indicators exercise now working satisfactorily. We reject proposals for further development such as performance targets, monitoring zones and triggers for special consultations.

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Background

Economic Prospects

8. Economic activity in the major industrial countries was exceptionally strong in 1988. The Fund's forecast level of GDP in the major industrial economies in 1989 is now 2½ per cent higher than the forecast made a year ago. The IMF now estimates GDP to have increased by 4.2 per cent in the major seven in 1988 and forecasts a slow down in growth to 3.4 per cent in 1989 and 3.1 per cent in 1990, closer to potential. The increase in the volume of world trade is also expected to slow down from the exceptionally high level of 1988, but to a still substantial growth rate of 6 per cent. These IMF forecasts are provisional, and revised forecasts may be produced in advance of the Interim and Development Committee Meetings.

Forecast of Output and World Trade*

		IMF (February)	HMT (FSBR)	
Real GNP in major seven	1987	3.4	3½	
	1988	4.2	4	
	1989	3.4	3	
	1990	3.1	2½	(1990H1)
World trade at constant prices	1987	6.1	5½	
	1988	9.2	8½	
	1989	6.2	6	
	1990	5.7	5	(1990 H1)

* percentage increases

9. For each of the US, Japan, and Germany IMF forecasts for both output and domestic demand growth in 1989 have been raised since six months ago. But in each of the three countries, real GNP growth is predicted to be around one per cent lower in 1989 than in 1988. The forecast for US real GNP growth in 1990 seems high.

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Output and Demand of Major Three*

		Real Domestic Demand	Real GNP
US	1987	3.0	3.4
	1988	3.0	3.8
	1989	2.8	3.1
	1990	2.7	2.8
Japan	1987	5.2	4.5
	1988	7.7	5.7
	1989	5.2	4.6
	1990	4.9	4.3
Germany	1987	3.1	1.8
	1988	3.7	3.4
	1989	2.2	2.4
	1990	3.2	2.8

* Percentage increases
Source: IMF Forecasts

10. There are clear signs of inflationary pressure, with consumer price inflation edging upwards in all the major economies and capacity utilisation at or above its levels at previous cyclical peaks. Governments have responded with monetary tightening in most major countries since last May, and this will reduce inflationary pressures in the coming months. Commodity prices rose in 1988 but from a low level. They have not been a major source of inflationary pressure but do need careful monitoring. Wage cost pressures, although strengthening, have been less important than strong demand in causing the upward creep in inflation. The G7 inflation rate in January 1989 was 3.9 per cent, higher than the IMF's forecast for 1989.

Forecast of Inflation*

	IMF February	HMT (FSBR)
1987	2.8	3
1988	3.1	3¼
1989	3.8	4¼
1990	3.4	3¾ (1990H1)

* percentage changes in consumer prices in G7

11. The process of adjustment of G3 current account surpluses and deficits came to a halt during the second half of 1988, and little further adjustment is expected in 1989. Nevertheless, as percentages of GDP, the best basis for comparison, there has been considerable adjustment since 1986.

Current Account Surpluses and Deficits

	Current balance $ billion	Current balance % of GDP
United States		
1986	-139	-3.3
1987	-154	-3.4
1988	-124	-2.5
1989	-125	-2.4
1990	-137	-2.4
Japan		
1986	86	4.3
1987	87	3.6
1988	80	2.8
1989	84	2.6
1990	90	2.5
Germany		
1986	39	4.4
1987	45	4.0
1988	49	4.0
1989	52	4.0
1990	54	3.8

Source: IMF forecasts

Fiscal Policy

12. After the sharp reduction in the US Federal budget deficit in FY1987, the IMF expects some further adjustment by 1989 and a larger fall in the deficit/GNP ratio in 1990. The central government budget deficit in Japan declined in 1988. There is a discrepancy, which we have not been able to resolve, between IMF and OECD projections of the Japanese general government financial position. The IMF's estimate and forecast of a growing Japanese general government financial surplus is quite at odds with the OECD's (and our own) forecast of a continuing small deficit and represents a much more optimistic picture of the net surplus from social security and local government funds. (The Fund Staff refer to

revisions of data in January by the Japanese Ministry of Finance, but MOF refer enquirers to OECD data). The budget deficits in Germany rose in 1988 due to income tax cuts worth almost ¾ per cent of GDP. Indirect taxes will be raised in 1989, and direct taxes will be cut again in 1990 as part of tax reform. Some further consolidation is expected in each of the G3 countries by 1990. Government financial deficits are still a problem in Italy and Canada of the other G7 countries.

Budget Deficits (% of GDP)

		Calendar Year			
		1987	**1988**	**1989**	**1990**
US:	Federal Government	3.4	3.3	3.1	2.5
	General Government	2.3	1.8	2.2	1.6
Japan:	Central Government	2.7	2.1	1.6	1.4
	General Government	-0.6	-1.1	-1.6	-2.0
Germany:	Federal Government	1.4	1.8	1.3	1.4
	General Government	1.8	2.0	0.8	1.4

Source: IMF projections

Interest Rates

13. Interest rates have risen since significantly May 1988 in all the major countries expect Japan. Even so in real terms, short rates are only half a per cent above their average levels in 1984-88.

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3-month Interest Rates

	US	Japan	Germany	UK	G7
Nominal					
1984-88 average	7.9	5.4	4.9	10.6	7.9
1986	6.5	5.1	4.6	11.0	7.0
1987	6.9	4.2	4.0	9.7	6.8
1988	7.8	4.6	4.3	10.3	7.3
1989 (13 March)	10.1	4.7	6.7	13.0	9.2
Real*					
1984-88 average	4.3	4.4	3.7	5.6	4.5
1986	4.5	4.6	4.9	7.2	5.0
1987	3.2	4.4	3.7	5.4	4.0
1988	3.5	4.0	3.1	5.2	4.1
1989 (13 March)	5.2	3.6	4.0	5.1	5.1

* Nominal rates deflated by change in consumer price index on a year earlier. January 1989 inflation rates used for 13 March figures.

Exchange Rates

14. Since its sharp fall from the peak of February 1985 ended in early 1987, the dollar effective exchange rate has been more stable, with a further depreciation over the past two years against the yen but only limited fluctuations against the DM.

Exchange Rate of the US dollar

	Effective (Index 1985=100)	Yen/$	DM/$	$/£
$ Peak 27 February 1985	113.1	261	3.43	1.05
1985	100	238	2.94	1.30
1986	80.2	168	2.17	1.47
1987	70.3	145	1.80	1.64
Louvre 20 February 1987	72.6	154	1.83	1.53
1988	66.0	128	1.76	1.78
1989 14 March	67.7	130	1.86	1.73

Developing Countries

15. Strong growth of world trade and the recovery in commodity prices have improved prospects for many developing countries. The external debt of developing countries has declined as a percentage of exports since 1986, though it is still above its 1983 level. IMF forecasts show some continuing improvement in the living standards and the debt position of developing countries in the aggregate. However the aggregate picture conceals considerable variation from country to country: exporters of manufactures (particularly in East Asia) and agricultural producers have usually fared better than exporters of oil and tropical products, and countries without debt-servicing problems have usually fared better than countries with such problems. See Brief 3 on heavily indebted countries.

Forecasts for Developing Countries*

	1987	1988	1989	1990
Real GDP	3.2	4.4	3.4	4.3
Real GDP per head	1.2	2.6	1.1	2.3
Consumer prices	41	66	42	17
Current account balance**	0.2	-2.2	-2.9	-3.1
External debt**	159	142	136	130

* Percentage changed unless otherwise stated
** Percentage of exports of goods and services
Source: IMF forecasts

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Brief No. 2

HER MAJESTY'S TREASURY

IMF/IBRD SPRING MEETINGS 1989

MIDDLE INCOME DEBTORS

OBJECTIVES

1. i. To obtain agreement among creditors and debtors of continued validity of case-by-case, market-oriented approach to debt strategy.

   ii. To halt or slow the current trend in transfer of risk from private to public creditors.

   iii. To maintain pressure on the Fund and Bank to sustain conditionality.

(On Brady)

   iv. To ensure application of proposals is not inconsistent i-iii above and does not breach principles of operation of IFIs.

LINE TO TAKE

2. Basis of strategy to middle income debtors remains adoption of appropriate adjustment policies by debtors in conjunction with provision of finance by creditors (including voluntary debt reduction by commercial banks). Strong conditionality vital to this process. Eventual aim is to restore debtors to creditworthiness in world financial markets.

3. UK Government (with others) playing important role through financial support to IFIs, through Paris Club reschedulings, via provision of new export credits and by maintaining and encouraging an open trading system and a favourable world economic environment.

4. Majority of middle-income debt owed to commercial banks. Responsibility for handling this debt mainly with banks and debtors. Banks need to face up to consequences of past mistakes. Against taxpayers bailing out banks, either directly or indirectly through transfer of debt burden to public sector as consequence of withdrawal of net new lending by banks.

5. Welcome expansion of activity in secondary market for LDC debt. Market developments support 'menu approach' with range of financing options to encourage provision of new money and debt reduction. Recognise debt/equity swaps and debt buybacks as particularly desirable forms of debt reduction. Wish to encourage private direct and portfolio investment as future means of sharing risks and providing finance without build-up of fixed debt.

6. (On tax and regulatory treatment). Easier to design debt reduction schemes to fit in with regulatory structures than to change structures. UK has examined its regulatory and tax structures and found no need to alter tax structure. Regulatory structure can accept bond conversion schemes without necessarily requiring provisioning on new asset, and buybacks pose no problem.

7. (On Brady) Proposals are an interesting extension of existing strategy which already provides option of voluntary debt reduction. They will need careful study. In particular, need to assess in relation to the following criteria: (a) Do they improve conditionality? (b) Will debt service reduction be significant? (c) Will principles of existing debt strategy be undermined?

<u>BACKGROUND</u>

8. Secretary Brady announced US proposals on debt at a conference of the Bretton Woods Committee on March 10. (Details at Annex A). Some discussion of these ideas has taken place in G7D and they will be given further consideration at the G7 meeting prior to the Interim Committee.

9. A summary of recent international debt initiatives at Annex A. A list of Baker 15 countries follows at Annex B.

Economic Background

10. Since 1982 most middle income debtors have put in place reform programmes and made significant adjustment progress, particularly on the external front. Baker 15 countries' annual trade surpluses have exceeded $20 billion, reducing current account deficits sharply. Major debt ratios, after rising until 1986, have since fallen; the real debt burden is now 9 per cent below peak. (Chart 1). Per capita GDP growth, however, has been negative: annual average 1983-88: -0.4 per cent.

Table 1

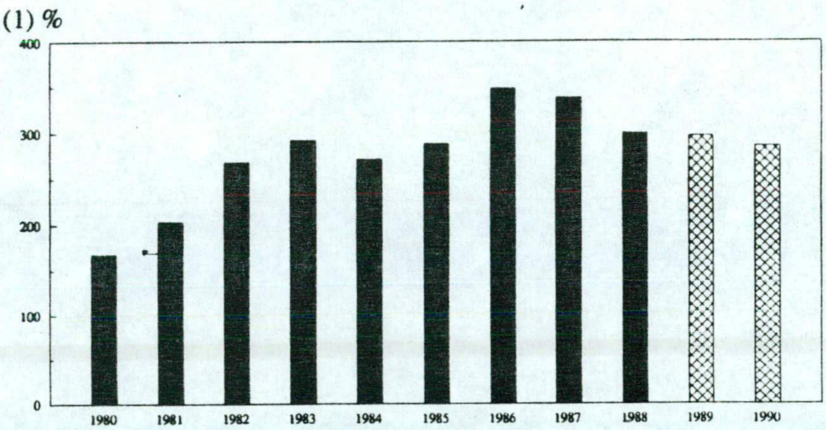
Baker 15: Summary

	1982	**1986**	**1988**	**1989***	**1990***
Current account, per cent of exports	-36	-12	-5	-7	-9
Debt/export ratio %	268	349	300	296	285
Debt/GDP ratio	42	47	45	44	42
Interest due/export ratio %	32	31	27	27	26
Debt $ bn	382	447	477	491	509
Debt $ 1980 bn	405	495	459	452	449
	1982-85	**1985-88**	**1988**	**1989***	**1990***
Growth of GDP, % pa	1.1	2.5	1	1	3
Growth of export volume % pa	5.5	4.7	11	3	5

*IMF forecast
Source: IMF draft WEO, March 1989

11. The world economic background has been generally supportive to adjustment by debtors, with strong growth in output (3½ percent a year since 1982 in the industrial countries) and lower nominal interest rates. But real interest rates have been positive and some commodity prices, particularly oil and tropical beverages, weak. Only a few middle income debtors (eg Chile, Brazil) have benefited from a combination of high export price rises and falling oil and other imported commodity prices.

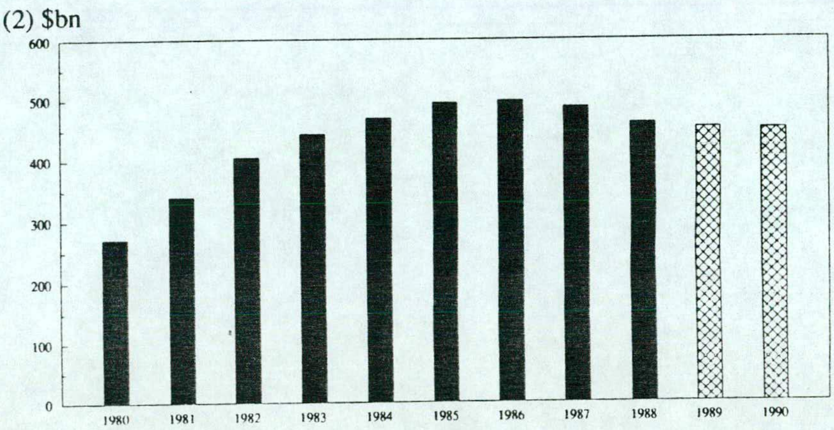
CHART 1:
DEBT DEVELOPMENTS IN BAKER 15 COUNTRIES
a. DEBT/EXPORT RATIO %



(1) TOTAL DEBT (OTHER THAN TO IMF) DIVIDED BY EXPORT OF GOODS AND SERVICES

SOURCE: IMF DRAFT WEO MARCH 1989

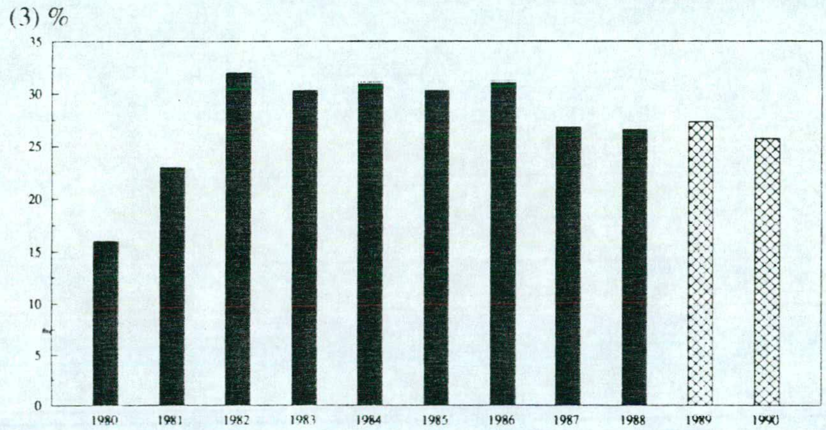
b. REAL VALUE OF DEBT 1980$bn



(2) TOTAL DEBT (OTHER THAN TO IMF) DIVIDED BY INDEX OF DOLLAR UNIT VALUE OF WORLD TRADE

SOURCE: IMF DRAFT WEO MARCH 1989

c. INTEREST SERVICE RATIO %



(3) INTEREST DUE DIVIDED BY EXPORTS OF GOODS AND SERVICES

SOURCE: IMF DRAFT WEO MARCH 1989

12. Output growth among Baker 15 countries in 1988 slowed to 1.3 per cent (influenced by slow growth in Mexico and recession in Brazil): a disappointing performance in view of the strong growth in exports. Poor growth is partly explained by declining investment and the tightening of financial policies in the face of accelerating inflation; in some countries, notably Mexico, real exchange rate appreciation also encouraged imports. IMF projections of growth in 1989 show little change from last year, due to a combination of higher expected interest rates, slower net export growth and the need for tighter fiscal and monetary policies in the major debtors.

Importance of Middle Income Debtors to the World Economy

The Baker 15 countries represent only a small and decreasing share of world export markets, taking around 4 per cent of OECD mechandise exports in 1986. The fall partly reflects the substantial import compression experienced in some debtor countries.

Table 2 Share of US, UK and EC Exports to Baker 15 countries, 1980 and 1987

%	1980	1987
USA	17	12
UK	5	2
EC	5	3

Source: IMF: Direction of Trade Statistics 1988

Recent Developments Among Major Debtors

13. The situation in major middle-income debtors has deteriorated in the last six months. Concerns of a coordinated Latin American approach to debt appear to have receded for the time being. But disturbances in Venezuela, forthcoming elections in Argentina and Brazil, and election commitments by Salinas in Mexico continue to make debt a high profile issue in Latin America.

* IMF programme for Brazil was thin; several 1988 targets missed, 1989 targets largely unspecified. A programme review is due soon. Recent Summer Plan has offered some respite from hyperinflation but now in jeopardy. Debt/equity programme suspended.

* Mexico negotiating with IMF: looking for $7bn a year from external creditors. Sharp deterioration in current account in 1988 due to substantial import growth and lower oil prices. Large-scale capital flight late last year further depleted reserves. Recent pact for Economic Stabilisation and Growth at risk from growing discontent among business and labour.

* Argentine government under political pressure in run-up to May elections. Inflation accelerating after several failed 'anti-inflation' plans; output falling. IBRD policy loan disbursements suspended following unfavourable report. IMF negotiations unlikely to make headway until after May. Interest arrears to banks mounting.

* Riots in Venezuela coincided with announcement of austerity programme and IMF letter of intent. EFF and CCFF sought. Lower oil revenues and failure to make early adjustments depleted foreign exchange reserves, forcing request for US (and Spanish) bridge finance. Presidential tone on possible debt moratorium has apparently moderated.

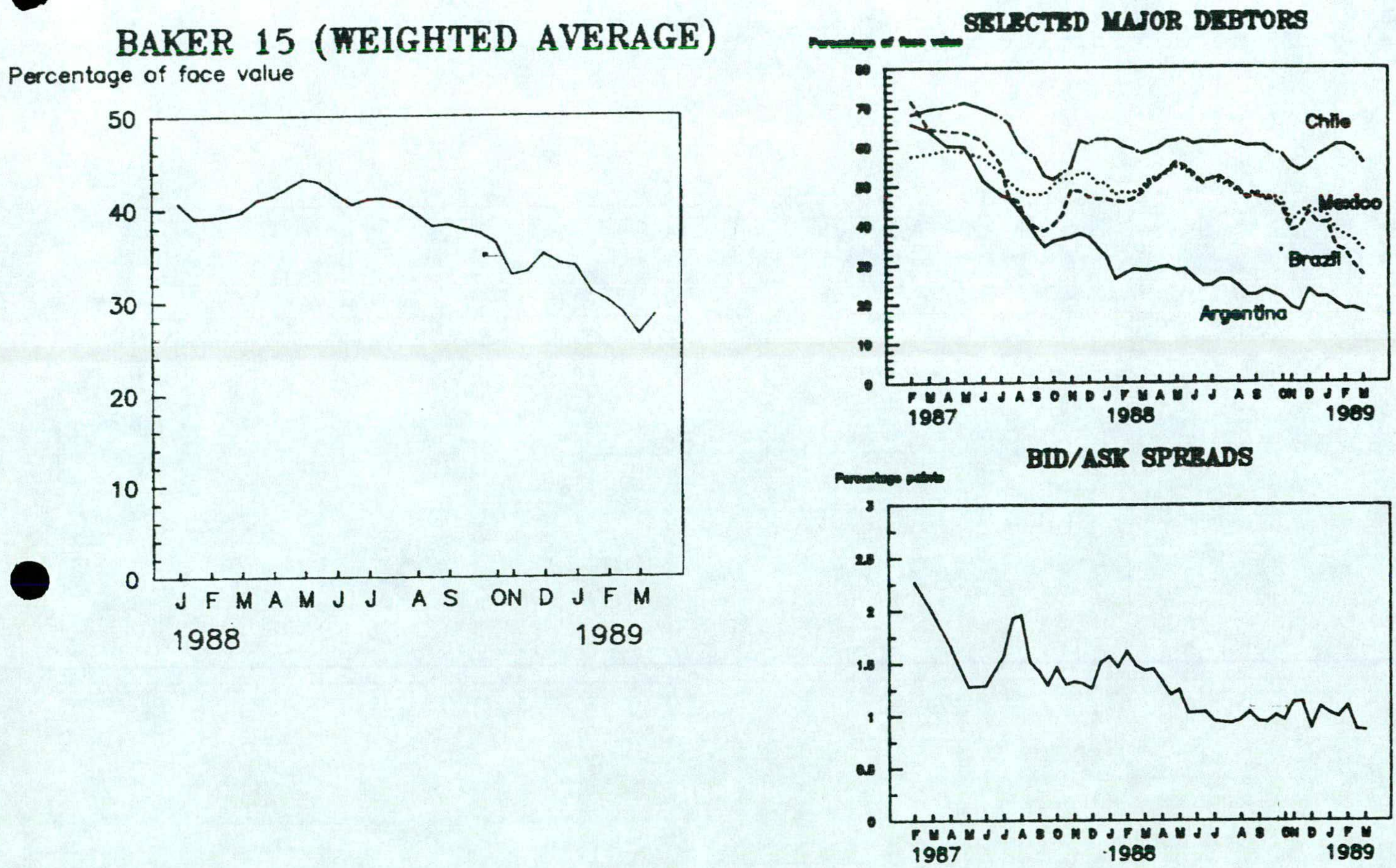
14. More detail on individual countries is at Brief No 4.

Secondary Market For Debt

15. Prices for LDC debt in the secondary market have continued to decline. Whereas average prices for Baker 15 countries were around 50¢ in the dollar six months ago they are now below 30¢. Particularly sharp falls have occurred since the beginning of the year in prices of Brazilian and Mexican debt, reaching lows of 27¢ and 33¢ respectively. (Chart 2). Brazilian prices have fallen in particular because of suspension of the debt/equity programme. Very recently there has been some recovery in Mexico prices, partly anticipating the implications of the Brady proposals.

16. Turnover in the secondary market has expanded rapidly, more than doubling each year since 1984 to an estimated $40-45bn last year. Of this total, probably some $17bn is related to final demand, in the form of debt/equity swaps, buybacks, the Mexican debt exchange, and prepayments of debt at a discount. Activity is heavily concentrated in Brazilian, Mexican and Chilean debt.

CHART 2. INDICATIVE SECONDARY MARKET PRICES[1]



(1) Source : Salomons, mid-point of bid-ask spread

Provisioning

17. Current provisioning by the major 5 UK banks amounts to over 1/3 of total exposure to debtor countries. This year's reporting of banks' results suggests little, if any, additional provisions have been made in respect of LDC exposure. UK bank shares have continued to underperform the market but US bank share performance has picked up relative to the S&P 500 during the last 12 months.

Regulatory and Tax Treatment of Debt

18. Unlike the position for most of the major banks in the US, the UK and most European countries do allow tax relief for provisioning. There have been some suggestions that this discourages debt reduction because there is no additional tax benefit if it is only to the provisioning level. The point to make is that the same or greater tax benefits can be realised in countries such as the United States simply by making a "wash-out" swap between banks which creates a write down on the banks' own books at the value at which the swap was conducted, but

which does not affect the contractual debt in any way. In any case, our treatment of provisions could not be changed except by legislation which would have to take into account the effects on general commercial tax losses. This is simply not on. UK regulations offer no discouragement to debt exchange operations, such as buybacks and debt/bond exchanges.

Baker Plan

19. The Baker Initiative, launched in 1985, called for a case-by-case approach, with emphasis on growth-oriented adjustment. While IBRD (and IADB) disbursements have come close to Baker's aim, commercial bank net disbursements have turned out lower than he hoped.

Table 3. IBRD, IADB and Commercial Bank Lending to Baker 15 against Plan, 1986-88

$bn	Baker Plan	Estimated Outturn
IBRD+IADB		
Gross Disbursements	27	21
Net Disbursements	na	10½
Banks		
Net Disbursements	20	4½[a]

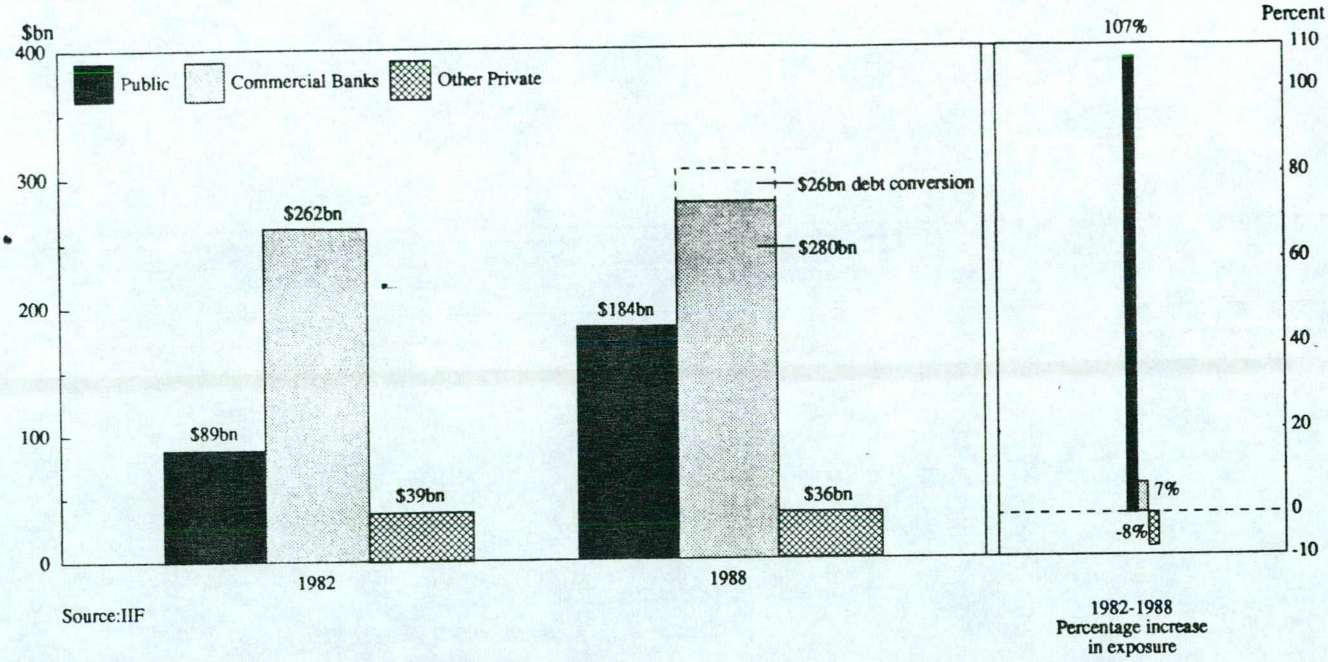
[a] Includes officially guaranteed bank credits. Excludes short-term credits and arrears.

Source: IBRD, R89-21 and see M89-172(Rev); IADB

Creditors

20. Total creditor exposure to problem debtors has been rising in dollar terms. It is falling in real terms. The largest proportionate increase has been borne by the public sector. (Chart 3). Between 1982 and 1988 the IIF estimate that public sector creditors' share of Baker 15 countries total external debt rose from 23 per cent to 37 per cent, while that of commercial banks fell from 67 per cent to 56 per cent. (Table 3). Even after allowance is made for commercial bank debt reduction - adding in its full value would raise the banks' share to 61 per cent - there has been a clear shift in the debt burden from private to public creditors.

CHART 3. **Public & Private Sector Exposure To Baker 15 Countries: 1982 & 1988**



Source:IIF

<u>Table 4.</u> Total External Debt by Creditor, Baker 15 Countries, 1982-88.

	1982		1988	
	$bn	**% of total**	**$bn**	**% of total**
IMF	6	(1)	19	(4)
MDBs	23	(6)	60	(12)
Official Bilateral	60	(15)	105	(21)
Total Public	89	(22)	184	(37)
Commercial Banks	262	(67)	280	(56)
Other Private	39	(10)	36	(7)
(Banks, including debt reduction)	(262)	(67)	(306)	(61)
Total Private	301	(77)	316	(63)
TOTAL	390	(100)	500	(100)

Source: IIF

Capital Flight

21. Capital flight is very difficult to define and even harder to measure. Outflows of capital for flight reasons have moderated substantially in the last three years (Table 5a). But the value of stocks of flight assets have continued to grow as they earn income which is not repatriated. Table 5b shows estimates of stocks by the IMF and Morgan Guaranty. Large differences in estimates illustrate the uncertainties involved in measurement. According to Morgan Guaranty, in 1987 stocks of these assets among Baker 15 countries amounted to just over half external debt. Capital flight assets belong largely to the private sector whereas debt is mainly a liability of the public sector. It would be difficult to set effective targets for repatriating flight capital. Far better to remove causes of capital flight - mainly imprudent macroeconomic policies.

Table 5a: ESTIMATES OF CAPITAL FLIGHT, WESTERN HEMISPHERE COUNTRIES, 1975-87

	1975-78	1979-82 (Annual Averages)	1983-85	1985-87+
Capital Flight	3	14	10	1½

Sources: IMF, Bank of England + Major Latin American Countries only

Table 5b: STOCKS OF FLIGHT CAPITAL AND OVERSEAS DEBT, 1985 (and 1987): ALTERNATIVE ESTIMATES

	Argentina		Brazil		Mexico		Venezuela	
Flight Capital Assets								
IMF	35		14		37		23	
Morgan Guaranty	44	(46)	17	(31)	73	(84)	49	(58)
Total Overseas Debt	49	(57)	106	(124)	97	(108)	35	(37)

Note: 1987 figures are in parentheses

ANNEX A

INTERNATIONAL DEBT INITIATIVES

France

i. Industrialised nations' share of new SDR allocation at the IMF (SDR 15bn) put into an escrow account and used in context of IMF programmes to guarantee all or part of interest/dividend payments on new debt/equity instruments exchanged at a discount or carrying sub-market rates.

ii. Fund could be topped up by bilateral (including debtors) or other multilateral (including private) contributions.

Japan

i Debtor agrees a medium-term adjustment programme with IMF.

ii Debtors reserves deposited in IMF escrow account to back fully a part of their debt exchanged for bonds at par.

iii Pre-agreed proportion of future foreign exchange earnings hypothecated to second IMF escrow account to part guarantee payments on remaining debt, rescheduled at concessional rates.

iv Separately, Japan to offer increased flow of bilateral finance (untied Eximbank loans) in parallel with IMF funds.

US

Major debt and debt service reduction for good performers undertaking IMF programmes comprising:

i Programmes to emphasise improvements to investment environment through requirement of effective debt/equity swap programmes and targets for new investment and capital flight repatriation.

ii Set-aside portion (25%) of IFI policy-based loans to facilitate cash buybacks and collateralised debt/bond exchanges at significant discounts. (Total IFI funds used over 3 years: $10-12bn).

iii Rolling support for interest payments on (discounted) debt-exchanges or on major reductions in interest rates on restructured debt. Might take the form of credit lines or loan proceeds placed in an escrow account. World Bank might also offer guarantees. (Total IFI funds used over 3 years: $12-14bn).

iv Banks to agree 3-year waiver of "negative pledge" and "sharing clauses".

v Abandonment of gapology: full financing assurances not necessarily required by IFIs before loan disbursements.

<u>Spain</u>

Keen to use its EC Presidency to promote assistance for Latin America debtors. Proposals very unclear. Elements may include:

i 25-30% write-off.

ii Remainder exchanged at a discount for bonds/equity.

iii (Possibly) rescheduling at fixed interest rates.

iv "Interest capitalisation in such a way that it does not continue to accumulate".

v New money (source unspecified).

<u>USSR</u>

i International debt management agency to acquire debt at a discount.

ii Write-off or 100-year moratorium on all official debt (presumably for poorest countries). Soviets would write-off all official debts owed by 22 LLDCs.

iii Agreed limits on interest payments depending on debtors' economic results (presumably for middle-income countries).

iv. Debt conference at UN.

ANNEX B

BAKER 15 COUNTRIES

Argentina
Bolivia
Brazil
Chile
Colombia
Cote d'Ivoire
Ecuador
Mexico
Morocco
Nigeria
Peru
Philippines
Uruguay
Venezuela
Yugoslavia

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Brief No 3(i)

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

DEBT ISSUES AFFECTING THE POOREST COUNTRIES

A) IMF/IBRD RESPONSE

Objectives

1. i. to underline the differences between the problems of middle-income debtors and those of the poorest debtors, particularly in sub-Saharan Africa;

ii. to welcome the signs that adjustment is beginning to produce results, and to emphasise the need for adjustment process to continue.

iii. to underline need for strong programmes under IMF Enhanced Structural Adjustment facility (ESAF) and World Bank special programme for Africa, and to secure credit for UK contributions;

Line to Take

2. UK has led the way in drawing attention to the special problems and special needs of the poorest debtors, particularly in sub-Saharan Africa.

3. Welcome efforts by some countries to adjust. Fundamental reforms needed. Some encouraging signs that first of these are beginning to bear fruit. Essential to maintain momentum of adjustment.

4. IFIs have central role to play in advising on policies and in helping to provide finance. Right that Fund should be playing its part through ESAF. UK providing subsidy on up to SDR 1bn of ESAF lending. Essential that ESAF resources be used carefully in support of strong adjustment programmes. Track record important, but purpose of ESAF is not to reward past efforts. More finance has to be justified by more adjustment, and clear analysis of expected results.

5. UK also among lending contributors to World Bank's Special Programme of Assistance to low-income debt distressed countries in Africa. £250 million in support of co-financing over 1988-90.

Debt

6. The end-1987 total of sub-Saharan African debt was $120 billion (detailed figures are given at Annex A). Around 75 per cent of this total is owed to multilateral institutions and governments (including both aid and export credit agencies); around 25 per cent is owed to banks and other private sources.

7. This total was more than double the 1980 figure of $52 billion. On all indicators, the position of sub-Saharan Africa had worsened significantly over this period:

	1980	1987
Debt: GDP	38.1	68.3
Debt: Exports	146.0	324.3
Debt service ratio	16.3	22.1
Interest due/Export ratio	9.1	16.1

Source: IMF Draft WEO, August 1988; figures exclude Nigeria.

8. Over this period only 12 of the 44 sub-Saharan African countries were able to service their debt promptly. 24 countries undertook rescheduling with official and/or commercial creditors (4 countries: Madagascar, Senegal, Sudan and Zambia rescheduled five or more times).

Adjustment

9. There has been a general improvement in SSA economic performance since 1984 supported by a rapid rise in aid commitments to adjusting countries. Growth has been positive on average, after negative growth over 1980-84. Export volumes have risen again after persistent decline. Food production has kept pace with population growth since 1984. This improved performance has been helped by better weather but there are also signs that better policies have helped. The main area of progress has been pricing reform including significant falls in real exchange rates and improved agricultural pricing. There has also been some reduction in inflation and fiscal deficits.

10. But adjustment will be a long and difficult process: sustained results will take time to achieve, and this could undermine the momentum of change. Aid requirements are not likely to diminish in the forseeable future. In view of the inducements of SAF/ESAF, a larger share of IDA8 and bilateral co-financing, and possible debt relief, there is a good chance that many countries will persist with structural adjustment. These additional concessional financial resources are expected to allow LIDDs to increase imports and achieve economic growth of some 4 per cent without debt service default.

<u>Enhancement Structural Adjustment Facility (ESAF)</u>

11. The ESAF is designed to provide SDR 6 billion in concessional loans to 62 IDA eligible low-income countries: 34 in sub-saharan Africa, listed in Annex B and 24 elsewhere (including Pakistan, and Bangladesh, and a number of small Caribbean and Pacific Islands, as well as India and China which have voluntarily agreed not to draw on the facility). The terms and conditions are intended to be the same as the SAF: a three-year programme; lending at 0.5 per cent (provided the Fund can secure sufficient contributions to the subsidy account); maturity 10 years with 5½ years grace.

12. But contributions remain some way short of target. The major contributors are (SDR mn):

	Grants or Grant Equivalents	Loans
UK	439	-
Japan	312	2200-2500
France	326	800
Germany	98	700
Italy	172	370
Canada	140	300
Saudi Arabia	93	200
US (not yet approved by Congress)	114	-
(others	599	746)
Total	2293	5316-5616
Target	2675	6000

13. The <u>UK</u> remains the largest single contributor to the subsidy cost of the ESAF. We have agreed to subsidise lending of up to SDR 1 billion, with a ceiling of £327 million on our contribution (calculated on the basis of interest and exchange rates in December 1987). The detailed arrangements were set out in an

Exchange of Letters between the Chancellor and Camdessus in May 1988. The Fund are still looking for more contributions, and the size of the UK contribution will depend on the eventual final total.

14. So far 6 ESAF programmes have been approved (Bolivia, Gambia, Ghana, Malawi, Niger and Senegal). Total commitments are around SDR 0.75 billion. The number of programmes is expected to rise to around 20 by end 1989 and around 30-40 by end 1990 (if the present cut off date for the approval of programmes is extended).

15. These first few cases have involved mainly countries with a reasonable record of adjustment. We agree that this is an important precondition for an ESAF programme. But it is not enough by itself. We also want to see significantly stronger adjustment. This has not been apparent in at least some of the programmes. It also has been difficult to establish the expected 'returns', in terms of the direct results from new policies and additional finance. In one or two cases, it has looked as though the results of the programme amounted to little more than additional reserve accumulation. We intend to continue to press both on the quality of programmes, and on the quality of their presentation to the Executive Board.

World Bank's Special Programme for Africa

16. The World Bank's Special Programme of Assistance for low-income debt-distressed countries in Africa was launched in December 1987 (eligibility of countries, and their latest World Bank GNP per capita figures, are shown at Annex B). At its launch we announced our intention to spend at least £250 million over the three years 1988-90 (effectively our financial years 1988/89-90/91) in bilateral co-financing grants to support the aims of the Programme. We are now taking forward detailed arrangements with the World Bank for the implementation of the programme, and we have agreed to untie half of our contribution for procurement from developing (Part II) countries and from other donors who untie similarly. Contributions from bilateral and multilateral sources (EC and AFDB) are expected to be about US$ 6.4 billion over the 3 years of the programme.

9. Sub-Saharan Africa: Individual Country Debt Positions

(end of 1987)

	Debt Outstanding					
	Total[1]		Medium- and long-term publicly guaranteed debt, of which, in percent			
	(billion U.S. dollars)	Of which outstanding use of Fund credit (million U.S. dollars)	Multilateral creditors	Bilateral creditors	Financial institutions and others	Debt ratio[2]
Market borrowers						
Congo	4.36	13.5	10.8	21.8	67.4	435.6
Côte d'Ivoire	10.11	576.7	25.7	32.2	42.0	296.2
Gabon	1.64	60.3	11.3	78.4	10.3	114.2
Nigeria	26.65	—	7.9	49.1	43.0	352.7
Official borrowers						
*Burkina Faso	0.72	—	67.1	31.2	1.7	300.8
*Burundi	0.71	12.1	68.4	27.9	3.7	627.8
*Cape Verde	0.11	—	58.9	38.4	26.8	250.0
*Central African Republic	0.64	45.4	51.0	48.3	0.7	330.7
*Chad	0.27	18.6	72.7	27.3	—	162.7
*Comoros	0.15	—	59.6	40.4	—	704.2
*Djibouti	0.15	—	43.5	54.4	2.0	109.5
*Equatorial Guinea	0.15	7.7	21.9	75.2	2.9	483.9
*Gambia, The	0.25	34.7	53.3	31.3	15.4	244.9
*Ghana	2.78	836.5	48.7	39.9	11.4	318.4
*Guinea	1.62	46.2	25.8	60.2	14.0	275.6
*Guinea-Bissau	0.36	4.5	37.8	48.9	13.3	1,500.0
*Liberia	1.30	291.4	36.6	45.8	17.6	328.3
*Madagascar	3.14	223.0	28.3	64.0	7.7	754.8
*Malawi	1.25	110.3	67.3	26.0	6.7	399.7
*Mali	1.69	75.1	34.4	64.0	15.5	523.7
*Mauritania	1.63	71.2	28.7	60.8	10.5	347.5
*Rwanda	0.43	—	72.5	27.5	—	216.8
*São Tomé and Principe	0.11	—	38.9	42.2	18.9	873.0
*Senegal	3.53	327.2	30.2	57.2	12.6	290.3
Seychelles	0.13	—	26.5	37.9	35.6	152.9
*Sierra Leone	0.66	99.6	33.7	46.2	20.1	562.7
*Somalia	1.80	166.2	32.6	63.7	3.7	1,428.6
*Sudan	12.10	858.7	13.8	62.5	23.7	1,520.1
Swaziland	0.27	3.2	51.4	39.0	9.7	58.3
*Tanzania	3.67	94.9	38.4	57.6	4.0	677.1
*Togo	1.27	78.4	46.0	47.0	7.0	301.4
*Uganda	1.82	257.1	63.5	33.8	2.7	497.3
*Zaïre	7.97	916.4	18.5	71.6	9.9	413.2
*Zambia	6.51	956.9	23.5	57.6	18.9	915.5
Others						
*Benin	0.84	—	34.9	14.7	50.4	371.4
Botswana	0.51	—	60.0	29.7	10.3	48.2
Cameroon	2.91	—	38.1	46.2	15.7	104.0
*Ethiopia	2.33	62.7	36.1	53.1	10.8	385.6
*Kenya	4.59	380.9	46.9	36.9	16.2	267.2
*Lesotho	0.22	—	88.9	9.2	1.8	55.5
Mauritius	0.54	149.7	47.9	33.9	18.1	58.8
*Mozambique	3.59	17.3	6.7	77.6	15.8	1,726.0
*Niger	1.11	114.7	38.1	43.2	18.7	264.5
Zimbabwe	2.48	156.5	18.3	20.6	61.1	182.0

*Countries eligible for the use of the IMF's concessional structural adjustment facility.
[1]Excludes arrears; includes short-, medium-, and long-term publicly guaranteed and unguaranteed debt, plus outstanding use of Fund credit.
[2]Total debt outstanding plus use of Fund credit over exports of goods and services.

Data: IMF, country level data base, *World Economic Outlook*; IMF, *International Financial Statistics*, and IMF staff estimates.

Sub-Saharan Africa: Income Levels, Programme Status, and Eligibility

Country	GNP per Capita $ 1987 a	SAF/ESAF Eligibility	Fund Activity	SPA Eligibility
Low Income (35)				
Benin	300	*	-	++
Burkina Faso	170	*	-	-
Burundi	240	*	SAF	+++
Cape Verde	500	*	-	-
Cent. African Rep.	330	*	SAF	+++
Chad	150	*	-A-	++
Comoros	380	*	-	+
Djibouti	na	*	-	-
Eq.Guinea	na	*	SAF	+
Ethiopia	120	*	-	-
Gambia	220	*	ESAF	+++
Ghana	390	*	ESAF	+++
Guinea	na	*	SAF	+++
Guinea-Bissau	170	*	SAF	+++
Kenya	340	*	SAF/SBA	+++
Lesotho	360	*	SAF	-
Liberia	440	*	-A-	-
Madagascar	200	*	SAF/SBA	+++
Malawi	160	*	ESAF/SBA	+++
Mali	200	*	SAF/SBA	+++
Mauritania	440	*	SAF	+++
Mozambique	150	*	SAF	+++
Niger	280	*	SAF	+++
Nigeria	370	-	-	-
Rwanda	310	*	-	-
Sao Tome & Principe	280	*	-	+++
Senegal	510	*	SAF/SBA	+++
Sierra Leone	300	*	-A-	+
Somalia	290	*	-A-	++
Sudan	330	*	-A-	+
Tanzania	220	*	SAF	+++
Togo	300	*	SAF/SBA	+++
Uganda	260	*	SAF	+++
Zaire	160	*	-A-	+++
Zambia	240	*	-A-	+
Others (9)				
Botswana	1030	-	-	-
Cameroon	960	-	SBA	-
Congo	880	-	-	-
Cote d'Ivoire	750	-	SBA	-
Gabon	2750	-	-	-
Mauritius	1470	-	-	-
Seychelles	3180	-	-	-
Swaziland	700	-	-	-
Zimbabwe	590	-	-	-

-A- = Arrears

+++ = Eligible
++ = Elibility Near
+ = Elibility under Review

a Based on IBRD method of conversion to $ by averaging exchange rates, adjusted for differences in relative inflation rates, over 3 years.

Source: SecM88-1028, IBRD; IMF; Jaycox letter to Ainscow, 28 Feb 1989.

BRIEF NO 3(ii)

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

CHANCELLOR'S INITIATIVE/TORONTO TERMS

Objectives

1. i. To take credit for the success of the Chancellor's initiative.

   ii. To discourage any suggestion that Toronto terms should be extended to middle income debtors.

Line to take

2. Eligibility criteria for Toronto terms only recently agreed, after much difficulty. Must see how they work out in practice before considering any changes.

3. (Defensive, if raised). Criteria themselves not geographically specific although understand some countries unable to give concessional reschedulings outside sub-Saharan Africa.

4. In the context of the Brady proposal for middle income debtors, it should be emphasized that the official sector's contribution will continue to be in the form of new financing and not debt reduction.

Background

Chancellor's initiative

5. Launched April 1987 at Interim Committee of IMF. Three elements: longer rescheduling of official debt in Paris Club, lower interest rates, and conversion of old aid loans into grants. Proposals welcomed at Venice summit. Paris Club rescheduled $2 billion debts owed by 10 African countries over 15-20 year periods between April 1987 and July 1988. Initiative formed basis for eventual agreement on Toronto terms.

Toronto Summit

6. Summit leaders accepted the case for special relief for poorest countries after the US had agreed that a menu approach should be adopted. Creditors may choose between lower interest rates, partial debt write offs, longer repayment periods or a combination of these (See Annex). Summit also called for more RTA. UK has written off £1 billion of old aid loans, nearly 300 million in Africa. FRG and Canada also have good records on RTA but others eg US and Japan could do more. We estimate that there are $7½ billion outstanding of old aid loans to low income Africa.

Toronto reschedulings

7. Seven countries have now received Toronto terms: Mali, Central African Republic, Madagascar, Tanzania, Niger, Senegal and Uganda. We expect several more to benefit over the next few months. We estimate that so far the total debt rescheduled on concessional terms is around $1 billion, UK share about 9%.

8. A request for Toronto terms from Bolivia, supported by Spain, was turned down. Bolivia was not regarded as one of the poorest, and US and FRG strongly opposed extending Toronto terms outside sub-Saharan Africa. The US is afraid of contagion on the continent, FRG would require a Parliamentary decision since at the moment budgetary authority for concessional reschedulings is limited to countries in sub-Saharan Africa. Spain opposes limiting eligibility to sub-Saharan Africa, and by way of a tit-for-tat held up Senegal's rescheduling arguing that Senegal was too rich to fall within the criteria. More recently the Club has been unable to reach a consensus on Guyana (see brief), which meets all the criteria apart from track record on servicing debts.

9. The UK does not oppose extending Toronto terms outside Africa provided all criteria are met. The criteria themselves originally referred to sub-Saharan Africa, but this was dropped at the insistence of Spain. It is illogical to argue that very poor countries should not benefit on geographical grounds and our reputation for technical interventions would suffer were we to do so. And we would not want to argue against Bangladesh or Pakistan if they were to reschedule.

10. We do however oppose extending the income criteria upwards. (In the case of Senegal, income per capita $510, we were able to justify Toronto terms on technical grounds). The criteria were only agreed after much bargaining. The IDA-only eligible criterion is an easily identifiable and independent yardstick which gives the Club some flexibility to be able to decide genuinely on a case-by-case basis. Abandoning it would make it very hard to draw the line. There are already some suggestions that Toronto terms are the forerunner of more widespread relief. We should resist these: we do not want Egypt, in particular, to receive Toronto terms.

11. Nigeria originally requested Toronto terms but did not press for it in the rescheduling on 2/3 March. Nigeria as a blend country is ineligible, and many creditors would have been unwilling to meet the high cost of including Nigeria in the concessions.

ANNEX

Paris Club Agreement on Toronto terms

1. Paris Club agreed that for eligible countries creditors would choose between:-

i. reducing moratorium interest rates on the whole of the rescheduled debt by 3.5 percentage points or by half whichever is the less.

ii. writing down one third of the debt service falling due during the consolidation period

i. and ii. will be repaid over 14 years, with 8 years grace.

iii. rescheduling over 25 years, with 14 years grace.

Creditors may also choose to combine options, or to choose different options during the same rescheduling for aid debt and commercial debt.

2. The Club recognised that the three options were not strictly comparable, but it was agreed that the greater risk of non-repayment undertaken by the third group balanced the reductions in claims by the first two groups, who are repaid first.

3. The Club agreed that the question of whether a country was eligible for Toronto terms would be agreed by consensus before the relevant rescheduling on the basis of the following criteria:-

- poverty: "notably IDA only eligible" but excluding blend countries - those countries below $610 per head still considered creditworthy for IBRD lending; but the Paris Club formulation avoids deliberately an explicit figure

- indebtedness, based on the relationship between debt service and exports. Again, the precise figure is not specified, but in agreeing to longer term rescheduling the Club took the World Bank special programme for Africa criteria of 30% before rescheduling over the period 1988-1990

- following an approved adjustment programme with the IMF

- track record on debt service in the past.

4

Brief No 4(a)

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

MAJOR DEBTORS: ALGERIA

Minister of Finance: Sid-Ahmed GHOZALY
Central Bank Governor: Badreding NOVIOVA

Objective

1. Resist any French pleas for special treatment for Algeria.

Line to take

2. Essential to continue adjustment process to maintain creditors' confidence. No reason why if sound policies are followed Algeria should not continue to have access to market financing.

Background

3. IBRD forecasts less than 2 per cent GDP growth for 1988-90, a fall in living standards given the population growth rate of 3.2 per cent. This is due mainly to cutbacks in investment caused by decline in hydrocarbon income from $12.8 billion in 1985 to $7.2 billion in 1988. Unemployment is rising (10,000 jobs created annually but labour force is increasing by 200,000 a year) and is a major problem: 40 per cent of Algerians under 25 (who comprise 50 per cent of the total population of 27 million) are out of work. Central government borrowing requirement reduced slightly in 1988 to 9 per cent of GDP from 10 per cent in 1987, half of which was financed through the banking system. Inflation is estimated to have risen to 12-15 per cent in 1988, from 10 per cent in 1987. Following riots in October 1988 provided by shortages of basic foods following Government restrictions on imports further measures were announced, including stricter monetary controls. Revenues are projected to rise by 11.4 per cent, to reduce the Government deficit to AD 6.7 billion from AD 10 billion in the 1988 programme.

4. The current account is estimated to have shown a small ($70 million) surplus in 1987, which the combined effects of low hydrocarbon prices, drought, locust plagues and increased commodity imports (post the October riots) will have pushed into sizeable deficit (of perhaps $8-900 million) in 1988. The Algerians have, however, finally reached agreement with Gaz de France on the price of LNG exports, although not until the French paved the way with a FF7 billion ($1.1 billion) aid/credit package. The US is providing $750 million a year in commodity credits and appears ready to continue to do so for the foreseeable future, while the Spanish government has just granted $380 million in mixed credits. By contrast, the UK has taken a more cautious attitude in view of the perceived increase in Algerian risks and in December 1988 reduced the amount of undrawn cover available for Algeria and downgraded the market.

5. The authorities' previous insistence on the finest terms available has alienated some of Algeria's traditional creditor countries (eg the US and to some extent the Europeans - although not the French, with whom Algeria has retained close, if strained historical links) and the authorities have turned increasingly towards Yen or DM-denominated private placement bonds. This has led to a currency mismatch between Algeria's exports (largely dollar-denominated) and its borrowing (increasingly Yen/DM-donominated). Hence, while dollar earnings from hydrocarbon exports are reduced, thereby stretching to the limit the authorities' ability to import goods, Algeria is having to face increases in dollar terms in the value of its Yen/DM borrowing just to roll-over existing debt.

6. Debt service obligations on Algeria's external debt (which the OECD put at $26.7 billion at end-1987, excluding perhaps $3 billion of military debt) continue to present a burden for the economy, even though borrowing in 1988 was only roughly equal to amortisation payments and merely rolled over the debt. Interest payments are projected at $1.7 billion in 1989 and long term debt service at $5.0 billion. Unless there is a substantial recovery in oil/gas prices, the debt service ratio is also likely to increase form 64 per cent reported last year. In December the Arab Monetary Fund approved its second loan to Algeria (for $115 million) and the IBRD approved a $110 million credit as half of a $220 million co-financing with Japan's Eximbank.

Relations with IMF/IBRD

7. Algeria has in the past fought with determination to avoid recourse to the IMF, due to connotations of "colonialism". (Although the authorities have made technical enquiries about Fund credit facilities Algeria would in any case be a difficult customer with its dirigiste background). The IMRD has approved a $50 million loan to assist the anti-locust campaign and may provide an agricultural loan during fiscal 1989, when Algeria is otherwise expected to become a net repayer to the IBRD.

Relations with Paris Club

8. The absence of a Fund programme precludes an approach to the Paris Club. Instead it is likely that the Algerians will continue to delay payments where possible and, as a final resort, seek to reschedule bilaterally, while ensuring that it remains current on its banking debt.

Relations with UK

9. The UK's market share is 3 per cent and ECGD ranks sixth in ECA exposure to Algeria (down from second). Total exposure under Section 2 is estimated to be £592 million.

	1987	1988	1989 (forecast)
GDP Growth (%)	1.0	2.8 (est)	-
Inflation (%)	10	12-15	-
PSBR (% of GDP)	9.3	-	-
Current Account (% of GDP)	0.1	-	-
Total External Debt ($ bn)	26.7	-	-
Debt Service Ratio	60	64	-
Interest Service Ratio	15.7	-	-

BRIEF NO 4(b)

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

MAJOR DEBTORS : ARGENTINA

Ministry of Economy : Juan Vital SOURROUILLE
Finance Minister : Mario Simon BRODERSOHN
Central Bank President : Jose Luis MACHINEA

Objectives

1. i. Prevent further disbursements of World Bank policy-based loans before IMF programme agreed.

ii. Encourage maintenance of appropriate economic policies in pre-election period.

iii. Obtain support for removal of unfair trade discrimination against UK.

iv. Avoid suggestion that UK line affected by bilateral political considerations.

Line to take

2. Important that economic reforms are not delayed until after election. Recognise difficulties in giving policy commitments but never the wrong time to implement effective economic policies. Sound democracies are based on sound economies and not on unsustainable policies.

3. Deterioration in economy even since October vindicates UK refusal to back policy-based Trade and Banking sector loans without an IMF SBA. Further disbursements must wait for agreed comprehensive programme of adjustment.

4. Blatant discrimination against UK imports a breach of the first Trade Policy loan and must cease.

Background

5. Economic outlook has worsened. Severe drought has caused substantial power cuts and a loss of grain output; industrial output is down sharply and inflation has been rising since November. (9.6 per cent in February despite price control and interest rates between 25-40 per cent). Improvement in cash PSBR in 1988 due in part to growing internal public sector arrears. Business has withdrawn support from anti-inflation Plan, wishing to compensate for rising real wages (unions were not signatories to the Plan). Exchange rate reforms aimed to unify existing three rates by end of year have led to uncertainty and rapid fluctuations. The free rate at present is 180 per cent above the commercial rate. Political outlook is increasingly uncertain with army unrest, resurgence in terrorist activity, and prospect of a Peronist victory in the May elections. Peronists have pledged to press for a negotiated five-year debt servicing holiday if elected.

Relations with the IMF/IBRD

6. Camdessus reportedly thinks it pointless to negotiate an SBA before elections. Otherwise fiscal targets likely main stumbling block.

7. The IBRD approved a four-loan package worth $1.25bn last October. UK alone voted against 2 policy loans. Australia and Canada abstained. Second tranche ($150m) under 2nd Trade Policy loan, and effectiveness and first disbursement ($200m) under Banking Sector loan, have been suspended because of unfavourable report on the macroeconomic situation by Staff on 2 March. $250m in planned 1990 disbursements from the IBRD are reportedly being brought forward to help tackle the energy crisis.

Relations with commercial banks

8. Negotiations with commercial banks are stalled with the elections imminent. Banks offered $2bn plus Brazil-style menu for 1988-89, but Argentina wants $3.5bn and restricted menu. Interest arrears to banks were $2.0bn est. at end-1988; only $170m arrears were repaid in 1988; President Alfonsin has acknowledged a de facto halt to interest payments since the end of last year and

proposes to make further payments conditional on new credits; no progress now likely before elections.

Relations with Paris Club

9. UK, Swiss and Austrians have still to sign bilaterals under the 1987 Agreement, although there are indications that the authorities are quickening the pace for signature. All bilaterals would have to be signed and an IMF programme in place before the next Paris Club rescheduling. Arrears have been reported under both the previous agreements.

Relations with UK

10. Argentina signed 1985 Paris club bilateral with UK on 16 February. UKDEL has been lobbying IBRD Staff about Argentina's trade discrimination against the UK; easier import licensing, introduced under the 2nd Trade Policy loan, specially excluded UK goods, formalising the existing discrimination through administrative barriers.

11. In January 1989, Machinea wrote to the Governor asking for details of Argentine balances totalling £148,000 frozen with the Stanley branch of Standard Chartered bank. This is a reply to Governor's letter of February 1986 proposing that Falkland Island official balances (now worthless) in Buenos Aires should be offset against originally comparable Argentine public sector assets in Stanley, allowing Argentine private deposits in Stanley to be unfrozen. The Governor replied on 15 February 1989 giving details of Argentine public sector deposits in Stanley.

Statistics

	1987	1988	1989
GDP growth %	2.0	0.7	1.0 (F)
Inflation Dec-Dec %	174.8	387.5	NA
Inflation average	131	343	NA
PSBR % of GDP	6.8	5.1	4.0
Current account % of GDP	-5.8	-3.0	NA
Total external debt (US$bn)	58.3	58.8	NA
Debt: GDP %	79.6	76.7	NA
Debt service ratio %			
Due	73.7	67.7	NA
Paid	73.9	45 est	NA
Interest service ratio %			
Due	47.6	43.1	NA
Paid	47.9	20.4	NA

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BRIEF NO 4(c)

HER MAJESTY'S TREASURY

IMF/IBRD SPRING MEETINGS 1989

MAJOR DEBTORS: BRAZIL

Finance Minister: Mailson Ferreira DA NOBREGA
Central Bank Governor: Elmo DE ARAUJO CAMOES

Objectives

1. To urge Brazil to reach prompt agreement with IMF to reactivate Fund programme.

2. To reaffirm support for Nobrega's economic reform efforts against strong opposition.

Line to take

3. Acknowledge steps in Summer Plan to avert hyper-inflation. But express concern at failure to win necessary congressional support for fiscal tightening.

4. Congratulate authorities on tight monetary policy since January. Urge steadfastness. Agree that suspension of indexation is needed to make policy credible, but roots of high inflation lie in irresponsible fiscal policies.

5. Urge resumption of debt reduction programme, with policies to sterilise inflows.

Background

6. With end-1988 inflation at almost 1,000 per cent, President Sarney introduced heterodox 'Summer Plan' in mid-January. Wages and price freeze; de-indexation; high interest rates; some proposed fiscal cuts. Plan is now in jeopardy after rejection of key elements in Congress. Inflation could return to 20-30 per cent a month later this year, if monetary policy overwhelmed by lack of fiscal rectitude and credibility. Deterioration of domestic situation which led to significant capital flight and difficulty in securing external finance could

lead to moratorium on external debt. Likely outcome of Presidential elections (due November 1989) very unclear.

7. A record trade-surplus of $19.1 billion in 1988 (cf $11.2 billion in 1987) due to depressed domestic demand and slower-than-expected import liberalisation. Debt reduced by between $6-8 billion in 1988 through debt-equity swaps.

Relations with IMF/IBRD

8. Second and third tranches of SBA undrawn as several 1988 criteria missed and first review (originally scheduled for February) yet to take place. Reactivation of programme more difficult following congressional rejection of key elements of Nobrega's policy.

9. IBRD Board discussion on Power Sector II Loan continues to be delayed both by IBRD doubts of the efficiency of third power station and by IBRD's own ambivalence over lending to a company with a nuclear component. Environmental concerns also adding to the problem.

Relations with Banks

10. Second tranche (for $0.6 billion) of bank new money delayed by stalling of SBA and Power Sector II Loan. De-linkage from latter now agreed but banks need letter from Camdessus reporting progress on SBA before they can release tranche and postponement of re-lending clauses is a technical breach of agreement. Interest payment of $400 million not paid on 15 March. Debt-equity programme suspended but authorities hope to re-start (smaller) auctions soon. 1988 rescheduling covered $62 billion over 20 years with 7 years grace at 13/16 per cent over libor.

US Bridging Loan

11. Non-receipt of expected new funds from external creditors led authorities to request informally a $3 billion bridge from US Treasury. Request could be renewed.

Relations with Paris Club

12. On 29 July 1988 creditors agreed to a generous rescheduling of principal and interest over ten years with 5 years grace.

Relations with UK

13. ECGD resumed medium term cover once SBA was declared effective but worsening economic situation has led to suspension of cover for +£5 million contracts (Brazilians unaware of suspension). EGC to review situation once bilateral is signed at end-March. At end-September '88 ECGD had an estimated £822 million at risk. UK registered banks at end-June had gross claims at $8.7 billion. The balance of trade was £438 in favour of Brazil in 1988 (cf £288 in 1987). [Mailson da Nobrega is due to call on Chancellor on 23 March - update will be needed.]

Statistics

	1987	1988	1989
GDP growth (%)	2.9	- 0.5 (est)	NA
Inflation average (%)	223	516	NA
PSBR (% of GDP)	30.6	40.0 (est)	NA
o/w excluding debt indexation	5.5	3.9 (est)	NA
Current Account (% of GDP)	- 0.3	1.3	NA
Total External Debt (US$bn)	121	115	NA
DSR Due [(1)]	48	42	NA
Paid [(1)]	30	56	NA
ISR Due [(1)]	31	29	NA

[(1)] as percentage of goods and non-factor services wpu.rmibrd4d

BRIEF NO 4(d)

HER MAJESTY'S TREASURY

IMF/IBRD SPRING MEETING 1989

MAJOR DEBTORS: EGYPT

Finance Minister: Mohamed Ahmed AL - RAZAZ
Central Bank Governor: Dr Mahmoud Salah el Din HAMED

Objectives

1. To resist pleas for special treatment for Egypt, in particular on weakening of Fund conditionality.

Line to take

2. (i) Political commitment to sustained economic adjustment essential pre-condition for new IMF programme, given the speed with which the last programme broke down. Important that credible programme is agreed and implemented as soon as possible, to arrest deterioration in Egyptian economy.

(ii) Understand Egyptian hesitation on the pace of adjustment, but programmes can contain off-setting measures to soften the effect on the poorest groups in the economy. Essential to reduce budget deficit more rapidly, and take firm action on interest rates.

(iii) UK strongly supports Egypt's adjustment efforts. UK votes at IMF board on technical and economic grounds, not political grounds.

(iv) Egypt is not eligible for Toronto terms.

(v) Past record of adjustment not sufficient for debt relief under Brady proposals.

Background

3. Forecast GDP growth 1988/89 is 2 per cent, growth rate is unlikely to increase in 1989. Inflation reached 30 per cent in 1988 and will remain high, influenced by exchange rate depreciation, increased energy charges, and falling industrial output. The IMF is doubtful that the authorities achieved a fiscal deficit of 14 per cent of GDP in 1987/88 as is claimed, and believe that the proposed budgetary measures are insufficient to reverse the upward trend in the deficit for 1988/89. Little progress has been made on the reduction of losses in public sector enterprises, and the Government remains unwilling to impose planned reductions in subsidies. Bank interest rates are set to remain negative in real terms.

4. The current account deficit narrowed substantially in 1987 to an estimated 3.2 per cent of GDP, half the level for fiscal 1986/87, but is projected to increase to around $3 billion (8.8 per cent of GDP) in calendar 1988. Higher foreign exchange receipts from buoyant tourism and higher 1988 Suez Canal revenues have been more than offset by rising prices of food imports and weaker oil prices. Although oil prices have strengthened, latest estimates suggest that Egyptian production capacity is past its peak and output in 1989 is unlikely to rise above 1988 levels. The emergency power generation programme, prompted by the Nile Waters Crisis, is set to remain a heavy trade on resources, although assistance has come from the African Development Bank, France and Italy. In 1988, Egypt rejoined the Arab League, and has been receiving support from Arab funds.

5. The IMF have continued to try to negotiate a new programme, following the breakdown of the 1987 programme which was one of the weakest ever and approved only on the understanding that it would be strengthened later. Both the IMF and the Egyptians agree that the main areas for reform are the exchange rate (on which some progress towards unification has been made), price subsidies, a reduction of the fiscal deficit, and interest rate policy. Real interest rates remain negative (13 per cent as against 30 per cent inflation) President Mubarak, heavily influenced by the bread riots at the beginning of his term of office, does not wish to implement these reforms at anything like the pace which the IMF consider necessary. He is at present touring Western capitals in a further attempt to lobby for support for some weakening fund conditionality. American aid appropriation of $2.3 billion per annum could be suspended if arrears on

military debt are not paid by the Brooke Amendment trigger date of 23 July, but the amount needed could be as little as $150 million, and so the US leverage is not as great as once supposed.

Relations with IMF/IBRD

6. The IMF mission which visited Egypt in January did not reach agreement, and there was a public row between Mubarak and Shalaan. The Article IV consultation has recently been concluded, but no progress has been made on a new standby arrangement, and when Camdessus met Mubarak in Tokyo he reiterated the Fund position. The World Bank is reported to have been more encouraged by the Egyptian efforts towards reform than the IMF. The Bank is willing to lend between $500-600 million a year over a 3-5 year period, provided satisfactory macreconomic conditions exist. In the past year the Bank have said this means an IMF programme in place. Mubarak may well try to play off the IBRD against the IMF: the Egyptians used the African Development Bank loan for the Cairo Waters Project as evidence that the international community was beginning to understand the realities of Egypt's difficult economic position.

Relations with commercial banks

Bank debt is 15 per cent of total external debt. 9 per cent of bank debt is owed to UK registered banks. They are still active in short term financing against Egyptian deposits but arrears are building up on medium term debt. IMF calculate that there were $1bn of commercial debt arrears at end 88, but Egyptians are still making repayments where new money depends on it.

Relations with Paris Club

7. In May 1987 the Paris Club rescheduled $2 billions of arrears and $5 billion of debt service payments falling due between January 1987 and June 1988. After prolonged haggling over the interest rate, Egypt signed the bilaterals under this agreement and is current on moratorium interest. Arrears have built up since June 1988 on non-rescheduled debt, including post cut-off date credits. However, the Australian Wheat Board has been fully paid, annoying the other creditors, and particularly the Canadians. An IMF programme would require further generous rescheduling from the Paris Club, but Egypt is not at present eligible for

Toronto terms. GDP per capita was calculated for 1987 at $710 by the IBRD, although other estimates takes more account of exchange rate changes and are much lower.

<u>Relations with UK</u>

8. UK exports were £289 million in 1988, making Egypt the UK's third largest African export market, after South Africa and Nigeria. ECGD remains off cover for Egypt, but has commitments of £0.7 billion and further potential commitment of £0.1 billion. UK aid programme (approximately £70 million a year) is small compared with others, but on the recent visit paid by Mr Patten the UK undertook to convert an aid loan given for the Maghara Coal Mine Project to a grant, providing Egypt has signed and was adhering to an IMF programme.

		1987	**1988**	**1989(f)**
GDP growth (per cent)		-1	2	
Inflation average (per cent)		25	30	
PSBR (per cent of GDP)		16	15	
Curent account deficit (per cent of GDP)		3.2	8.8	
Total External Debt (US$bn)		50	52*	
DSR	Due	109.8	108.6	
	Paid	35	39	
Interest	service ratio	35	39	

*includes military debt.

BRIEF NO 4(e)

HER MAJESTY'S TREASURY
IMF/IBRD SPRING MEETINGS 1989

MAJOR DEBTORS: MEXICO

Minister of Finance: Pedro Aspe ARMELLA
Governor of Central Bank: Miguel Mancera AGUAYO

Objectives

1. - To encourage Mexico to agree a new IMF adjustment programme

   - To discourage Mexico from seeking a financing package involving disproportionate contribution from official sector

   - To discourage excessive expectations from US proposals, and warn against brinkmanship.

Line to take

2. - Acknowledge substantial efforts already made by Mexico to tackle its economic problems.
   - Welcome decision to talk to IMF
   - Cannot agree to softening of IMF/IBRD conditionality
   - Cannot accept further transfer of risk to public sector nor pressure private banks to follow a particular course
   - Change in the cut-off date for Paris Club would lead to closure or reduction in export credit cover.
   - Hope Mexicans will put debt/equity schemes back onto menu.

Background

3. Inflation has been reduced considerably due to wage and price restraint and tight fiscal and monetary policy contained in the Economic Solidarity Pact in 1988, but has been rising since September and the rate in January was 2.4 per cent. The Pact for Economic Stabilisation and Growth (PECE), due to run from January to July 1989, is designed to consolidate progress. The 18 per cent

inflation target for 1989 is optimistic in view of growing frustration among business and labour, and public sector price rises at start of PECE. High real interest rates caused by the tight monetary policy rose yet higher in 1988 H2 due to concern over severe capital flight caused by political uncertainty and a rising real exchange rate. The latter, along with falling oil prices and import liberalisation, contributed to a sharp decline in the trade surplus from $8bn in 1987 to $1.5bn in 1988. Current deficit $3 billion. Reserves fell.

4. Capital flight increased sharply before Salinas inauguration on Dec 1 in anticipation of a devaluation judged necessary to restore dollar/peso relationship to its 1987 level. The announcement of a $3.5bn loan facility from the US Treasury stemmed capital outflows and there were new inflows in January and the first half of February. A crawling peg devaluation of one peso a day was part of the PECE. Salinas and Aspe know this is insufficient but a faster rate of depreciation is judged politically unacceptable. Cash flow problems could arise by early summer.

<u>Relations with IMF/IBRD</u>

5. An IMF mission currently conducting Article IV consultations will also discuss Mexico's request for an EFF and a CCFF. A CCFF of up to $600mn may be sought to compensate for the decline in the oil price. An SBA of 1.4bn SDRs was completed in March 1988.

6. Likely loan approvals from the IBRD total $1.3bn in 1989. The planned Agricultural Sector Loan ($300mn) would be fast disbursing. Other big projects could include Steel Sector Restructuring ($400mn), Fertiliser Sector Adjustment ($265mn), and Housing Finance ($300mn). Mexicans have expressed surprise at conditions attached to lending programme (ie satisfactory financial plans and compliance with present loans conditions, but essentially bank will not go forward until agreement reached with IMF.)

<u>Relations with commercial banks</u>

7. Commercial banks are to be asked to restructure $12.5bn of maturities falling due 1989-94; to provide either new money or interest capitalisation in a multi-year agreement, and to reduce the stock of debt and/or its interest rate. The Mexicans have said that debt/equity conversions will not be part of the menu. Mexico is keen to attempt a new debt-bond exchange similar to the Morgan scheme

of March 1988, but with interest payments guaranteed by the IBRD and/or creditor nations. However, talks have not yet begun with the Banks.

Relations with Paris Club

8. Paris Club is unlikely to agree to Mexican request for a MYRA with partial interest capitalisation. Aspe is likely to drop his request for a shift in the cut-off date from 1985 to 1988, if the US agrees to a bilateral rescheduling of post cut-off date CCC credits. ECGD had £680.8mn of exposure to Mexico as at 30/9/88.

Relations with UK

9. Aspe called on the Chancellor in February as part of a tour of western capitals.

Statistics

	1987	1988	1989 (budget forecast)
GDP growth (%)	1.4	0.4	1.5
Inflation annual (%)	131.8	125.6	25
PSBR/GDP	14.3	10.8	6.4
Current Account/GDP	2.9	-2.4	-3.4
Total External Debt (US $bn)	107.4	103.5	N/A
Debt Service (1)	84	79	N/A
Gross Interest Service (1)	22.7	25.5	N/A

(1) as ratio of goods and non-factor services.

Brief No 4(f)

HER MAJESTY'S TREASURY
SPRING INTERIM/DEVELOPMENT COMMITTEE
MEETINGS 1989

MAJOR DEBTORS: NIGERIA

Minister of State for Budget and Planning: Alhaji V.Hon Abubakar ALHAJI
Minister of Finance: Dr Chu OKONGWU
Governor of Central Bank: Alhaji Abdulkadir AHMET

1. <u>Objectives</u>

- To ensure that Nigeria maintains its adjustment policies under the IMF programme.
- To ensure banks take their share of 1990 et seq financing gap.
- To take credit for success of aid support group meeting and Paris Club rescheduling.
- To urge other donors to consider further commitments for Nigeria in the context of planned donor consultative group.

2. <u>Line to take</u>

i Welcome agreement with the IMF and the scale of courageous adjustment measures taken so far.

ii Vital to maintain adjustment policies, particularly exchange rate reform and control of budgetary expenditure. Over the medium-term, must improve the allocation of domestic resources, stimulate non-oil sector and follow more cautious financial policies to build up credibility and investor confidence, and stimulate much-needed inflows in the 1990s.

iii Important to check effects of measures taken and carry out regular reviews of the programme, to enable prompt implementation of offsetting measures if targets likely to be missed and/or oil price drops below $14.

iv **Worried that Paris Club rescheduling leaves unfilled gap of** $400 million in 1990. If necessary may have to approach banks, to re-open negotiations. Banks' attitude still untested and will depend on future of Brady proposals.

v (With other donors) continued assistance in next few years likely to be required. Donor consultative group later in the year. (With Canada) hope you can provide contribution for 1989 as indicated.

3. <u>Background</u>

Nigeria's request for an SBA received unconditional Fund approval on 3 February - after the UK took the lead in providing concessional finance and in co-ordinating support from other creditors. The 1989 target for donor finance was $600 million (including $100 million from UK). Signature of the draft agreement between Nigeria and the commercial banks is expected on 22 March, following to the clearing of interest arrears. A generous Paris Club rescheduling was achieved on 3 March, despite difficult negotiations because of complaints of unequal treatment from smaller creditors. The IMF agreement has also opened the way for disbursement of the World Bank's Trade and Investment Policy Loan ($500 million). This leaves a financing gap of approximately $400 million over 1989/90 to be filled by revenue from a higher oil price and/or increased donor support. Nigeria may need to re-open discussions with commercial banks. The IMF mission will return to Lagos at the end of March, and the first review of the SBA is due in April. Despite abandoning the foreign exchange action in favour of a supposedly free rate set daily the free rate is still 30 per cent below the black market rate. This however represents an appreciation by 9 per cent in the past week, since the black market rate dropped to N12.05 to the dollar on 24 February and was about N11 on 2 March against an official rate of N7.59 to the dollar.

New calculations by the US embassy in Lagos estimate inflation rate for urban middle class is now 53.4 per cent per annum, and inflation rate for rural areas is likely to be higher still. Real interest rates are substantially negative. Uncontrolled credit expansion fuelled inflation in 1988 and the authorities will have to monitor the situation closely in 1989.

4. **Latest progress on aid commitments**

The following table shows the latest position on donors' commitments.

	$ million
UK	100
FRG	40
EC	12
AFDB	100
Japan	225
USA	25
France	10
Canada	30 (may slip)
Saudi Arabia	N/K
TOTAL	542

A further $100 million Eximbank loan was expected in the next Japanese financial year but the Japanese are said to want others to provide more before committing themselves. Babangida did not ask for more balance of payments support when in Tokyo.

5. Nigeria's elibility for concessional lending and aid

IDA	Now eligible. Latest IDA 9 discussion paper indicates that SDR 150 million may be available under IDA 8 and SDR 650 million under IDA 9.
Toronto terms	If agreed to be IDA-only eligible could technically qualify under criteria for Toronto terms but Club very unlikely to agree. [GDP per head calculated at $370 by IBRD in March '88 before recovery in oil price.]

ESAF — Does not automatically follow IDA eligibility. Would cause major problems given size of Nigeria's quota and hence potential claim on ESAF.

6. <u>Statistics</u>

	1987	**1988**	**1989 (budget)**
GDP growth (per cent)	0.2	1.2	1.5
Inflation (per cent change over previous years)	9.7	33.0	22.0
Current account deficit (per cent of GDP)	3.8	6.2	9.7
Total external debt ($ bn)	27.7	29.4	29.2
Debt Service Ratio	72.6	84.7	79.3
Interest Service Ratio	27	30.1	N/A
PSBR (per cent of GDP)	-7.4	-11.4	-8.3

Brief No 4(g)

HER MAJESTY'S TREASURY

IMF/IBRD SPRING MEETINGS 1989

MAJOR DEBTORS : POLAND

DEPUTY PRIME MINISTER (Responsible for economic affairs):
Ireneusz SEKULA
MINISTER OF FINANCE: Andzej WROBLEWSKI
GOVERNOR OF CENTRAL BANK: Zdzislaw PAKULA

Objectives

1. To resist any idea that western countries should resume new lending to Poland before an IMF agreement is in place and there are clear signs of successful economic adjustment.

Line to take

2. Hope talks proceeding well with IMF. Prior measures and evidence of honouring debt service commitments will be necessary pre-conditions to IMF programme, as well as political consensus, on the need for economic adjustment.

Background

3. 1988 was a year of missed opportunity. Government intentions to remove subsidies and price controls were abandoned as a result of strikes in April and May. Government concessions led to substantial rises in real incomes of 14 per cent inflation for the year reached 74 per cent year on year in December. Real personal expenditure was up by 5.25 per cent and although hard currency exports increased by about 11 per cent imports also rose sharply in the last quarter (a 17 per cent increase over 1987) and the current account deficit remained the same in nominal terms.

4. The inability of the Messner government to implement its own reforms successfully led to the resignation of Messner and the appointment of Rakowski as Prime Minister in September. The new government immediately commenced working on a consolidation plan for 1989 and 1990; moreover, it agreed to enter into "round table" talks with opposition representatives including Solidarity. The preliminaries to the negotiations took a long time, but eventually on 6 February 1989, they began with Solidarity, OPZZ (the official unions' organisation), and other interested parties. The political group at the Round Table has produced a draft agreement on major political reform,including legislation of Solidarity and major electoral changes which will allow a place for the opposition in parliament. Nothing comparably far-reaching, however, has emerged on economic reform. There has been discussion on index-tying wages to inflation, abolishing the system (nomenklatura) under which the party appoints almost all industrial managers, and a consensus seems to be emerging on the need for the West to provide economic help to support domestic reform. The government has begun to introduce a host of economic reforms in 1989, but meanwhile economic prospects look no better. No sign of inflation coming down; forecast 850 million current account deficit in 1989. Budget deficit was 200- 250 million zlotys in 1988 (because of failure to reduce subsidies).

5. A balance or surplus on the current account is still considered well within Poland's capability, and is likely to be an IMF programme target. The Poles argue that imports cannot be further restrained without reducing growth and have already hinted that they will be looking for a resumption of export credit from the West once they have signed with the IMF (see brief No 7). FRG in particular is reported to favour 'some coordinated economic action' by Western Countries. The Foreign Ministry have said that the natural framework for further loans was an IMF Standby Arrangement. Those with influence should be urging Camdessus to take early and favourable action.

<u>Relations with IMF/IBRD</u>

6. The Poles have now asked the IMF to draw up a programme. They are looking at the removal of restrictions on foreign investment, exchange rate reform and possibilities for joint ventures. Because of the Poles' poor past performance any programme is likely to contain major requirements for prior actions;

political acceptance of the need for economic adjustment will also have to be demonstrated, and it is unlikely that agreement can be reached in the first half of this year.

Relations with Banks

7. A two stage MYRA negotiated in 1987 was signed in 1988 with the interest rate reduced to 13/16 from 15/16 over LIBOR after the Poles had claimed comparability with Yugoslavia. The Poles have remained current on interest to the banks.

Relations with Paris Club

8. The Poles' attempts to renegotiate past Paris Club agreements and secure a concessional rate of interest in bilateral agreements under the 1987 rescheduling were unsuccessful. The new Polish negotiator, Sawicki, after a tour of G7 capitals, has accepted that bilateral agreements specifying interest at the appropriate market rate must be signed before an IMF programme can be agreed. No official creditor has received any payments under the 1987 rescheduling. Trichet asked Mulford to ask Secretary Brady to raise the Paris Club impasse at the G7 meeting.

Relations with UK

9. A date has been agreed in April for signing the UK bilateral. The Prime Minister's visit took place in November after two postponements. She said then that political reform was an essential precondition of economic reform. Jarulzelski is to make a return visit to the UK in May.

Statistics

	1987	1988
GDP growth (percentage change over year earlier	2.0	5.0
Inflation (percentage change on previous year)	25.2	73.9
PSBR (per cent of GDP)	0.1	0.1
Current account (per cent of GDP)	-0.7	-1.3
Total external debt (US$bn)	39.2	39.2
Debt service ratio (per cent)(1)	38.2	34.7
Interest service ratio (per cent)(1)	35.5	42.2

(1) credits to the socialised sector

Brief No 4(h)

HER MAJESTY'S TREASURY

IMF/IBRD SPRING MEETINGS

MAJOR DEBTORS: VENEZUELA

Minister of Finance: Sra Eglw ITURBE DE BLANCO

UK Objectives

1. Encourage authorities to maintain adjustment programme despite recent protests and bloodshed as the only long-run answer to Venezuela's problems.

2. Discourage CAP from seeking collective G8 initiatives to debt problems.

3. Minimise transfer of risk from private sector to official sector in dealing with current crisis in Venezuela.

4. To ascertain how far the US consider debt reduction appropriate for Venezuela.

Line to take

5. Commend broad outline of reforms announced by Government on 16 February. Deeply regret casualties in riots protesting against these reforms. Note Venezuela's intention to implement new welfare measures specifically targeted at the poor. Glad to hear talks progressing well with the Fund. Welcome signature of letter of intent. But even if Fund programme approved soon, adjustment will require continued commitment to sound macro and structural policies. Essential to persevere despite difficulties.

Background

6. Loose fiscal policy ahead of the election and a surge in imports from consumer demand encouraged by low interest rates and high exchange rates lead to balance of payments deficit of $4.5 billion last year. On 16 February the new government led by Carlos Andres Perez announced a major package of structural reforms, including the establishment of a single floating exchange rate

(implemented on 14 March), more realistic interest rates, fiscal restraint, tariff reform and price liberalisation. The increase in domestic petroleum prices provoked riots across the country, which were badly handled by inexperienced police. Estimates of casualties vary from 250 to 600 people killed.

Relations with the IMF/IBRD

7. On 28 February Venezuela signed a Letter of Intent requesting the purchase of SDR 343 million, equivalent to the first credit tranche of Venezuela's quota as a first step towards an Extended Fund Facility (perhaps preceded by a Standby Arrangement). Board will consider on 29 March. Camdessus wishes to propose that the draw down of the first credit tranche be approved even if critical mass has not been reached on a financing package. This would mark the first case following the announcement of the Brady proposals that the IMF has proposed disbursing into a financing gap. Venezuela expected to seek a total of $3 billion in 1989 from IMF, IADB, and IBRD. To comply with the terms of the MYRA agreed with commercial creditors in 1983, Venezuela had an enhanced surveillance arrangement with the IMF involving six-month policy reviews but no IMF lending. This arrangement did not work well, and there were serious disagreements between the IMF and the government. As a result of declining per capita GDP, Venezuela became eligible for World Bank lending in 1987 and a trade policy loan is under negotiation.

Relations with commercial banks

8. The banks' advisory committee endorsed suspension of principal payments on public sector debt while negotiations on a rescheduling and $2 billion new money take place. Since the beginning of February interest arrears on commercial bank debt have built up because of an estimated cash flow shortage of $600 million in the first quarter of the year. The Government has announced that maintenance of interest payments will depend on inflows of bridging finance. A total of $1.8 billion is being sought: $1.2 billion from governments and $600 million from the banks. The US Treasury has agreed to provide $450 million and Spain $350 million. UK has so far not been asked to participate in the bridge: British banks' exposure in Venezuela is about 8 per cent of total bank debt.

Relations with Paris Club

9. Venezuela has never rescheduled Paris Club debt and it is not clear that this will be necessary or whether a request will be made. Paris Club debt forms a small part (under 10 per cent) of total external debt.

Relations with UK

10. Last August the EGC improved an increase in the limit from £50 million to £200 million. Total exposure remains low, and ECGD's offer of cover for £80 million contract for Scorpion tanks was not taken up before the expiry date. A request in late February for the expiry date to be extended has been refused. Bilateral relations have improved since the Falklands War, when Venezuela suspended an order from the UK for aircraft. Venezuela has since cooperated with the UK in a drugs eradication scheme, and Mr Eggar attended President Perez's inauguration.

Statistics

	1987	**1988**	**1989 (f)**
GDP percentage growth	3	4.2	-0.3
Inflation - annual rate	40.3	35.5	35.5
- average	28.1	29.5	NA
PSBR (per cent of GDP)	5.6	6.3	3.0
Current Account (per cent of GDP)	-2.6	-8.1	-4.7
External debt ($bn)	34.4	33.6	37.7
Debt service (1)	44.6	47	54.5
Interest service (1)	25.5	28.0	32.8

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(1) as ratio of goods and non-factor services

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Brief No 4(i)

HER MAJESTY'S TREASURY

IMF/IBRD SPRING MEETINGS 1989

MAJOR DEBTORS: YUGOSLAVIA

Minister of Finance: Branco ZEKAN
Head of National Bank: Dusan VLATKOVK

Objectives

1. Stress importance of political commitment to sustained economic adjustment.

Line to take

- Welcome turn round in external account in 1988.

- What are prospects for 1989? When will Yugoslavs meet Fund to discuss follow on SBA?

- Important to bring inflation down.

Background

2. Performance under the IMF SBA, approved mid-June, has been mixed. External performance exceeded expectations but the domestic situation, and in particular inflation, significantly deteriorated.

3. External performance was marked by strong export growth, supported by the real devaluation of the dinar and increased pressure on enterprises to export goods that could no longer be sold on the stagnating home market. Imports, though consistently higher in 1988 than in 1987, rose at a slower rate than was anticipated following liberalisation of the import regime, and together with high invisible inflows (earnings from tourism exceeded $2bn in 1988), the convertible currency current account in 1988 topped $2bn. Foreign exchange reserves rose significantly. The domestic economy continued to stagnate in 1988, with GSP falling by 2% in comparison with 1987, the first time since the War that a fall in production has been registered in two successive years. The fall in

agricultural production was 3.3 per cent and in industry 1.2 per cent. Inflation has continued to rise, reaching a December on December price increase of 251 per cent for 1988 (compared with 170 per cent for 1987), and 346 per cent by end February 1989; estimated to reach 900 per cent for the year by the end of the year unless checked.

4. Economic problems, together with enormous ethnic tensions, to which the government appeared to have no answers, led to the resignation of Prime Minister Mikulic and his administration on 30 December 1988. Though some economic reforms have recently been passed by the Federal Assembly, tough appropriate measures, to reduce nominal expenditure, curb monetary expansion and bring down inflation, are in limbo until the new government, with Ante Markovic as Prime Minister, has decided its policies. Supporting legislation still to be passed.

Relations with IMF/IBRD

5. Negotiations with the IMF on new targets and the revival of the stalled SBA are also waiting on the new government. Until agreement is reached Yugoslavia is ineligible to make drawings under the third and fourth tranches of the SBA.

Relations with Paris Club

6. The Paris Club agreement signed in May 1988 covered principal and interest and PRD falling due to the middle of 1989. All bilaterals were signed by the date specified and the Yugoslavs are current on payments.

Relations with Commercial banks

7. The commercial banks' agreement, covering all maturities (some $7bn) up to end-September 1996 (over 18 years with 6 years grace) was signed in September 1988. Interest payments under it are all current. The National Bank reported (20 January 1989) that external debt stood little over $20bn, and that all obligations were being met fully and on time. (The BIS bridging loan was repaid early and was largely undrawn.)

Relations with UK

UK bilateral under the 1988 Paris Club Agreement was signed in January.

Statistics

	1987	1988
GSP growth (percentage change over year earlier)	- 0.5	- 0.2
Inflation (percentage change on previous year)	**170.6**	**251.2**
Public sector surplus (per cent of GSP) (1)	0.2	0.1
Current account (per cent of GSP)	1.6	3.3
Total external debt (US$ bn)	20.0	21.0
Debt service ratio (per cent)	28.8	25.4
Interest service ratio (per cent)	13.2	8.8

(1) the state runs a nominally neutral fiscal policy

5

BRIEF NO 5

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

ROLES OF THE FUND AND THE BANK

Objectives

1. i. To express concern at recent public failures in Fund/Bank co-operation in operational matters.

   ii. To stress vital importance of full agreement on consistent policy advice to all individual borrowers.

   iii. To press for swift practical steps to ensure close working relations at operational, senior staff and executive director level.

   iv. To remind fellow Governors of their own responsibilities in ensuring consistent signals are sent to both Boards.

Line to take

2. i. Publicised disagreements between Fund and Bank are to the advantage of no-one. They undermine the authority of the institutions' policy prescriptions, send confusing signals to debtors, and undermine the common objectives of securing orderly adjustment as the basis for growth.

   ii. Bank and Fund must co-operate, not compete. This means avoiding unnecessary and wasteful overlap whenever possible, and recognising and drawing on the complementary specialisms of the two institutions.

   iii. The Fund has prime responsibility for the macroeconomic framework, ie fiscal, monetary and exchange rate policy, including interest rate policy (these instruments are in practice the main means of attracting back flight capital), and all measures intended for short-term stabilisation. Especially in poorer countries, structural reforms are an integral part of Fund programmes in order to achieve external viability.

iv. The Bank's prime responsibilities are for long-term development, which includes public sector investment, private sector development, deregulation of markets, agriculture, international trade, individual subsidies, training etc. Measures in these areas can affect certain aspects of fiscal policy (eg elimination of government subsidies, broadening the tax base).

v. Allocating prime responsibility for different areas does not eliminate the need for both institutions to take a view on some areas. Close co-operation is vital whenever, as is often desirable, economic adjustment and structural reforms support one another; or where shorter and longer run objectives impact on, or even conflict with, one another.

vi. Where there is a disagreement, the presumption remains that the institution which does not have prime responsibility gives way. If the disagreement persists the matter would have to be referred to the relevant Board.

Background

3. The overlap between the Fund and the Bank has increased recently. But for much of the post-war period the division was relatively clear:

- the IMF's primary concern was in the macroeconomic area; its role involved the provision of short-term loans at near market rates, tied to appropriate macroeconomic policy changes, for countries (both industrial and developing) in temporary balance of payments difficulties.

- the IBRD's role from the 1950s was that of a development funding agency, providing longer-term finance, at both market and concessional rates, mainly to developing countries, to fund new projects.

4. Areas of overlap have however been growing in recent years as:

i. the IMF's lending to developing countries has increased and it has turned its attention increasingly both to the medium-term and to structural as well as macroeconomic issues; the trend was reflected for example in the establishment of the 3-year Extended Fund Facility (EFF) in the mid-1970s; EFF disbursements grew from $100 million in the late 1970s to over $4 billion in 1984. (Although it fell into abeyance after 1984, new EFF programmes are now starting to come forward again).

ii. the Bank expanded its policy-based lending, in response to the acute balance of payments constraints and growing recognition that fundamental policy changes (for instance the deregulation of business and agriculture) were essential in many developing countries; loans tied to policy changes increased from about $400 million in 1980 to nearly $5 billion in 1988: about 25 per cent of total loans approved in that year.

5. The overlap increased further with the establishment in 1986 of the IMF's <u>Structural Adjustment Facility (SAF)</u>, a concessional medium-term facility designed to finance structural as well as macroeconomic reform in low-income countries. The SAF, and now the enhanced SAF(ESAF) have much the same purpose as the structural adjustment lending (SALs) now undertaken by the World Bank (SAF-eligible countries are indeed defined as IDA-eligible countries).

6. For low-income sub-Saharan countries applying for a SAF or ESAF, the PFP <u>process</u> - under which strategic Policy Framework Papers incorporating plans for both macroeconomic and structural reforms are jointly agreed between Fund, Bank and the government concerned - provides a needed discipline which generally results in reasonably close collaboration.

7. But there is no parallel arrangement for <u>middle-income countries</u> although there is the same need for a strategic medium-term plan, drawing together both macroeconomic and structural reform.

Recent Problems

8. This has led to a series of recent rows, many of them public, between the two institutions. Co-operation has been shakiest on individual country issues,

notably on macroeconomic conditionality, arrears and the assessment of financing requirements. Major problems include:

i. in Argentina the Bank agreed Trade Policy and Banking Sector loans in the absence of a Fund programme and in the face of serious concern in the Fund Board. The UK voted against. There is still no Fund programme, and the Bank has humiliatingly had to suspend programmed disbursement of the second tranches recently, following Argentina's failure to meet the loan conditions.

ii. The Bank has also lent to Honduras in similar circumstances.

Other signs of strain include:

iii. In Tanzania widely divergent assessments by missions became known to the Tanzanians themselves.

iv. In Guyana the Bank proposed clearance of Bank arrears before Fund arrears without first seeking the Fund's agreement.

v. In Zambia the Bank has opposed the establishment of a support Group because Zambia is eligible for the Bank's own SPA (Special Programme of Assistance).

vi. Attempts by the Fund and Bank to agree a joint paper on responsibilities have resulted in a large measure of agreement, but entrenched differences remain on how to define the prime responsibility of each institution reflecting the Bank's reluctance to defer to the Fund on macroeconomic issues. For its part, the Fund has handled the dispute very badly.

Improving Fund/Bank collaboration

9. G10 deputies, under the chairmanship of Dini (Banca d'Italia) have largely agreed a report listing the practical steps which need to be taken to improve matters (with all of which we agree). It will be finalised for Ministers after the Spring Meetings. Under this threat, Fund and Bank staff have at last begun to face the issues, and have produced a series of papers, which continue to reveal differences of view (see 8 vi above). These reflect not only the

personalities involved and the increasingly similar nature of some Fund and Bank operations, but also the strong resistance to any apparent cross-conditionality between the two institutions.

10. However a consensus in G10 and the two institutions is beginning to crystallise around some useful operational steps (joint committees at various staff levels, joint missions, staff exchanges, joint research etc).

11. There is now growing support in G10 and the two institutions for the extension of the PFP, or similar process (see paragraphs 6 and 7 above) to Middle Income Countries (first proposed by the Chancellor at the 1988 Spring meetings when it was suggested only for countries with an EFF. We would now aim for PFPs for all countries with Fund programmes which are also negotiating policy-based loans at the Bank). There is also a useful proposal to increase the exchange of information on forward operational plans (loans, missions etc) in individual countries.

12. One area for which shareholders must accept some responsibility is the tendency for capitals to send conflicting messages to the two Boards. We are urging the benefits of appointing a single ED to both boards (as do UK, France and Belgium). Others send a Finance Ministry official to the Fund and an Aid Ministry official to the Bank. We are also pressing for greater contacts between the two Boards.

13. However the key issue is that the understanding on the institutions' prime responsibilities listed in 2(iii) and (iv) respectively is upheld, and that any attempts to fudge or dilute the allocation of these key roles is rejected.

6

BRIEF NO: 6

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

ARREARS AT THE IMF AND WORLD BANK (INCLUDING THE ROLE OF SUPPORT GROUPS) WITH ANNEXES ON GUYANA SUPPORT GROUP AND BURDEN SHARING

Objectives

1. i. To underline seriousness of arrears situation and hence ensure that very high priority continues to be given to its resolution.

ii. To endorse strategy of avoiding new arrears cases by further improving the design and implementation of Fund programmes, consistent with strong adjustment and including a better assessment of the members' capacity to repay.

iii. To reduce the number of existing cases as quickly as possible by promoting enhanced collaboration with members willing to co-operate and adjust ("the carrot"); to adopt strong remedial measures to isolate recalcitrant members ("the stick").

Line to take

2. Stress to non-arrears developing countries that arrears increase the cost of using Fund resources (and could in the long-run restrict access by diminishing the pool of these resources).

3. Emphasise need for all arrears countries, in their own interest, to "regularise" their payments to the Fund and Bank: initially, by maintaining a regular pattern of payments; then meeting current obligations, then as soon as possible clearing arrears according to an agreed timetable.

4. Stress that if countries do not tackle arrears, problem becomes more intractable the longer it is left.

5. Note that IFIs and donors stand ready to mobilise exceptional assistance in support of exceptional adjustment. Recognise potential role for Support groups to mobilise such assistance (but only to be established once PFP has been agreed and there is full commitment to vigorous adjustment). In mobilising concessional aid the Support Group role must be seen as complementing existing World Bank chaired consultative groups.

6. Emphasise usefulness of a shadow programme, in the form of a "Fund-monitored programme" (FMP), the norm for which should be 12 months. Stress need for members to meet current repayment obligations during period of FMP.

7. Welcome MD's adaptation of Chancellor's proposal for backdated access to ESAF resources, in helping members to return to normal relations with the Fund.

8. Confirm that UK is prepared to accept sequential clearance of arrears to Fund and Bank if this significantly eases the financing package.

9. Best way to avoid new cases is through strong Fund and Bank programmes, incorporating careful assessment of members' capacity to repay.

10. More stringent action needs to be taken for countries that are unwilling to deal with their arrears problem - including the freezing of quota increases at the Fund, and the withdrawal of technical assistance.

11. The Fund and Bank also need to co-operate closely

- The Bank should continue to apply its policy of not making new structural adjustment loans, or disbursing tranches to existing ones, to countries where the macroeconomic framework is not in place - taking fully into account whether a country has arrears to the Fund.

- equally the Fund should take fully into account any Bank arrears before approving new programmes or disbursing its resources.

Background

12. At the Interim Committee meeting last September, the Executive Board was asked "to pursue its work on the modalities of this cooperative approach and to report back to the Committee at its meeting in April 1989".

13. This "intensified collaborative approach" was designed to tackle the problem of large and protracted arrears to the Fund. It is essentially a phased approach, both because of the need for the country concerned to establish a track record, and because of the difficulties of mobilising the large financing needed to clear arrears. The idea of "Support Groups" emerged as a means of mobilising such exceptional finance, to be combined with exceptional adjustment efforts from the country concerned.

14. The first stage would be to agree an outline programme which is endorsed by the Fund (a PFP in SAF/ESAF eligible countries) and Bank. This would be followed by a full "Fund monitored programme" (FMP) which would be endorsed by the IMF Board and would only differ from a formal programme insofar as it would not involve any commitment of IMF funds. The Board could, however, at the time note the MD's intent to recommend commitment of a specific amount under a subsequent arrangement provided that the FMP targets were fully met. It is envisaged that the length of FMPs programmes should be at least 12 months, but with some flexibility in individual cases. In return, the Support Group would aim to mobilise the essential financing to cover imports and debt service obligations over the period of the shadow programme to support the necessary economic reforms. It would establish a timetable for action, identify the financial requirements (both for import cover and debt-service payments during the life of the programme and for clearance of arrears prior to the full programme, if necessary by bridging) and sources. It would co-ordinate its activities with other established groups such as the Paris Club, World Bank consultative groups and commercial banks advisory committees.

15. Support groups should complement rather than duplicate the work of other groups. The World Bank consultative group would remain the primary focus for mobilising development assistance; the Support Group's role would be to develop a strategy to co-ordinate and tackle the clearance of arrears.

16. Chairmanship of the group for a particular country would be decided on a case by case basis, although it is expected that countries with strong bilateral

political links would lead on specific countries. Although there is no formal commitment on countries who chair a support group to provide large aid contributions, there is likely to be considerable pressure to do so. Hence the UK has taken a cautious line on creating support groups and an even more cautions line on any suggestion that we should chair one despite our strong bilateral links with some of the most difficult arrears cases (particularly Zambia).

17. The Guyana Support Group has involved a substantial commitment of staff resources by the Canadians as Chairman: in any future cases Fund and Bank staffs should provide much of the technical analysis. We favour a wide membership of support groups to facilitate the burden sharing and to reinforce the point that the solution to the arrears problem is a concern of all parties.

18. Arrears at the Fund and Bank continue to grow and new cases arise from time to time. The amount of IMF arrears as a percentage of Fund credit outstanding has risen by 70% a year for the last three years.

bn SDR

	Dec 85	**Dec 86**	**Dec 87**	**Dec 88**
1. Arrears	0.62	1.04	1.75	2.61
2. Fund credit outstanding	35.2	33.3	28.8	24.8
1. as a % of 2.	1.8%	3.15%	6.1%	10.5%

19. Arrears are almost three times as large at the IMF as at the IBRD. They are concentrated in four countries (Zambia, Sudan, Liberia and Peru account for about 80 per cent). At the IBRD the top four (Peru, Syria, Nicaragua and Zambia, account for about 70 per cent of arrears). Eleven countries at the Fund and twelve at the IBRD are one month or more in arrears for more than $10m. The current total arrears position is summarised in the tables below.

Arrears at end December 88 (IMF, IBRD, IDA)

$million (1SDR = $1.34 @ end December 1988)

	Total	**of which overdue 6 months or more**
IMF	3500	2876
IBRD	1227	796
IDA	20	12
TOTAL	4747	3684 (78%)

20. The amount of arrears as of 27 February 1989 as a percentage of quota for the main cases at the IMF were:

Million SDRs

	(1) Arrears	**(2) Quota**	**(1) as % of (2)**
Sudan	734	169.7	433
Liberia	250	71.3	351
Zambia	609	270.3	225
Guyana	89	49.2	181
Peru	537	330.9	162
Somalia	62	44.2	140
Kampuchea	33	25.0	132
Panama	104	102.2	102
Sierra Leone	55	57.9	95
Vietnam	101	176.8	57
Zaire	100	291.0	34

21. The amount of arrears and other relevant indicators are shown for all the main arrears cases in the table overleaf.

COUNTRIES IN ARREARS TO THE IMF,IBRD AND IDA: LATE 1988

COUNTRY	TOTAL ARREARS $M	ARREARS/ EXPORTS %	ARREARS TO: IMF $M	IBRD $M	IDA $M	EXPORTS OF GOODS & SERVICES $M	INTEREST SERVICE RATIO %	DEBT/ EXPORTS	SPA STATUS	GNP PER CAPITA $ 1987
Guyana	154	59	119	35 *		262 a	12.2	2.8 a		380
Haiti	9	2	9			430	3.5	1.6		360
Honduras	30	3	10	21 *	0 *	994	15.3	2.8		780
Kampuchea	44		44							
Liberia	382	88	331	49 *	3 *	433 b	10.9	2.4 b		440
Panama	246	4	148	98 *		5910	4.8	0.6		2240
Peru	1140	32	725	415 *		3588	27.2	3.9		1430
Sierra Leone	82	54	76	4 *	2 *	153 b	10.5	3.0 b	ei	300
Somalia	84	73	83		1	116 a	35.3	17.9 b	eu	290
Sudan	975	137	975		0	712	55.0	11.6	ei	330
Vietnam	136		136							
Zaire	145	8	145			1930	21.0	3.8	e	160
Zambia	955	100	816	135 *	4 *	955	23.0	4.6		240
Argentina	59	1		59		8599	41.5	5.9		2370
Colombia	3	0		3		7720	17.0	2.0		1220
Congo	4	0		3	0	1045	27.4	3.5		880
Costa Rica	11	1		11	0	1503	17.5	2.6		1590
Cote d'Ivoire	9	0		9		3624	19.7	3.2		750
Dominican Rep.	1	0		1	0	1668 b	12.0	1.7 b		730
Ecuador	8	0		8		2383	32.7	3.8		1040
Egypt	18	0		18		11735	10.4	3.0		710
Guatemala	2	0		2		1172	15.5	2.1		940
Jamaica	5	0		5		1692	14.2	2.1		960
Morocco	4	0		4		5424	17.3	3.5		620
Nigeria	26	0		26		7782	23.3	3.3		370
Senegal	1	0		1	0	1290	9.5	2.4	e	510
Tanzania	2	0		1	1	449	40.0	9.1	e	220
Turkey	24	0		24		16454	13.6	1.9		1200
Nicaragua	143	48		139	4 *	297 b	102.4	17.6 b		830
Syria	156	6		153	3 *	2457	6.5	1.5		1820
Benin	0	0			0	211	18.0	4.4		300
Cameroon	0	0			0	2120	8.6	1.6		960
Guinea	0				0				e	
Guinea Bissau	0	1			0	24	45.4	16.4	e	170
Uganda	1	0			1	372	9.4	3.0	e	260
TOTAL	4858		3615	1223	20	93504				

NOTES TO TABLE

* Countries with non-accural status; disbursements suspended
a = 1985
b = 1986

Col. 1 The sum of cols. 3,4,5

Col. 2 Col 1/Col 6

Col. 3 Data drawn from Selected Data on Commitments as at the Close of Business February 23 1989. SDR figures converted to $ at end-January rate ($1.31 per SDR) . Overdue Financial obligations include repurchases, charges, and assessments in the General Resources Account, net SDR charges, repayments and interest on Trust Fund and SAF loans, and special charges

Cols. 4,5 Data drawn from SecM89-20 and IDA/SecM89-2 respectively. Figures are overdue service payments (excluding those overdue for less than 30 days)

Col. 6 Export of Goods and Services (on balance of payments basis). From World Debt Tables, 1988/9 edition

Col. 7 Interest due on Total Long-Term debt for 1988 as projected in the World Debt Tables 1988/9 edition.

Col. 8 Total public and publicly Guaranteed long-term debt outstanding/ Exports of Goods and Services. From World Debt Tables 1988/9 edition.

Col. 9 Special Program for Africa countries are identified as e = eligible; eu = eligible under review; ei = currently ineligible.

Col. 10 Data drawn from the 1988 World Bank Atlas

ANNEX A

GUYANA SUPPORT GROUP

Objectives

1. i. To stress that UK attaches great importance to Guyana implementing a Fund programme and clearing arrears.

ii. To underline the extremely helpful precedent that this will set as an example of a country able to get back on board with IFIs (though precise financing arrangements will of course vary from case to case).

iii. To underline the UK's substantial aid contribution to the financing package.

Line to take

2. Welcome Guyana's commitment to economic reform.

3. Recognise the importance of moving ahead quickly to a Fund-monitored programme (FMP) now expected in early April.

4. Support Group (chaired by Canadians) has made good progress and Canadian efforts should be applauded.

5. Emphasise that donors have made exceptional efforts to enable Guyana to cover its financing gap over 1989-91. UK contribution £12 million of new fast spending programme aid over 1989-91, to be increased to £13.7 million if other donors make comparable efforts. (But financing for other Support Group cases will depend on the circumstances in each individual case).

6. Underline the importance therefore of Guyana fully implementing all measures agreed in the adjustment programme.

7. Stress that donor confidence, vital to medium-term viability, will depend on Guyana's performance.

Background

8. Guyana has been experiencing considerable economic difficulties since the 1970s and accumulated arrears to the IMF and World Bank in the 1980s. It has been in arrears to the IMF since April 1983. More recently, Guyana has begun to tackle its economic problems. It has now become a test-case for the new arrears strategy.

9. Agreement was reached in July 1988 with the IMF and World Bank on a Policy Framework Paper (PFP) which outlined the structure of a medium-term economic reform programme. The main obstacle to restoring normal financial relations with creditors in Guyana's case (and other arrears cases) is the need to clear arrears with the IMF and World Bank before any new fund programme involving disbursements could be made.

10. However there was early limited progress in mobiling the finance necessary for this. A Support Group was therefore established in November, chaired by the Canadians, to mobilize finance for the period 1989-91, including funds necessary to enable arrears to be cleared.

11. The key roles of the Canadian led SG was to identify sources of finance to fill the projected balance of payments gap, estimated in Guyana's case at around $160 million over the period 1989-91. These sums have now been substantially found: the main sources being rescheduling by Guyana's largest creditor, Trinidad and Tobago together with substantial IFI and bilateral donor contributions.

12. The Letter of Intent has now been signed and it is envisaged that the programme will be brought to the Fund Executive Board early in April for approval. Once the "Fund-monitored programme" has been agreed the next steps will be a Paris Club rescheduling which is likely to take place in April or May, (the Club has been unable to reach a consensus over Guyana's eligibility for Toronto term (see brief 3(ii), bilateral disbursements on the basis of Fund endorsement of the programme, a Fund review after 6 months both to evaluate the progress made in meeting performance criteria and to examine in more detail the means of clearing arrears prior to disbursements of IFI resources. However, there are still one or two outstanding difficulties.

13. These centre around the cash-flow problems in 1989 and the phasing of the donor commitments which have been pledged. In the first year of the programme, arrears to the IFIs amount to around $180 million compared with initial disbursements from the IFIs sum to only around $132 million. This leaves a shortfall of around $50 million which can be reduced to around $40 million by targeting a lower level of reserve accumulation in 1989 than originally envisaged. The Canadians propose that the remaining gap be filled by donors providing a medium term bridge into the finance that they intended to provide over the rest of the 3 year period. They have approached the US, UK, Japan and Germany to join in such a bridge. They set a deadline of 20 March for replies.

14. We do not expect this deadline to be have been met by others (and we were unable to meet it ourselves). In this case the Canadian Minister of Finance (Wilson) will write to his colleagues before the Interim Committee, requesting their agreement to join in a medium term bridge, and saying that unless this is settled at the Interim Committee, the Canadians will give up the chairmanship of the Support Group. A separate submission will be prepared on this before the Interim Committee.

ANNEX B

ARREARS TO THE IMF: BURDEN-SHARING

1. The burden-sharing arrangements at the IMF are designed to divide equally between the Fund's creditors and borrowers, the cost of:

i. making up the shortfall in the Fund's income resulting from arrears on Fund charges (ie the interest on Fund lending)

ii. building up a "Special Contingent Account" (SCA), in addition to the accumulation of reserves which the Fund finances every year from its general income.

2. Quarterly adjustments are made to the rate of remuneration to creditors and the rate of charge to borrowers to generate equivalent sums from each group. So, the existence of arrears results in real costs to borrowers - an important point to emphasise. The adjustment to the rate of charge is currently 0.92 per cent (somewhat greater than the typical adjustments of between 0.5-0.7 percentage points over the last 2 years):

	Basic rate	Adjustment	Adjusted rate
Rate of charge	7.38	0.92	8.30
Rate of remuneration	7.39	0.86	6.53

3. There is however under the arrangements a floor of 85 per cent of the SDR interest rate to the downward adjustment which can be made to the rate of remuneration. The increase in the SDR interest rate has meant that more resources can be generated without breaching this floor. So it has still been possible to cover deferred charges, even though these have been increasing. But if major new arrears cases arise, this might no longer be possible. This would mean either

- that any sums which could not be equally shared between creditors and borrowers would have to be borne by borrowers, through further adjustments to the rate of charge

- alternatively, if equal-burden sharing were to be maintained, a lowering of the floor (for instance to 80 per cent) - the minimum allowed by the Articles).

4. The sums generated by the burden-sharing arrangements (with projected figures for FY1989) are (SDRmn):

	FY 1987	**FY 1988**	**FY 1989**
Deferred Charges	181.7	154.1	194.5
SCA	28.0	60.6	74.6
	209.7	214.7	269.1

5. The cost of burden-sharing to individual creditors depends on the use made by the Fund of their currency in its lending operations, and specifically the amount on which they receive 'remuneration' (a portion is not remunerated at all - the unremunerated reserve tranche - and is thus not affected by a reduced rate of remuneration). Figures for 1987 are (in SDR mn, assuming average adjustment of 0.5 percentage points):

	Remunerated Reserve Tranche	**Cost of burden sharing**
US	6459	32.3
UK	702	3.5
Germany	2372	11.9
France	1026	5.1
Japan	1368	6.8

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BRIEF NO 7

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

AID, INCLUDING GLOBAL AID FLOWS AND UK AID PROGRAMME, PRIVATE DIRECT INVESTMENT FLOWS AND BANK FLOWS (INCLUDING STATISTICS ON PERCENTAGES OF GNP)

<u>Objectives</u>

1. i. To focus discussion on ways of improving investment climate in developing countries.

   ii. To present the volume and quality of UK aid in the best possible light.

   iii. To encourage better use of aid by developing countries.

   iv. <u>Defensive</u>: to resist any suggestions that might lead to increases in British aid.

<u>Line to take</u>

2. IBRD estimates of total net resource flows for 1987 reveal a real terms fall of 5.1% with only a small nominal increase (from US$82 billion in 1986 to $89.1 billion in 1987).

3. Clear that in recent years official development assistance (oda) has replaced private flows as principal source of development investment. Important to rebuild right investment climate. As President's report says, "an essential part of this effort is the necessity for developing countries to provide a receptive and productive environment for these resource transfers." Britain has strong record on private direct investment (see paragraph 5).

4. A number of recent positive developments: increasing numbers of countries following internationally-agreed programmes of economic reform (cf brief no 20); 85% increase in total net direct investment between 1986 and 1987 (see table 5);

forecasts of 2% real terms increase in oda in coming years; growing awareness of the need to differentiate between developing countries.

5. Britain playing a significant role both in international initiatives - ESAF, debt - and in aid programme. In the period 1983-87 total UK direct investment in developing countries was almost the same as the total for the rest of EC (see table 2). Aid programme substantial (1988/89 £1387 million: 1989/90 £1430 million), of high quality, and growing in real terms. Bilateral aid focussed on the poorer countries.

6. Defensive: fall (from 0.31% in 1986 to 0.28% in 1987) in Britain's net oda measured as a proportion of GNP reflected the strong growth in Britain's economy in 1987 and the fact that in the financial year 1987/88 a larger than usual proportion of spending took place in the final quarter. Estimated figure for oda in 1988 is 0.29% of GNP. The British net aid programme, using an 1988/89 price base, showed a small real increase between 1982/3 and 1987/8.

Background

7. More and more aid is being untied from donor procurement (eg through co-financing with World Bank). Encouraging trend, speeds up disbursement and gives receipients more opportunity to get best value for money. We have agreed to untie 50% of our own pledge to the co-financing initiative ie £125 million over the three years 1988-90.

8. Total net resource flows (official and private) are estimated to have increased in current dollar terms from $82 billion in 1986 to $89 billion in 1987, which is, however, a decline in real terms of 5.1 per cent. Last three years have seen steady growth in the element in these figures of direct investment (see table 5). Total aid from DAC countries (as defined by the OECD) rose in current dollar terms from $36.7 billion in 1986 to $41.5 billion in 1987, a fall of 2% in real terms. However, principally because of the current rapid growth of Japanese aid, total aid flows are likely to increase in coming years.

9. In recent years oda has replaced private flows as principal source of development investment. Private flows constituted 51.6 per cent of total net disbursements to developing countries in 1980 and only 34.3 per cent in 1987.

10. Britain's aid programme is planned to grow in real terms over the next three years. Published allocations are:

	£m, current prices	
1988/89	1387	(estimated outturn)
1989/90	1430	
1990/91	1513	
1991/92	1574	

11. Britain has accepted the UN targets of 0.7 per cent of GNP for net oda and 0.15 per cent of GNP for aid to LLDCs in principle, but like many other major donors have not been able to set a timetable for reaching them. We have, however, achieved the 1 per cent of GNP target for total flows in all but two years since 1979 (1985 and 1987) and have a strong record on direct investment. Among the G5, we ranked number 2 on overseas direct investment (behind the US) over the period 1982-86 although recently Japan has overtaken us (Table 1).

__Table 1__ AID FLOWS

	1987 net oda	% of GNP	$ billion 1986 net oda	1986 Private flows at market terms	1986 resource flows
US	8.9	0.20	9.6	7.5	18.2
Japan	7.5	0.31	5.6	16.5	21.5
Germany	4.4	0.39	3.8	2.4	7.9
UK	1.9	0.28	1.7	4.3	6.5
France	6.5	0.74	5.1	3.0	9.2
Italy	2.6	0.35	2.4	-0.6	2.6
Canada	1.9	0.47	1.7	-0.1	1.6
Total DAC+	41.5	0.34	36.7	33.4	75.6

+ includes non G7 DAC
* Totals do not reconcile because they also include grants by private voluntary agencies and other official flows (of eg export credits).
Source: DAC, OECD

__Table 2__ TOTAL DIRECT INVESTMENT IN DEVELOPING COUNTRIES

£ million

	1983	1984	1985	1986	1987	Total 83-87
UK	975	1576	1617	1301	1150	6619
EC	1562	1349	1146	1236	1372	6665

Table 3 **UK TOTAL NET OFFICIAL AND PRIVATE FLOWS TO DEVELOPING COUNTRIES 1983-87**

£ million

NET PRIVATE FLOWS	1983	1984	1985	1986	1987
1. Export credits	871	415	-226	115	354
2. Long-term investment of which:	1,875	1,676	517	2,801	-350
a. direct investment	975	1,576	1,617	1,301	1,150
b. bank lending	900	100	-1,100	1,500	-1,500
3. Voluntary grants	67	105	132	119	135
4. Total private flows	2,813	2,196	423	3,035	139
NET OFFICIAL FLOWS					
5. Net official development assistance	1,063	1,070	1,180	1,185	1,138
6. Total net official flows	1,200	1,425	1,479	1,404	1,268
7. Total net flows	4,013	3,621	1,902	4,439	1,407
As % of GNP Official Development Assistance	0.35	0.33	0.33	0.31	0.28
Total Flows	1.33	1.12	0.54	1.17	0.34

Source: British Aid Statistics 1983-87

Table 4 **PRIVATE DIRECT OVERSEAS INVESTMENT DEVELOPING COUNTRIES BY THE G5,**

	1982-86	(1986)	(1987)	$BN
UK	1.8	1.9	1.9	
US	3.2	3.1	8.0	
Japan	1.2	2.9	7.4	
Germany	0.6	0.4	0.7	
France	0.6	0.6	0.7	

Source: DAC

TABLE 5: NET DIRECT INVESTMENT FROM DAC DONOR COUNTRIES 1983-1987

COUNTRY YEAR	$million					TOTAL
	1983	1984	1985	1986	1987	1983-87
Australia	141	329	20	403	609	1,502
Austria	30	11	11	18	-	70
Belgium	60	17	116	220	238	651
Canada	572	473	85	104	-82	1,152
Denmark	31	56	42	46	106	281
Finland	17	30	25	39	30	141
France	399	266	578	609	696	2,548
Germany	843	706	-143	411	661	2,478
Italy	996	387	360	302	375	2,420
Japan	433	1,489	1,046	2,902	7,421	13,291
Netherlands	40	371	532	224	259	1,426
New Zealand	41	19	24	25	26	135
Norway	76	23	-	4	10	113
Sweden	159	100	277	141	92	769
Switzerland	135	107	489	475	-163	1,043
United Kingdom	1,479	2,106	2,096	1,907	1,885	9,473
United States	2,340	4,419	930	3,107	8,016	18,812
TOTAL	7,792	10,909	6,488	10,936	20,179	56,305

ANNEX TO
BRIEF 7

HER MAJESTY'S TREASURY

IMF/IBRD SPRING MEETING 1989
WESTERN CREDITS FOR EASTERN EUROPE

Objectives

1. Discourage any plans for concerted large scale government financing of economic reform in the Soviet Union or Eastern Europe.

Line to take

2. Glad need for centrally planned economies to convert to market economies is becoming widely accepted. Welcome political reform which will be a necessary condition precedent to lasting economic adjustment. If necessary reforms are undertaken, sufficient money to finance adjustment will flow from private sources to make official concerted lending superfluous. If reform measures are not undertaken no amount of official money will help the situation.

Background

3. Suggestions of a "Marshall plan for Eastern Europe" surfaced about a year ago, and have since been gathering support. Delors raised the prospect of EC money for Yugoslavia in May. FRG, and Genscher in particular, have talked about assistance for Poland. US Secretary Baker also met Polish Foreign Minister Olechowski in Vienna this January, and later told Sir Geoffrey Howe that the US would "help finance" economic reform in Poland if the political reforms Olechowski had spoken of were effected.

4. However the argument is not one sided. There is evidence that while the German Government is keen to take the lead in lending to the USSR, German banks and German companies are adopting normal tests for credit worthiness and return on capital. with the result that German lending is less than the Government would like. There has been a suggestion that a 1975 political loan of DM 1 billion for Poland could be repaid in zlotys and the funds applied to eg environmental projects thought desirable by the German Government. Latest reports following

German/Polish talks in Bonn suggest that FRG may urge us and others to press Camdessus to take 'early and favourable action' on a stand-by Arrangement, following which new loans could be arranged.

5. The announcement in October of a £1 billion credit from UK banks to coincide with the annual meeting of the Anglo-Soviet trade commission provoked much uninformed adverse criticism in the United States. A congressional sub-committee was set up to consider Western Bank lending to the Soviet block. The report eventually found that the debt of the Soviet Union and Eastern Europe allies had risen much less in real terms than in nominal terms; that much of the increase in Western claims had been due to the depreciation of the dollar, and that there was no clear parallel between the growth of exposure to the Soviet block and the origins of the Latin American debt situation. In the event, the £1 billion loan facility did not come to fruition. A more modest Protocol of Intent on credit arrangements, which did not mention any figures, was signed in January during the visit of Mr Kamentsev. This is not a credit agreement, but a framework under which financing arrangements can make exports to the Soviet Union.

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BRIEF NO:8

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

TRADE AND AGRICULTURE, GATT, AND COMMODITIES

Objectives

1. i. To secure a consensus that agreement at the TNC in the four outstanding GATT negotiation areas, particularly agriculture, is vital.

ii. To continue to promote our deregulatory approach to the commodity issues, opposing any support for new commodity agreements with market-intervention provisions. To resist any suggestion that the First Account of the Common Fund should be used.

Line to take

2. GATT Round has a crucial role in maintaining and strengthening the multilateral trading system defence against protectionism. Not only offers prospect of further liberalisation in trade in goods but also provides a valuable opportunity for GATT disciplines to be applied to significant areas such as agriculture, services, investment and intellectual property.

3. Disappointing that agreement not reached at Montreal on all the negotiating areas though provisional agreements which were struck are important . Vital that TNC can reach agreement on four outstanding issues, particularly agriculture, otherwise success of Round could be jeopardised. Progress on agriculture is not only important in itself is essential to unblocking negotiations on the other three issues. Pleased with US flexibility on long-term objective and willingness to discuss short-term action: recognise that EC will have to move and UK is pressing for EC to adopt a flexible and constructive position.

4. Welcome agreement reached at Montreal that Dunkel should explore possible improvements in links between GATT and IMF/IBRD. Improving productive links between these bodies would significally strengthen multilateral trading system.

5. The difficulties caused by many developing countries dependence on commodities is acknowledged but the evidence shows that intervention in markets is not the way to tackle these problems. UK supports various measures designed to assist such countries; eg structural adjustment financed by IMF/IBRD, UK aid programme and preferential access for imports from developing countries under the GSP and the Lome Convention. Success of GATT negotiations on agriculture would be highly beneficial for many commodity exporters.

6. Entry into force of the Common Fund on the horizon. But conditions in commodity markets have changed significantly since 1976. Only two international commodity agreements with buffer stocks now exist thus calling into doubt need for First Account. Much better to place emphasis on bringing Second Account into operation on a cost effective and efficient basis. UK prepared to play a constructive part in addressing the practical and administrative issues needed to set up the Fund on a sound economic basis. But this cannot be done overnight.

7. EC Member States have given firm commitment that completion of Single Market in 1992 will not result in creation of a "fortress Europe". The UK aim now is to press for this to be carried through in individual measures.

Background

8. There is evidence that the international trading system has become less liberal in recent years. Countries have increasingly pursued protective and discriminatory trade policies through for example the Multi Fibre Arrangement, Voluntary Export Restraints and (VERs) anti-dumping policies. The number of VERs in the European Community doubled between 1987 and 1988, from 67 to 137. At the end of 1988 there were 80 EC anti-dumping investigations and reviews in progress - the highest figure during the 1980s. And an increasing proportion of these have been directed at competitive electronic products from the Far East. Since the Uruguay round started in 1986, 29 disputes have been brought to the GATT compared with about 20 between January 1980 and mid-1986, and about 1 per cent during the 1970s. These developments underline the importance of reaching agreements to reduce protection in the Uruguay round negotiations.

9. At the Montreal Mid-Term Meeting agreement was reached in the eleven out of the fifteen negotiating groups. However, the proceedings were suspended until the meeting scheduled for 3-7 April of the Trade Negotiations Committee of officials (TNC) because of the failure to agree in the four outstanding areas - agriculture, intellectual property, textiles and safeguards. If these issues can be settled in informal negotiations before the TNC meet, the whole package will be formally approved and the negotiations will proceed into the second half. The key features of the agreements provisionally reached at Montreal were: (a) tariffs should be cut by at least one third; (b) the GATT system should be strengthened by setting up a surveillance mechanism examining national trade policies, establishing a more efficient dispute settlement procedure and the Director General of GATT (Dunkel) should explore ways of improving links with the IMF and IBRD; (c) a framework agreement was settled for services setting out principles for negotiations on a cross-sectoral agreement, and (d) tariff on tropical products should be cut - the EC has implemented part of its offer in advance of the TNC.

10. No progress was made on agriculture largely because the US persisted in the view that agreement should be reached on its long term objective of eliminating all trade-distorting subsidies before short-term action could be discussed. The deadlock on agriculture increased the reluctance of certain LDCs to agree on texts allowing further negotiations on textiles, protecting intellectual property and safeguards. The current view is that if agreement can be reached on agriculture, the LDCs will be prepared to settle on three other subjects.

11. Since Montreal discussions have been taking place in Geneva under the chairmanship of Dunkel to try and resolve the difficulties in the four outstanding areas. The most significant development so far is that in the talks on agriculture the US has dropped its insistence on the long term goal being defined before short term action can be addressed. The long term goal still has to be agreed but the US seem likely to step round the "elimination" issue even if that still remains their real aim and there is some confidence that a compromise wording can be found. By being prepared to address short-term action the US have placed the EC under pressure to improve its short-term proposals. The Commission recognise the need to move, but apart from the UK and the Netherlands, Member States are reluctant to do so. The US and Cairns Group have demanded a freeze and reduction in support and protection defined in terms of specific policies at current levels and covering all products. The EC's formal position is that such measures should be carried out by reference to an aggregate measure of support

thus ensuring that all parties make changes of roughly equal value. The UK is working for a more flexible EC position which could include commitments in terms of specific policies, a willingness to consider some action on import barriers and export subsidies, and a freeze and reduction based as closely as possible to current levels and not to 1984 levels (which is the present EC position).

12. There has been some hardening of positions on intellectual property. But some progress has been made in the discussion on textiles and safeguards where the focus of discussions has moved away from substantive and difficult issues and onto a procedural framework to enable substantive negotiations to take place in the remainder on the Round. There are indications that the Community's insistence of the linkage between textiles liberalisation on one hand and liberalisation by the NIEs and the strengthening of the GATT rules (particularly safeguards) on the other may no longer be seen by the LDCs as merely a blocking tactic.

13. The UK's approach to <u>commodity issues</u> is well known. UK opposition to agreements with price stabilisation measures is borne out by the current problems with the Cocoa Agreement (where levy arrears and a failure to agree on a revision of the target price is jeopardising its future) and by the lack of progress made in the renegotiating of the Coffee Agreement. But the climate may change when the <u>Common Fund</u> comes into being. Work is expected to start in the summer to set up this organisation which was originally conceived in 1976. Its First Account is intended to finance buffer stock operations in international commodity organisations and its Second Account is designed to support a range of commodity development measures such as increased market transparency and research and development. There are currently only two commodity agreements with buffer stocks, cocoa and rubber, and so at present there will be little or no demand for First Account to become operational. But there is the risk that its existence will prompt calls for new agreements to be established. The EC intends to work to shift the emphasis of the Fund's activities from the First to the Second Account when the Fund becomes operational. The Fund will be unable to start work until detailed operational and financial regulations have been agreed. These will take time and so the Fund is unlikely to commence operations for some time.

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BRIEF NO: 9

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

IMF/IBRD STAFF COMPENSATION (KAFKA II)

Objective

1. To press for a more market orientated (but not excessively costly) pay comparison system consistent with the requirements of budget discipline.

Line to take

2. UK places emphasis on budgetary aspects of pay; if there were adequate budgetary control, pay can be left within competence of IMF/IBRD management to be determined on the basis of recruitment and retention needs.

3. UK yardstick remains zero real growth in administrative budgets of both institutions to provide financial discipline.

4. We expect that higher pay for some staff should be offset at least in part by savings elsewhere in the budget.

5. UK attaches some degree of importance to competitive salaries to attract European staff but not appropriate to boost all pay to levels of higher European salaries - need to consider other options.

Background

6. The report on staff compensation (Kafka II) represents four years of effort to reach a compromise on a new IMF/IBRD compensation system. New pay structure reflects greater comparability with outside world, particularly private sector.

7. UK has been closely involved in the Joint Compensation Committee (JCC) and was a member until end-1987. US has taken strongest line in pressing for pay restraint in two institutions with Europeans taking much softer line. UK has

moderated between the two. Main factor for UK is not detailed modalities of pay or benefits but rather the need to meet budgetary objectives.

8. Europeans (particularly the Dutch, Ruding) have argued strongly for the need to increase dollar salaries to offset the depreciation of the dollar against European currencies and to continue to attract European staff. We have argued that to boost <u>all</u> pay to the levels of the highest paid European staff is not efficient as these salaries in part reflect the cost of living in particular countries and it would thus create high economic rents for the rest of the staff. We have suggested the possible use of expatriate allowances but this has been strongly opposed by other directors in the Fund and Bank on equity grounds (arguing equal pay for equal work).

9. The report on staff compensation will be considered again by the Fund's Executive Board after the Spring meetings on 6 April.

10

Brief No 10

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

IMF: RECENT DEVELOPMENTS

<u>Objective</u>

1. (i) To improve conditionality in Fund programmes

   (ii) To resist any pressure for arbitrary lending targets (eg net outflow of Fund resources)

   (iii) To underline recent improvements to Fund facilities.

<u>Line to take</u>

2. Strong and sustained adjustment the key to economic recovery. Recognise political and social constraints. But Fund should <u>not</u> be pressured into weak programmes which postpone adjustment (and which also weaken Fund authority and credibility, as well as risking further increases in arrears).

3. Recent review shows that conditionality has often been inadequate in the past, due for instance to over optimistic assessments of key variables, failings in programme design, and inadequate commitment from authorities. Essential that all of us - Fund management and the Board - should ensure that these are properly taken into account in future programmes.

4. Net reflows to Fund: these are result of large programmes in early 1980s. Note that net reflows in fact mainly from Europe and Asia - relatively little change in Fund exposure to Latin America and Africa. Right that Fund's resources should revolve in this way. Arbitrary lending targets would be wrong - Fund should judge programmes as they came forward. No shortage of resources.

5. Welcome important improvements made to Fund facilities last year - in particular establishment of new Compensatory and Contingency Financing Facility

(CCFF). Will offset impact of unforeseen external developments, including rises in interest rates, to help keep adjustment programmes on track.

Trends in lending

6. 43 countries now have arrangements of some sort with the Fund:

- 16 with stand-by arrangements (SBAs) (some of these are barely operational)
- 2 with Extended Fund Facility (EFF) programmes
- 24 with Structural Adjustment Facility (SAF) programmes
- 6 with ESAF programmes.

(5 countries have both a SAF or ESAF programme, and an SBA or EFF). A complete list of all current arrangements is at Annex A; the rate of charge under SBAs or EFFs is 7.38 per cent (ordinary resources) or 7.53 per cent under borrowed resources); the rate of charge under SAFs or ESAFs is 0.5 per cent.

7. Total Fund credit outstanding was around SDR 24 billion at end-February. Of this total, around SDR11.7 bn (or almost half) is concentrated in 5 countries: Mexico (which is the largest single borrower from the Fund - SDR 3.6 billion at the end of January, compared to around SDR 4.8 billion for the whole of sub-Saharan Africa). Argentina (SDR 2.7 bn), Brazil (2.5 bn), India (1.9 bn) and Yugoslavia (1.0 bn).

8. Total Fund credit outstanding has thus fallen by around SDR 11 bn since its peak of around SDR 35 billion in 1985. But most of this fall (around SDR 7-8 billion) has taken place in net lending to Europe and Asia, reflecting both a fall in new credit, and a substantial flow of repayments from some very large loans made early in the 1980s. There have thus been large falls in Fund credit outstanding to some previously major borrowers (India, Korea, Yugoslavia, Turkey, Romania, Portugal and Hungary). Fund credit outstanding in Latin America is in contrast down by about SDR 1 billion since 1985 (in Mexico and Argentina it is significantly up); in Africa excluding South Africa it is down by only about SDR 0.75 billion (partly balanced by use of SAF/ESAF resources - around SDR0.5 bn

disbursed to date). More details of purchases, repurchases and Fund credit outstanding are given at Annex B.

9. Over the same period (since 1985) the Fund has repaid large amounts of the borrowing which helped to finance the surge of large programmes earlier in the 1980s. Total Fund borrowing has fallen from a peak of over SDR14 billion in 1985 to around SDR 6 billion at end July. Staff projections show that the Fund would be able to meet a projected expansion of demand in 1989 and 1990 (to SDR 6.0 and 5.4 billion respectively) and continue to repay borrowing (reducing this to around SDR 3.5 billion at end-1990). In short, although the precise figures could change, the Fund's present financial position is a extremely strong one. (Brief 11 refers).

Conditionality

10. At the 1987 Spring Meetings the Chancellor expressed concern at weakening of IMF conditionality, stating that "some of the new programmes have very little prospect of bringing about the amount of adjustment needed in the countries in question". Subsequently, 3 countries including the UK, abstained on the Zaire SBA in May 1987 (the programme subsequently broke down and Zaire is now in arrears to the Fund).

11. Between December 1987 and the 1988 Spring Meetings there was a spare of weak programmes including both inadequate policy effort (notably Argentina in December 1987) and large financing gaps (Costa Rica, Ivory Coast and again Argentina, all in early 1988). This led to a series of abstentions from (in all) 7 countries in the Executive Board: the UK abstained on 3 occasions, Australia and the US twice, Nordics, Canada, Netherlands and Austria once.

12. Our concerns were borne out by a staff review of 'issues in conditionality' which appeared in February. Thus looked at a series of programmes in 9 Sample countries over the 1980s. It found major problems in programmes in 5 countries, and lesser problems in a further 2 issues identified included over-optimistic assessments by Fund staff (for instance of key exogenous variables), failures in programme design (for instance in the specification of targets), and inadequate commitment from the authorities. The review explicitly identified cases where weak programmes had been approved for 'other' reasons, for instance to maintain international confidence. Its findings more than justify the emphasis we have

been placing on maintaining/strengthening conditionality. We need to press for the lessons which emerge to be incorporated in future Fund practice.

Improvements to Facilities

13. At the last Spring meetings there was discussion on the creation of a new Compensatory and Contingency Financing Facility (CCFF), and on reviving the use and improving the terms of the Extended Fund Facility (EFF).

14. Following this agreement was reached in the Executive Board in August on the detailed provisions of the CCFF. This combines:

- the previous Compensatory Financing Facility (CFF), which provided finance to help cover shortfalls in export earnings;

- a new contingency financing element, which is intended to help over a broader range of contingencies, including rises in import prices and interest rates. The CCFF will not cover the entire costs of such developments - the extra finance which it provides will need to be blended with further adjustment - but by making some additional resources available it will help to keep adjustment programmes on track.

15. Agreement was also reached last year on improved terms for the EFF, including:

- provision for longer programmes (4 years maximum instead of 3)

- a six-month schedule of disbursements and performance criteria

- changes to the detailed arrangements for using ordinary and borrowed resources under the facility, which will tend to reduce charges and lengthen the maturity of purchases.

16. This completes a trio of major changes to Fund facilities since 1987 - the other being the establishments of the Enhanced Structural Adjustment facility (ESAF): Brief No 3 refers.

ANNEX A

Stand-By, Extended, Structural Adjustment Facility (SAF), and Enhanced Structural Adjustment Facility (ESAF) Arrangements as of January 31

(million SDRs)

	Date of Arrangement	Expiration Date	Total Amount	Undrawn Balance
Stand-by arrangements			**2,801.40**	**1,724.15**
Brazil	Aug. 23, 1988	Feb. 28, 1990	1,096.00	730.70
Cameroon	Sept. 19, 1988	Mar. 31, 1990	69.53	46.35
Costa Rica	Oct. 28, 1987	Mar. 31, 1989	40.00	40.00
Côte d'Ivoire	Feb. 29, 1988	Apr. 30, 1989	94.00	87.00
Ecuador	Jan. 4, 1988	Feb. 28, 1989	75.35	60.28
Guatemala	Oct. 26, 1988	Feb. 28, 1990	54.00	30.84
Hungary	May 16, 1988	May 15, 1989	265.35	100.00
Jamaica	Sept. 19, 1988	Nov. 30, 1989	82.00	68.30
Kenya	Feb. 1, 1988	July 31, 1989	85.00	22.40
Madagascar	Sept. 2, 1988	July 1, 1989	13.30	10.50
Malawi	Mar. 2, 1988	May 30, 1989	13.02	3.77
Mali	Aug. 5, 1988	Oct. 4, 1989	12.70	10.16
Morocco	Aug. 30, 1988	Dec. 31, 1989	210.00	140.00
Pakistan	Dec. 28, 1988	Mar. 27, 1990	273.15	131.11
Togo	Mar. 16, 1988	Apr. 15, 1989	13.00	2.64
Trinidad and Tobago	Jan. 13, 1989	Feb. 28, 1990	99.00	56.50
Yugoslavia	June 28, 1988	June 27, 1989	306.00	183.60
Extended arrangements			**1,032.30**	**263.55**
Chile	Aug. 15, 1985	Aug. 14, 1989	825.00	56.25
Tunisia	July 25, 1988	July 24, 1991	207.30	207.30
SAF arrangements			**1,484.06**	**766.27**
Bangladesh	Feb. 6, 1987	Feb. 5, 1990	182.56	—
Burundi	Aug. 8, 1986	Aug. 7, 1989	27.11	5.76
Central African Rep.	June 1, 1987	May 31, 1990	19.30	4.10
Chad	Oct. 30, 1987	Oct. 29, 1990	19.43	13.31
Dominica	Nov. 26, 1986	Nov. 25, 1989	2.54	—
Equatorial Guinea	Dec. 13, 1988	Dec. 12, 1991	11.68	8.00
Guinea	July 29, 1987	July 28, 1990	36.77	25.19
Guinea-Bissau	Oct. 14, 1987	Oct. 13, 1990	4.76	3.26
Haiti	Dec. 17, 1986	Dec. 16, 1989	28.00	19.18
Kenya	Feb. 1, 1988	Jan. 31, 1991	90.17	61.77
Lesotho	June 29, 1988	June 28, 1991	9.59	6.57
Madagascar	Aug. 31, 1987	Aug. 30, 1990	42.16	28.88
Mali	Aug. 5, 1988	Aug. 4, 1991	32.26	22.10
Mauritania	Sept. 22, 1986	Sept. 21, 1989	21.53	4.58
Mozambique	June 8, 1987	June 7, 1990	38.74	8.24
Nepal	Oct. 14, 1987	Oct. 13, 1990	23.69	5.04
Pakistan	Dec. 28, 1988	Dec. 27, 1991	346.90	237.64
Sierra Leone	Nov. 14, 1986	Nov. 13, 1989	36.77	25.19
Somalia	June 29, 1987	June 28, 1990	28.07	19.23
Sri Lanka	Mar. 9, 1988	Mar. 8, 1991	141.67	97.05
Tanzania	Oct. 30, 1987	Oct. 29, 1990	67.95	14.45
Togo	Mar. 16, 1988	Mar. 15, 1991	24.38	16.70
Uganda	June 15, 1987	June 14, 1990	63.25	13.45
Zaïre	May 15, 1987	May 14, 1990	184.79	126.59
ESAF arrangements			**775.69**	**615.79**
Bolivia	July 27, 1988	July 26, 1991	136.05	113.38
Gambia, The	Nov. 23, 1988	Nov. 22, 1991	20.52	17.10
Ghana	Nov. 9, 1988	Nov. 8, 1991	368.10	281.80
Malawi	July 15, 1988	July 14, 1991	55.80	46.50
Niger	Dec. 12, 1988	Dec. 11, 1991	50.55	42.13
Senegal	Nov. 21, 1988	Nov. 20, 1991	144.67	114.89
TOTAL			6,093.44	3,369.75

Note: Components may not add because of rounding

Data: IMF Treasurer's Department

IMF: PURCHASES, REPURCHASES AND OUTSTANDING FUND CREDIT, 1982-88 (SDR mn)

	Financial Year Ended April 30						
	1982	1983	1984	1985	1986	1987	1988
Gross purchases 1/	6,960.2	10,258.2	10,164.1	6,059.8	3,940.9	3,168.1	4,117.6
Industrial countries	--	54.0	--	--	--	--	--
Developing countries	6,960.2	10,204.3	10,164.1	6,059.8	3,940.9	3,168.1	4,117.6
Africa	1,986.4	2,056.1	1,642.7	1,017.6	841.8	593.3	649.5
Asia	3,151.9	2,748.0	2,589.7	746.7	844.1	1,224.4	665.7
Europe	1,326.0	1,590.1	1,658.3	837.5	322.5	67.5	--
Middle East	--	25.1	--	57.4	--	--	116.0
Western Hemisphere	496.0	3,785.0	4,273.4	3,400.5	1,932.5	1,282.9	2,686.4
Total repurchases	1,894.0	1,547.0	2,015.0	2,730.0	4,274.0	6,162.0	7,935.0
Changes in outstanding Fund credit	5,066.0	8,711.5	8,148.9	3,214.8	-340.6	-2,993.8	-3,817.0
Outstanding Fund credit	14,801.4	23,589.9	31,741.6	34,972.6	34,640.2	31,646.4	27,829.4
Number of SBAs and EFFs as of April 30	35	39	35	30	26	24	20
Number of countries with outstanding Fund credit	79	85	84	83	79	80	76
Outstanding Borrowing	6,773	10,952	13,791	14,203	14,556	12,700	9,070 3/
Liquidity ratio 2/	73.5	43.2	71.0	71.5	68.6	74.9	92.7

1/ Excluding purchases in the reserve tranche.

2/ Figures available only by CY; Figure for 31.12.81 under column FY ending 30.4.82, and so on.

3/ SDR 7.7bn at 31.7.88; projected SDR 6.9bn at 31.12.88.

ANNEX B

11

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Brief No 11

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

IMF: NINTH QUOTA REVIEW

Objectives

1. i. To continue to argue for no more than a moderate increase in total quotas, but to avoid commitment to a specific figure, given current discussions on the debt strategy

ii. To support extension of timetable for completion of Review (preferably until the end of the year) because of need to agree first on possible revisions to debt strategy

iii. To separate the issue of rankings in the Fund from that of the overall quota increase

iv. To avoid taking any decision on Japan's request for a special quota increase.

v. Beyond this, to limit any possible fall in the UK's ranking, to fourth (behind US, Japan, Germany); to resist strongly any French pressure for joint fourth position with the UK.

Line to Take

2. **Quotas**

- UK strong supporter of Fund. Recognise that it is important that it should have adequate resources.

- Need to look at case for any quota increase in context of Fund's current financial position.

- This is exceptionally healthy:
    - stock of resources at all-time high
    - liabilities have continued to decline
    - liquidity position strongest on record.
- To put this in context, Fund's financial position
    - not only stronger than position in 1983 before last quota increase
    - but stronger than position <u>after</u> that increase.
- Simply not credible to argue that Fund now needs a large increase, comparable for instance to that agreed in Eighth Review.
- And indeed detailed technical analysis confirms that Fund could accommodate a substantial increase in lending, <u>if</u> there were a good case for this, with no more than a moderate increase in quotas.
- A large quota increase, when the Fund is already in such a strong financial position, would be the wrong signal. It could be taken to mean that the Fund was planning to increase its lending dramatically and could put pressure on it to do so. If this took place, it could lead to an unacceptable transfer of risk to the Fund itself and ultimately to its shareholders.

3. <u>Japanese Special Increase/UK ranking</u>

(for use within G7 only)

- Recognise large and growing disparity between Japan's actual and calculated quotas;
- Do not rule out exceptional arrangements to deal with this;

- But essential that we should not allow rankings issue to distort positions within G7 on overall quota increase. This should be considered purely in light of Fund's needs.

- Japan's case should be decided after we have agreement on size of overall quota increase.

- Strong resist French bid for joint fourth. No case for French special increase - actual quota <u>not</u> significantly below calculated quota (Defensive : UK <u>not</u> willing to contemplate precipitate drop in its quota share to bring this in line with French share, quota shares should be adjusted gradually except than in very exceptional circumstances).

Background

4. The Ninth Quota Review began in July 1987. There have been a series of inconclusive discussions since than and at the Spring 1988 Interim Committee the timetable for completion of the Review was extended from April 1988 to April 1989. The key is the US position. Brady said on 10 March that he hoped a consensus could be reached before the end of the year. We would not wish to see an earlier deadline set (for instance the Annual meetings in September) as this would compress the time available to consider the US debt initiative.

5. The question of a quota increase has become entangled with that of rankings in the Fund (the Japanese want to see a large increase in order to secure a large increase in their share; our argument for a moderate increase loses credibility to the extent that we are seen as wanting to hold on to second place). We want to keep the issues separate, so that the case for a quota increase is considered purely in light of the Fund's needs. We see the size of the quota increase as a more important issue than rankings.

The size of the total quota increase

6. The Eighth General review resulted in a 50 per cent increase in overall Fund quotas from SDR61 billion to SDR90 billion. This represented a compromise between LDCs, who had argued for a doubling, and the US, which had originally wanted an increase of around 40 per cent to SDR85 billion. The UK had argued for a substantial increase to between SDR90 million and SDR100 billion. There is no

inconsistency between this , and our arguing for a smaller increase now, given the Fund's weak liquidity position in 1983 (the liquidity ratio was around 30 per cent compared to 112 per cent in January 1989), and the need for it to play a central role in managing the debt crisis after the Mexican default of August 1982.

7. Camdessus and a majority of chairs in the Board have argued for a large quota increase (in this most recent statement Camdessus referred to a quota increase of two-thirds or more - though in previous statements he had referred to a doubling). The UK has consistently argued for a 'moderate' increase ; we have not committed ourselves to a specific figure but our position is widely interpreted as meaning 25 per cent. The outcome of the review depends critically however on the US position.

8. Brady referred on 10 March to 'an increase in IMF quotas'. We have yet to see any quantification. But the US have said privately that it will be important for domestic political reasons not to give any impression of 'large' additionality of resources, though there might be 'some'. Moreover in Executive Board discussion on 16 March of the draft report to the Interim Committee, the US asked to be associated with the arguments put by the UK (stating explicitly 'these views are ours'). So it is by no means clear, despite the Brady initiative that the US will go for a substantial increase.

9. The Fund is in fact currently awash with resources. Its stock of unused usable ordinary resources is now around SDR42.5 billion - compared to under SDR20 billion before the last quota increase (and SDR 39.8 after the quota increase). At the same time Fund borrowing has been run down from a peak of nearly SDR15 billion to around SDR6 billion (and is projected to fall to around SDR3.5 billion by end-1990). This has reduced its liabilities. As a result, its 'liquidity ratio' (essentially the ratio of its resources to its liabilities) is over 110 per cent compared to around 30 per cent before the last quota increase, and around 70 per cent after). The present stock of usable resources (and thus the liquidity ratio) could of course be affected if some currencies becomes 'unusable'. But it is still fair to say that the Fund's financial position is extraordinarily healthy (indeed the liquidity ratio is the strongest on record).

10. Our own analysis indeed confirms that the Fund could comfortably accommodate a substantial increase in its lending with no more than a moderate quota increase (around 25 per cent)

- for instance, the Fund could increase its lending by 75 per cent (from the current level of around SDR24 billion, to around SDR42 billion by end 1994, and still retain an average liquidity position over 1990-94 significantly healthier than the long-run average (by end-94 the liquidity ratio would probably be below the long-run average, but well above the position before the last quota increase).

- this would enable the Fund to lend an average of SDR9 billion pa over 1991-94, compared to around SDR4.7 billion average annual access (actual and projected) over 1984-90 (or SDR 5.9 billion over 1982-90, a period including the sharp expansion of Fund credit in the early 1980s).

11. In short, there is simply no evidence that the Fund actually needs a substantial increase in resources - even if it were to undertake (for examples as a result of the US initiative) an major expansion of lending. A large quota increase, when the Fund is already in such a strong financial position, would signal that it was planning to expand its lending dramatically, and could create pressure on it to do so (access to the Fund's resources is conventionally measured as a multiple of quota). If this took place, it would result in an unacceptable transfer of risk to the Fund and its shareholders.

12. An 85 per cent majority is required for any overall quota increase. The position of the US (with 19.3 per cent of the vote) is crucial. If the US sticks at an increase of 25 per cent this will block any larger increase. If the US were to move to 50 per cent a consensus would probably form around this figure quite quickly.

<u>Rankings</u>

13. Quota shares change only very slowly in response to economic circumstances. This has the anomalous result that the UK is still second in actual rankings, and Japan fifth.

	Existing share	Calculated share (1986 data)
US	19.92	19.45
UK	6.89	5.18
Germany	6.01	7.35
France	4.98	5.33
Japan	4.69	9.00
Saudi Arabia	3.56	4.90
Canada	3.27	3.43
Italy	3.23	3.90

14. The extent of any changes in individual quota shares depends both on the size of the overall quota increase, and the way in which this is distributed. Several illustrative outcomes are shown at Annex 1 - with 25 and 50 per cent increases in quotas. Japan is certain to move from fifth to fourth place, above France, but is highly unlikely to move higher than this. The Japanese have therefore put in a bid for an 'special increase' to take them to second place.

15. This is an exceptional mechanism, which would require (as with a general increase) an 85 per cent majority. Before Brady's statement on 10 March there was little sign that the Japanese were making much progress in this - indeed opposition to special increases in general had been expressed by a fairly cohesive group of European ED (Germans, French, Nordics and Italians) who between than would be able to block a Japanese increase whatever the UK did. But press reports since 10 March have suggested that the US may have decided to support Japan's request. There may be some substance to this. On 16 March the US stated in the Executive Board that they had 'consistently maintained that there will be an ad hoc element' (ie special increase).

16. All this leads to a further complications. If Japan moved to second the UK would, in the absence of any other special arrangements, slip to third and Germany to fourth (with France fifth). The Germans are however adamant that they should hold on to third place. The UK would therefore have to accept a move down not just to third, but to fourth. But the French have also said that they would not accept a ranking below fourth, and it seems certain that they are aiming for joint fourth with the UK (as at the World Bank.) On 16 March both Germany and France stated in the Board that if Japan received a special increase, they would in turn be forced to request one too.

17. The UK's traditional interest has been to retain as high a ranking as possible. Keeping a place in the 'top 5' is particularly important as this entitles us to appoint our own Executive Director. A move down to fourth place need not matter greatly if it did not involve a large reduction in our quota share (though it could in the longer term make it more difficult to defend our joint fourth place at the Bank in view of the larger French IDA contributions). But joint fourth with France is more of a problem.

18. France's quota share is well below the UK's. But unlike the case of Japan, it is not significantly below their calculated share (Annex A refers). France thus has no case for a special increase. So joint fourth could in practice only be brought about though a large reduction in the UK's share, taking us well behind Germany, and leaving us more exposed to a fall to fifth in future reviews (though still some way ahead of Saudi-Arabia and Italy at sixth and seventh).

19. The best tactic at the Spring Meetings, given the uncertainty about the US position, both on the size of the quota increase, will be to 'play it long' on Japan's request. We can argue that this can only be properly considered once the overall quota settlement has been agreed (when we will know the extent of the discrepancy between Japan's calculated quota and its new actual quota). We should resist any pressure to take on decision now. We should strongly resist any French moves to secure the 'joint fourth' outcome. The case against a French special increase is clear (para 17 refers). The case against a large reduction in the UK share is that it would cut across the general principle of 'gradualism in adjusting quota shares (a case can be made for making an exception for Japan because the discrepancies between its actual and calculated shares would otherwise increase; but in the UK's case the discrepancy will narrow in any case, as our quota share falls).

Enlarged Access

20. The Enlarged Access Policy (EAP) was introduced in 1981. Prior to this, cumulative access levels stood at 100 per cent of quota for SBA, and 165 per cent for the Extended Fund Facility. The EAP allows individual countries to borrow more, through an increased multiple of their quotas, without increasing quotas themselves. It was introduced as a temporary policy but has been extended annually since the completion of the Eighth Quota review in late 1983, though

with some scaling down of the limits. These now stand (in percentage of quota, and excluding special facilities) at:

Annual	90 or 110
3 year	270 or 330
Cumulative	400 or 440

21. These figures are intended as ceiling rather than targets (and can in theory be exceeded in exceptional circumstances). Access in individual cases is determined according to criteria laid down by the Executive Board. Annual access for agreements approved in 1988 was within a range of [28-50] percent of quota, with an average of [43] per cent.

22. We accept that enlarged access limits, although these are in practice largely theoretical, are difficult to reduce whilst the quota review is under. The future of enlarged access will however need to be reconsidered after the review is completed. The extent of any increase in total quotas will determine the feasibility of securing a significant reduction in access limits (for instance, if quotas were increased by 25 per cent, the lower or 'normal' limits above could be reduced to 72 per cent, 213 and 320 without reducing potential absolute access)

23. But reducing access <u>limits</u>, would not necessarily reduce access actual <u>levels</u>, given that there are so far below the theoretical limits anyway. If, for instance, actual access remained within the range [28.50 percent] of quota, the result of a quota increase would clearly be larger <u>programmes</u>, notwithstanding any reduction in access limits.

ANNEX A

Existing and Calculated Quotas

Illustrative Outcomes of the Quota Review

	Existing Share	Calculated Share (1986 Quota)
US	19.92	19.45
UK	6.89	5.18
FRG	6.01	7.35
France	4.98	5.33
Japan	4.69	9.00

25 percent increase

	Distribution (1)	Distribution (2)
US	19.97	19.99
UK	6.67	6.55
FRG	6.13	6.19
France	5.00	5.01
Japan	5.13	5.37

50 percent increase

	Distribution (1)	Distribution (2)
US	20.12	20.23
UK	6.55	6.38
FRG	6.19	6.28
France	5.04	5.07
Japan	5.23	5.51

Distribution (1): 40 per cent equiproportional
60 per cent selective method A

Distribution (2): 40 per cent equiproportional
{50 per cent selective method A}
{10 per cent selective method B}
(39 member version)

These are illustrative distributions, based on preliminary views expressed at the Executive Board earlier this months, not firm proposals

Notes:

- Equiproportional distribution

  Distribution to all Fund members on basis of their present quota share; result is no change in shares

- Selective distribution: Method A

  Distribution to all Fund Members on basis of their calculated quota share; result is some change in actual shares

- Selective distribution: Method B

  Distribution to limited group of Fund Members on basis of their calculated quota share; result is greater change in actual shares.

12

BRIEF NO 12(a)

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOLPMENT COMMITTEE MEETINGS 1989

SDR ALLOCATIONS

Objectives

1. To oppose resumption of SDR allocations since currently no case on grounds of long-term need for additional global liquidity.

Line to Take

2. Continue to be unpersuaded of case for a general allocation. There is no overall shortage of global liquidity although there may be problems with its distribution. (less creditworthy countries experience shortages)

3. Oppose allocation for other purposes unconnected with global liquity (ie Frency debt scheme: Brief 3 refers). Not consistent with Articles governing criteria for allocation.

Background

4. The SDR is a composite currency unit defined in terms of 5 international currencies (dollar, DM, yen, franc and sterling). The IMF's Articles require SDR allocations to be justified by long term global need to supplement existing reserves. So far SDR 21.4 billion has been issued in proportion to Fund quotas. (SDR 9 billion during 1970-72; SDR 12 billion during 1979-81).This compares with total world reserves (excluding gold) at end-November 1988 of SDR 536 billion, 47 per cent higher than end-1986.

5. The UK has consistently rejected the case for further allocations in recent years,as have the US, Germany and Japan (although Japan indicated in the Board earlier last year that they might be willing to reconsider their opposition, and the US has recently shown signs of wavering).

6. In recent years the MD has simply reported that no allocation proposal commands the necessary support (85 percent). But in the run-up to the last Spring Meetings Camdessus put forward - in personal remarks - the idea of allocation of

SDR20-30 billion over the next two years. His principal argument was that heavily indebted counties had inadquate reserves. But:

i. The ratio of non gold reserves to imports for ldcs rose from 33.2 per cent at end 1985 to 38.9 per cent at end 1987. For capital importing developing countries, the ratio of non gold reserves to imports at end 1987 (33.6 percent) was considerably higher than the average ratio in the 1970s (23.6 per cent). 1987 also saw on enormous accumulation of dollars.

ii. The huge growth of international credit markets has morever totally altered SDR's rationale. A creditworthy country can, if it wishes, increase its gross reserves by external borrowing. But it is essential to follow prudent policies in order to retain the creditworthiness necessary.

iii. In any case past experience is that SDR allocations to LDCs get spent. In effect, this is a proposal for additional resource flows. Making any allocations conditional would not overcome the problem. We oppose conditional allocations as much as unconditional ones, as there is no discipline to make any specified conditions stick, and allocations once made are hard to reverse (the best way for the Fund to channel conditional resources is through SBAs/SAFs/ESAFs).

7. Subsequently President Mitterrand launched the idea of a new SDR allocation linked directly to debt reduction: the industrialised nations would under this scheme transfer their share of such an allocation into an escrow account used to guarantee all or part of interest/divided payments on new debt/equity instruments exchange at a discount, or carrying sub-market rates. This would however be inconsistent with the purposes of an allocation, under the Fund's Articles. Further comments on the proposal are contained in Brief 2.

8. In short the line up at the Spring Meetings will almost certainly be much the same as in previous years, with no consensus for a new SDR allocation. (although technical work continues on the narrower subject of how to improve the liquidity and usability of SDRs; we have no objection to looking at any ideas along these lines on their merits.)

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BRIEF NO 12(b)

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

ADMISSION OF USSR TO IMF/IBRD

Objectives

1. Not to rule out the possibility of the USSR eventually joining the Fund and Bank, but not to give any positive signals at this stage.

Line to take (if raised)

2. If USSR wishes to pursue application, then preliminary discussions would need to be held with Fund management, to establish whether the USSR was able to fulfil the obligations of membership set out in the Fund's Articles of Agreement. (IBRD membership would require membership of the Fund first.)

Background

3. Fund approached by Soviet authorities in July who wished to "improve their understanding of the Fund and its activities". A Soviet team visited Washington in October. We understand that the question of membership was not on the formal agenda. But the issue has been aired in Soviet journals over recent months, and it seems likely that it is being given serious consideration by the authorities. President Gorbachev's debt proposals in his UN speech in December 1988 indicated Soviet desire for closer links with the IFIs.

4. This is not the first time that the Soviets have sounded out the Fund. The Soviets have also sounded out the IBRD. Membership of the Bank would enable the Soviets to seek Bank-funded commercial contracts (and Bank finance). They have expressed rather clearer interest in joining GATT (although no formal application has been made) no doubt because the transitional arrangements would, in practice, open up Western markets for Soviet goods yet enable the Soviets to retain certain import barriers.

5. Present Fund membership does include several centrally planned East Bloc economies (including Hungary, Poland and Romania and Yugoslavia) as well as

China. Hungary and Yugoslavia are currently undertaking Fund-supported programmes under and SBA. The four East Bloc members do have large debts to Western economies and therefore their relationship with the Fund and their willingness to adopt Fund-supported programmes may well be influenced by their debt overhang. This would not be true of the USSR. And Hungary and Yugoslavia also have much more market-orientated economies than the USSR.

6. This suggests that the Soviets might, at some stage, be able to fulfil the Fund's Articles of Agreement. To do so however, they would have to provide much more (and better) statistical information on their economy than they do at present.

7. In the last analysis however, whether they were admitted to the Fund would be much more a political than a technical issue. Soviet membership would affect the political and economic complexion of the Fund - as the USSR would probably become the second or third ranking shareholder (it could also have implications for the Fund's resources, if the USSR were to adopt a programme). It is thus a far bigger step run admitting other Eastern EEC countries, or China. Views of G7 and particularly the US would be crucial (the US have gone on record on 20 January 1988 to oppose any formal application).

BRIEF NO 13

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

IBRD FINANCIAL MANAGEMENT INCLUDING EXPOSURE TRENDS, RESERVES, PROVISIONING AND CURRENCY MANAGEMENT

Objective

1. To support continued prudence in IBRD financial management and the protection of its AAA status.

Line to take

2. Welcome the most conservative levels of provisions and reserves that have been adopted; wise precautions to take to maintain the financial standing of the IBRD.

3. Note that key financial indicators of the Bank's profitability continue to be strong, though the outlook remains highly sensitive to assumptions regarding the trend of arrears and the levels of prepayments.

4. Urge early implementation of the new currency management proposals: matching the currency composition of reserves to that of the loan pool will protect the reserves to loans ratio from exchange rate fluctuations. This will reduce the need for transfers from income to reserves. Under the new system borrowers should also bear less (or more predictable) interest and exchange rate risk, see para 11-14 below.

Background

5. The current level of arrears (3½ per cent of total loan portfolio) means that the Return on Assets (see Table 1) will be reduced by 60 basis points below the level it otherwise would have been in FY89.

Table 1: Lending and Exposure, last five years and projections

US$ billion

WORLD BANK FY: (1 July - 30 June)	1983	1984	1985	1986	1987	1988	1989 (current)	1990 (forecast)	1991 (forecast)
IBRD									
Loans approved	11	12	11	13	14	15	17	19	20.5
Disbursements	7	9	9	8	11	12	12.5	13.5	14
Total income	4	5	6	7	8	8.5	9	9.5	10
Net income/a/	1	1	1	1	1	1	1	1	1.5
General reserve	3	3	4	5	6	7	9	10	11
Net borrowings	10	10	11	11	9	11	11.5	12.9	12.5
Subscribed capital	52	56	59	78	85	91	(up to 171 following 1988 GC1)		
Loans outstanding	34	38	41	61	76	82	92	97	101
Current lending	7.65 per cent								

Table 2: IBRD Financial Ratios

	FY83	FY84	FY85	FY86	FY87	FY88	FY89	FY90	FY91
Interest Coverage Ratio /b/	1.24	1.17	1.29	1.25	1.19	1.15	1.17	1.18	1.20
Return on Assets % /c/	1.78	1.20	1.98	1.78	1.26	0.98	1.09	1.13	1.27
Reserves/Loans Ratio % /d/	10.14	9.88	9.69	8.52	8.67	9.30	9.90	10.70	11.50
Memo Item									
Average Earning Assets ($bn) /e/	42.1	49.9	57.1	69.9	89.9	102.6	109	114	119

Notes

/a/: Projections assume annual additions to loan loss provisions of $350 million (12 per cent of the $2.9 billion outstanding principal of current arrears) and annual interest foregone from current of $260 million.

/b/: Interest coverage ratio: net income plus borrowing expense divided by borrowing expense.

/c/: Return on assets: net income dividend by average earning assets.

/d/: Reserves/loans: General plus Special Reserves divided by total loans net of cumulative loan loss provisions.

/e/: Loans plus investments.

Provisioning policy

6. Specific provisions are made on a consolidated basis against principal outstanding of arrears. These begin as soon as the members move into non-accrual status (that is after six months of non-payment).

7. By the end of FY89 the Accumulated Provision for Loan Losses should represent 28 per cent of principal outstanding on loans in non-accrual.

Table 3: Consolidated Provision for Loan Losses

		FY86	FY87	FY88
			(US$ millions)	
Loan Principal:	a) Outstanding	302	824	2924
	b) Overdue	24	71	378
Income not Accrued	22	76	320	
Accumulated Loan Loss Provisions		36	85	500
- as % of loan principal outstanding		11.98%	10.35%	17.10%

Reserves

8. An adequate level of reserves (expressed as a percentage of total loans) protects the Bank against impairment of capital in the event of possible loan defaults and helps assure the Bank's bondholders that these risks are well contained.

9. The Reserves to Loans Ratio (see Table 2) targeted at 10 per cent is sensitive to exchange rate movements. A mismatch of the currency composition between loans reserves caused this ratio to be vulnerable to a depreciation of the US$. This has meant that a larger than usual proportion of net income has hitherto had to be allocated to reserves and thus a higher Return on Assets targeted for loans and investment. The new currency management policy should avoid this.

Monitoring of Exposure Trends

10. The IBRD operates an informal exposure limit to any one country of 10 per cent of the whole portfolio of loans outstanding. The following countries are close to or have breached that limit.

Table 4: Portfolio Concentration

Country	Total loans Committed	Loans Outstanding	Percentage of total loans outstanding
	(US$ billions)		
Brazil	13.33	8.38	10.24
Indonesia	11.13	7.12	8.70
Mexico	10.40	6.72	8.21
Turkey	8.76	5.87	7.17

Currency Management

11. The Bank is currently introducing new currency management practices which will be more equitable towards borrowers and, as regards the finances of the Bank, more transparent and more efficient.

12. Under the old system, the Bank passed on to borrowers the exchange rate and interest rate risk of all the currencies it borrowed. It then invested the high interest rate currencies and lent borrowers the low interest rate currencies. The Bank could then recall from borrowers any currcncy which it needed to meet its obligations to its own creditors. Under this system the borrowers felt justly aggrieved that they bore the exchange and interest rate risk not only of currencies they borrowed, but also of those invested by the Bank.

14

BRIEF NO 14

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

IBRD: LENDING TO DEVELOPMENT FINANCE CORPORATIONS;
DIVISION OF LENDING (PROBLEM DEBTORS AND OTHERS)

Objectives

1. i. To welcome the setting up of a Task Force by the Private Sector Development Review Group (PSDRG) to examine the Bank's relationships with Development Finance Corporations (DFCs).

   ii. To encourage the Bank to give priority to increasing the effectiveness of its lending through DFCs, rather than expanding the volume of lending to DFCS.

   iii. To ensure lending through DFCs is consistent with overall policies to encourage private sector development, greater use of market mechanisms and removal of distortions in the financial sector.

Line to take

2. Recognise that DFCs can (if properly managed) have a worthwhile role in assisting private sector development.

3. Hope Task Force will produce clear guidance on how worrying performance of some DFCs can be improved. When is Task Force likely to report?

4. Encourage the Bank to play leading role in helping DFCs improve their performance.

5. Should not lend to those DFCs which require major reform of their organisations and financial structures.

6. Stress importance of DFCs not distorting private sector resource allocation by providing effective subsidies. They should generally pass on all their costs and risks.

7. Recognise that when exchange rates are highly overvalued Governments are likely to have to bear exchange risks, but suggest greater bearing of risk by DFCs in other circumstances.

8. Encourage Bank to investigate possibilities for supporting greater lending through private sector institutions, including commercial banks.

Background

9. State-owned Development Finance Corporations have played a major role in many developing countries in providing long term loans to small and medium scale private enterprises. Most were set up because of the difficulties such enterprises faced in obtaining funds from commercial sources. The World Bank has lent some $10-11 billion of DFCs to date. Lending to them by ODA has been limited (partly because of tying restrictions) but some other donors have channelled large sums through DFCs.

10. The performance of many DFCs has been poor, particularly in recent years. They have been ineffectively managed and unsound financially. Some of the financial problems have arisen because loans have been made to previously protected companies which are now unviable, following liberalisation and devaluation.

11. Since the World Bank is heavily involved in assisting DFCs there is some concern that the Task Force will not take an impartial line, as too critical a report could have an adverse impact on the Bank's volume of lending.

Table 1: Adjustment Lending

	FY81	FY82	FY83	FY84	FY85	FY86	FY87	FY88
Structural Adjustment Loans								
Number approved	6	6	7	6	3	7	13	8
US $ billion	0.7	1.1	1.3	1.1	0.2	0.6	0.7	0.8
% of total IBRD + IDA	5.8	8.2	8.9	7.0	1.1	3.7	3.8	4.0
Sector Adjustment Loans								
Number approved	3	-	8	8	13	18	18	23
US $ approved	0.1	-	0.6	1.3	1.5	2.3	3.5	4.2
% of total IBRD + IDA loans approved	1.1	-	4.4	8.5	10.3	14.0	19.5	21.9
All adjustment Loans								
Number approved	9	6	15	14	16	25	31	31
US $ billion	0.9	1.1	1.9	2.4	1.6	2.9	4.1	5.0
% of total IBRD + IDA loans approved	6.9	8.2	13.3	15.5	11.4	17.7	23.3	25.9

Table 2: Division in Lending (Problem Debtors and Others) Loans/Credits Approved

		1983	1984	1985	1986	1987	1988
Highly Indebted Countries(1)(3)	$bn:	4.7	4.4	4.6	5.9	6.3	6.4
% of total IBRD loans approved		42	37	40	45	44	43
LIDDs(2)(3)	$bn:	0.9	0.7	0.8	0.8	0.9	1.4
% of total IDA credits approved		26	18	27	26	25	32

(1) Argentina, Brazil, Bolivia, Chile, Colombia, Costa Rica, Cote d'Ivoire, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, Yugoslavia.

(2) Comoros, Equatorial Guinea, The Gambia, Ghana, Guinea Bissau, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Sao Tome & Principe, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Zaire, Zambia.

(3) One of the HICS (Bolivia) received IDA credits of $70 million in 1986, $75.4 million in 1987 and $112 million in 1988; two of the LIDDS (Zaire and Malawi) received IBRD loans of $93 million in 1984, $6 million in 1985 and $135 million in 1986. All these credits and loans are excluded from the table.

15

BRIEF NO 15

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

IDA 9

Objectives

1. i. To express strong support for IDA, and for a substantial and early Ninth Replenishment, but without endorsing management's $16 billion target.

   ii. To stress the continuing importance of IDA's role in support of adjustment in the poorest countries, particularly in Sub-Saharan Africa, alongside the other instruments such as the ESAF, Chancellor's debt initiative etc.

Line to Take

2. Too early to mention any particular total.

3. Note that reflows from earlier IDA credits are beginning to build up. Welcome proposals for recognising their potential for significantly topping up donors' contributions in this and future replenishments.

4. While recognising needs of other poor countries in Asia and elsewhere, needs of Sub-Saharan Africa remain very pressing and justify allocation at least equal to that under IDA 8.

Background

5. IDA 9 will be for commitment over the three years from 1 July 1990. Contributions are drawn down over 8 years or so, as commitments are disbursed. Negotiations began with the IDA Deputies meeting in Washington in February. At that meeting, the new US Administration asked for more time to prepare itself. The second meeting in Paris at the end of March will be an informal consultation of EC and Nordic Deputies, leaving the main negotiations to be resumed in London in May.

Size and Burden Sharing

6. Figures for recent replenishments are as follows:

	IDA 6	IDA 7	IDA 8	(IDA 8 inc vol. contrib.)
Total ($ billion)	12.0	9.0	11.5	12.4
		% shares:-		
US	27.0	25.0	25.0	23.2
Japan	14.6	18.7	18.7	21.0
Germany	12.5	11.5	11.5	11.1
France	5.4	6.6	7.3	6.8
UK	10.1	6.7	6.7	6.3
UK contribution: £ million	555.0	401.5	514.0	524.2

7. Staff proposals for IDA 9 envisage taking as a starting point the $12.4 billion IDA 8 total including voluntary additional contributions, leading to an IDA 9 target of $16 billion if donors' contributions were maintained in real terms. Several donors (including UK) indicated at the Washington meeting that they did not accept the inclusion of voluntary contributions in the starting figure, as such contributions were made on the basis that donors would not be held to them in subsequent replenishments.

8. It was recently agreed to increase IDA commitment authority by SDR 525 million ($695 million at current rate) per annum to take account of expected reflows (ie repayment of earlier credits). These should total about $2 billion over the IDA9 commitment period. We, and no doubt other donors, will want to argue that this should be used to reduce the burden on donors; management, on the other hand, will argue that it should be an extra bonus for recipients.

9. Negotiations on size are likely to be difficult: we and other Europeans are faced with the simultaneous renegotiation of Lome; and the budget deficit will continue to be a major factor in US policy.

10. Although the USA's 25 per cent is well below its proper share on the basis of relative economic weight amongst IDA donors, there may be difficulty in securing a satisfactory total Replenishment on the basis of four times whatever the US negotiating ceiling is for IDA 9. Japan, and other donors, including the UK,

could then come under pressure to put up more. Depending on the outcome of the negotiations on size, we would hope to maintain our 6.7 per cent share.

Regional allocations

11. In IDA 8 it was agreed that countries in sub-Saharan Africa should get a minimum of 45 per cent and up to 50 per cent "if warranted by progress with their economic adjustment programmes". 30 per cent was allocated to India and China leaving 20 per cent for the rest (mainly Asia). Japan is pressing for an increased share for Asia this time; China has already started lobbying us and others, and India is bound to follow suit (a large proportion of reflows (para 8) will come from India). But Africa's needs remain most pressing - the more so now that Nigeria has recently sunk back into IDA eligibility. While there is room for cautious optimism on the success of adjustment programmes in the region, the adjustment process is by no means complete in countries where programmes are in place, and has barely begun to be addressed in some other countries (Zambia, Sudan). There is thus a very strong case for maintaining at least a 50 per cent share for Africa in IDA 9.

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BRIEF NO 16

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

PRIVATE SECTOR DEVELOPMENTS INCLUDING MIGA AND IFC

Objectives

1. i. To reiterate our support for private sector development per se and stress the importance UK places on it as an important contribution to overall economic development.

ii. To welcome moves within the World Bank Group, especially the Report of the Private Sector Development Review Group, to rationalise the services it provides to the private sector.

iii. To encourage increased private direct investment in Ldcs, and to make the relaxation of controls on inward direct investment a condition for debt reduction.

iv. To signal need for more convincing case for a new GCI for the IFC.

v. To support debt/equity schemes and IFI support for them (see brief 2).

Line to take

2. Congratulate International Finance Corporation (IFC) on successful FY 88. In particular welcome improvement in performance of portfolio, but no room for complacency. Not convinced of need for General Capital Increase in FY92 or, if a GCI is agreed, for it to be fully paid in.

3. Glad to note that Multilateral Investment Guarantee Agency (MIGA) is nearly ready to celebrate its first birthday (12 April). When is it likely to commence guarantee operations?

4. Urge all countries which have not yet done so (especially large debtors) to sign and ratify the MIGA Convention as soon as possible and encourage those whose capital subscriptions are in arrears to meet their Convention obligations.

Background

IFC: FY90-92 Growth Strategies and FY(90) Business Plan and Budget Framework Paper

5. This paper reviews the FY 85-89 programme, concluding it has been successful. It discusses strategy for the next three years including a possible capital increase beginning in FY92. But the case for continuation of 20 per cent per annum growth of IFC operations and a consequentially fully paid GCI is not convincingly argued. A tentative budget framework for FY90 is presented which implies a 4-6 per cent real increase. Approval is sought for the formalisation of two financial policies in advance of IFC being credit rated: we consider that the proposal limit on leverage (2.5:1) is too high while that on equity investments is acceptable.

Multilateral Investment Guaranteed Agency

6. MIGA came into existence on 12 April 1988 when ratification of the MIGA Convention by US and UK triggered its entry into force. As at 14 February 1989 11 developed and 40 developing countries had ratified, thus becoming members of MIGA. The Inaugural Meeting of the Council of Governors was held in June 1988, and meetings of the Board of Directors have been held in June 1988, September 1988 and January 1989. These meetings have been concerned with getting MIGA established on a sound basis, including prudent underwriting arrangements, agreement of a standard contract of guarantee etc. At the time of writing no contracts of guarantee had been issued although a number of applications have been received and are expected to be considered at the next meeting in June. A number of major debtor countries have not yet signed the Convention including Argentina, Brazil, Mexico, Peru and Venezuela. The following member countries have not, as at 14 February 1989, met their Convention obligations - in part or in whole - on paid-up shares of contributions: Burkina Faso, Cameroon,

Cote D'Ivoire, Ghana, Togo, Vanuatu, Zambia, Nigeria, Tunisia, Madagascar, Malawi, Senegal, Sri Lanka, Western Samoa and Pakistan.

Private Sector Development Review Group (PSDRG)

7. Executive Directors have endorsed a broad-ranging report produced by PSDRG and dealing to a large extent with the macro-economic environment and World Bank Group (WBG) impact on this through adjustment lending and policy dialogue. One of the report's recommendations was for an in depth review by a task force of the Bank's institutional approach and policies towards Development Finance Corporations (DFC's), where there is a history of problems (see brief no 14).

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Brief No 17

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

CREDIT ENHANCEMENT BY THE IFIs AND WORLD BANK GUARANTEES

Objectives

1. Express open mind on credit enhancement methods by IMF and World Bank which do not undermine their financial position, and do not involve additional use of resources. But express doubts about the use of guarantees for debt reduction and oppose the use of additional resources for this purpose.

Line to Take

2. New money. Commend IBRD's existing conservative approach to credit enhancement, which can include guarantees in concerted lending packages with commercial banks, but only very selectively and with considerable caution. Note that guarantees can function as IBRD "seal of approval" of a new money package. Danger if widely used, that the absence of an IBRD guarantee could come to be regarded as a seal of disapproval. So caution needed in giving, or creating expectations of, IBRD guarantees of commercial bank debt.

3. Debt reduction. Express open mind on IFI credit enhancement for debt-reduction, provided that it does not involve a net increase in public sector risk relative to commercial banks, leads to acceptable burden sharing, and does not over-expose the IFIs. Prefer collateralisation to guarantees and buybacks to bond exchange schemes. But acknowledge that a menu of options has to be provided to banks operating under different tax laws and bank supervision arrangements.

4. IMF should not get involved in issuing guarantees but could facilitate debt reduction eg through escrow accounts.

5. World Bank could have a similar role in managing escrow accounts and might also issue securities (eg zero coupon bonds) to be bought for collateral. In some circumstances, which would have to be case by case, redeposit or escrowing of Bank loans by borrowers to provide credit enhancement could be an effective use of existing resources. Would oppose providing more resources or directly taking over risks of banks.

Background

6. Credit enhancement has become a major issue with the new focus on debt reduction. Credit enhancement features in the Brady proposals (and also in the earlier French and Japanese schemes).

7. The Bank has a number of instruments already at its disposal which it can use to enhance the credit risk on loans to ldcs. The principal instruments are "B-Loans" and guarantees. B-Loans involve direct participation combined with [optional] cross default for the whole period of the loan. The Bank's policy is to offer this only to countries which are reasonably creditworthy, and not in concerted lending packages for problem debtors, because of the greater credit risk for the Bank which is involved. Instead such countries may be offered, very selectively, guarantees. These have usually covered only the outer maturities of the loan and so represent no immediate call on the Bank's capital: but they are counted against capital and exposure limits from the time they become callable. The Bank had been using the instruments very selectively, issuing about 4-5 guarantees per year, mainly in voluntary lending packages, until 1987, since when the US have vetoed proposals for guarantees. The last guarantee for a problem debtor was that given to Mexico in 1986.

8. The Bank have not themselves sought to change their policy on credit enhancement. But they have a legitimate interest as a major creditor in seeking to share the burden of support for debtor countries with the commercial banks, whose contribution could take the form of either new lending or debt reduction. The selective use of guarantees could, possibly, contribute to this objective.

9. The Japanese have been strong supporters of the use of World Bank guarantees and have lobbied at official level to this effect.

The US Debt Initiative

10. The Brady proposal is for both IMF and IBRD to make $6-7 billion each available for credit enhancement over 3 years (probably involving an acceleration of the IBRD's next GCI and an intensified use of Fund resources). They would offer time-limited rolling support for interest payments on discounted debt-exchanges or partial interest forgiveness if the discount/interest relief was significant.

11. Brady suggests interest support by the IFIs might work in one of three ways:

i. credit lines;

ii. proceeds from policy loans redeposited in escrow accounts at the IFIs;

iii. in the case of the World Bank, conventional guarantees.

12. We have argued against World Bank guarantees for major debtors on the grounds that they create no additional leverage during the period in which they are callable; and that they produce an undesirable mingling of IFI and bank claims which could dilute the preferred creditor status of the IFIs, and might be to the detriment of non-preferred official debt service (eg Paris Club). They might also discourage a return to normal market access.

13. It is not clear how credit lines would work. In G7 Brady has spoken in terms of "pools" at the IFIs. If such pools were held by the IFIs themselves, the support provided from them would be open to some of the same objections as direct guarantees with comparable terms and conditions. We would not be attracted to "credit lines" along these lines unless they are simply undrawn loans.

14. There are no objections to the establishment of support funds by the debtor countries themselves using escrow accounts at the IFIs, or to using some of the proceeds of normal policy loans in this way, provided that this creates no legal or financial obligations on the IFIs. The effect would be the same as if a portion of the debtor's reserves were dedicated to collateralise the interest service for these transactions. We do not support the proposal to make additional resources available for this purpose, or to bring forward the commitment or disbursement of existing resources.

BRIEF NO 18

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

ENVIRONMENT: WORLD BANK ROLE, ENVIRONMENTAL CONDITIONALITY AND DEBT FOR NATURE SWAPS

Objectives

1. i. To commend Bank's actions and increasingly open attitude.

ii. To stress our continuing interest in environmental burden of individual projects while making clear our opposition to blanket "environmental conditionality".

Line to take

2. Glad that the Bank's increased programme of environmental assessments and research is bearing fruit. Particularly welcome the introduction of the Environmental Newsletter which will allow all of us to benefit from the Bank's leading role in research.

3. There continues to be great interest in the UK in individual World Bank projects notably the Power Sector II loan for Brazil. Ministers have undertaken to keep in close touch with concerned NGOs about it. Once precise terms are known we will need to consider environmental and social aspects extremely carefully.

4. Environmental safeguards for individual development projects are appropriate. However, we do not support blank **'green conditionality'** which threatens to withhold aid because of overall environmental performance. We should instead seek to improve countries' institutional capacity to deal with environmental matters, while withholding our support for projects that damage the environment.

5. It is right that people should be seeking resources for environmental protection. Welcome debt-for-nature swaps agreed voluntarily between commercial

banks and debtors as part of menu approach. Arrangements whereby conservation organisations can benefit from secondary market discount on debt (either purchased from or donated by banks) can provide valuable additional resources for environment. But role is likely to be limited. Not convinced by arguments for greater government involvement. Recognise that private "debt for nature" swaps also have a useful additional role.

Defensive

6. We are still examining the World Resources' Institute's paper on Conservation Funding.

Background

7. Mr Piddington, the new Director of the Bank's Environment Department, has just instituted a Newsletter which will make it much easier to follow Bank work. It is a welcome contrast to earlier secretiveness by the intellectural leader on environmental amongst donors. The first edition shows that the environmental agenda set out by Mr Conable at the time of reorganisation is now well underway.

8. Public interest in the UK in the Bank's environmental performance now centres on Power Sector II, a structural adjustment loan to Brazil's Power Sector. The lobby eroneously maintains this will be used to finance specific hydro power dams in Amazonia. In fact the proposal is expected to involve quick disbursing balance of payments relief linked to tariff reform and strengthening the sector's capacity to address environmental and social issues. Mr Patten has promised to consult environmental groups before a decision is made on our attitude in the Board. Although scheduled for May, the proposal may in fact be greatly delayed by Bank negotiations following the Brazilians' decision to transfer their nuclear plants to the commercial power sector.

9. Concern about Power Sector II has strengthened calls for environmental or green conditionality, especially amongst those who question the willingness of countries such as Brazil to abide by project conditions. They argue that threatening to cut off all aid on the basis of unsatisfactory overall environmental performance, would be a powerful incentive to greater awareness. This attitude ignores countries' manifest inability to monitor and manage their often fragile and poorly understood environments. The 'line to take' reflects language used by the Prime Minister in a letter setting out policy, following

Opposition claims she favoured green conditionality linked to forestry performance in an answer in the House.

10. There are increasing calls for new ways of financing environmental protection in the face of static global aid flows. Within the existing menu approach for commercial bank debt, conservation organisations have purchased discounted debt to finance conservation projects in Bolivia, Costa Rica and the Philippines. One UK bank has contributed debt for a UNICEF project in the Sudan. Following a US Inland Revenue Service ruling in late 1987, clarifying the US tax code governing charitable donations of bank debt, environmental lobbyists criticised the UK for having a less favourable tax regime. But the UK tax code would allow commercial banks to claim tax relief on a donation of debt, provided the donation met the normal requirements for relief on charitable giving.

11. Some have argued for greater government involvement - eg by using government funds to finance swaps involving commercial bank debt, by imposing 'green conditionality' on IMF programmes or Paris Club reschedulings, or by forgiving official debt in return for environmental action. Ministers will be asked to examine these issues further in the context of the Prime Minister's Global Climate Change group. However preliminary consideration suggests that such proposals could erode important principles in the debt strategy (eg opposition to governments taking over commercial bank risk, limiting conditionality to factors determining a debtor's ability to repay) and create other complications (eg arguments over debtor's sovereignty) without providing any great incentives for protection. The World Bank and ODA already take into account environmental aspects in assessing the developmental benefits of loans and grants to debtors. But we have taken the view that existing country aid programmes are better used for environmental projects or purchase of imports than for debt buy-backs. Most Latin American countries are not aid recipient anyway.

12. The World Resources Institute has just circulated for comment a UNDP commissioned study on alternative mechanisms for funding conservation. These might be linked to the World Bank. Officials have yet to examine the report.

Brief No. 19

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

IBRD: POVERTY

Objectives

1. i. To support and encourage the World Bank in rethinking its strategy on poverty alleviation.

ii. To maintain pressure for adjustment measures designed to create conditions for growth whilst seeking within them greater attention to poverty impact.

iii. To emphasise the need for specific poverty measures to be affordable, cost effective and sustainable.

Line to Take

2. Poverty alleviation is primarily the responsibility of the country concerned.

3. Welcome the Bank's renewed commitment to poverty alleviation, as expressed in the President's Report to the Development Committee in September 1988.

4. Hope the Bank will produce a report by the end of 1989 outlining progress following the President's Report.

5. Endorse the Bank's view that effective anti-poverty efforts need to be country specific and need a sector approach which focusses on policies and institutions.

6. Encouraged that the Bank is giving priority to poverty issues in its economic and sector work, which will be essential if viable lending programmes are to be developed.

7. Welcome progress being made on Social Dimensions of Adjustment initiative as a means of incorporating poverty concerns into adjustment efforts.

Background

8. A Task Force on Poverty Alleviation was established following the 1987 Annual Meetings to design a World Bank programme of action for increasing the scope and effectiveness of the Bank's poverty focussed operations. The Task Force reported to Executive Directors in July 1988. Following on from this, a central theme in the President's Report to the Development Committee in September was the need for the Bank to give greater prominence in its work to poverty reduction.

9. The Bank still sees structural adjustment as essential, but argues that long-term growth is necessary but not sufficient for the alleviation of absolute poverty: the problem of poverty needs to be addressed explicitly. So far the Bank has been cautious in adopting specific programmes. However, it has been carrying out considerable analytical work on poverty issues in different countries, which is an essential prerequisite for designing appropriate and sustainable programmes.

10. Linked to the Bank's initiative on poverty is the social Dimensions of Adjustment Project. This project is co-sponsored by the Bank, the African Development Bank and UNDP. It aims to improve household data collection in order to trace the social impact of adjustment policies and to help African policy makers use the information for improving the design of adjustment programmes to reduce their adverse effects on poorer groups. It also encompases short term action programmes to assist the latter groups. Country level projects are being developed in 26 African countries. ODA is supporting a number of these, having already participated in missions to zambia Tanzania and Mozambique.

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BRIEF NO. 20

HER MAJESTY'S TREASURY

SPRING INTERIM/DEVELOPMENT COMMITTEE MEETINGS 1989

STRUCTURAL ADJUSTMENT

Objectives

1. i. To reinforce the importance of structural adjustment to complement macro-economic adjustment and promote external viability and growth;

ii. Hence to keep up the pressure for strong adjustment in all cases.

iii. (Especially for the sub-Saharan African Countries) to press for more rapid adjustment in certain key areas (import licensing, foreign exchange allocation, restrictions), of particular relevance for the promotion of a vigorous private sector;

iv. To press for the closest collaboration between the Fund and Bank from the earliest stages of programme design by stressing complementarity in areas of respective expertise.

Line to take

2. Welcome conclusion of Fund and Bank reviews that adjustment programmes have contributed to faster economic growth (especially in export sector) and/or improved external positions in a number of countries.

3. Encouraging general improvement in sub-Saharan Africa (SSA) since 1984. Good weather helped, but policy changes clearly also important. Impact on exports in some cases limited by infrastructural and institutional bottlenecks: underscores importance of ensuring public investment programmes support pricing reforms; careful balance between, and sequencing of, Bank adjustment and investment lending important.

4. <u>Growing discrepancies in performance of Latin American economies</u>. No coincidence that those now experiencing sustainable growth are countries which have embraced adjustment most coherently.

5. <u>Too soon to tell whether this represents decisive turning point for SSA:</u> cautious optimism justified.

6. <u>No grounds for complacency</u>. Evidence shows fragility of adjustment process. Insufficient progress in a number of important policy areas. Few signs of any significant rise in private investment in response to adjustment policies. Political commitment in some countries still weak. (Bound to recognise also that vested interests in status quo also affects pace of adjustment in some countries.)

7. <u>Essential not to soften emphasis on strong and comprehensive adjustment.</u> But <u>time-frame needs to be realistic</u> and have regard for local implementation capacities. Greater priorisation of key adjustment measures, and more attention to problems of sequencing and time-tabling, consistent with this. Must also be adequate financing: note rapid rise in <u>real</u> net oda to adjusting SSA countries - by nearly 20 per cent year during 1985-87. So donors fulfilling their part of the bargain.

8. Every case <u>sui generis</u> but in sub-Saharan Africa particularly we would <u>like to see more rapid progress in eliminating administered systems of import licensing and foreign exchange allocation, as well as restrictions on private sector activities.</u> (Existence of thriving parallel economies in some countries suggests scope for more rapid adjustment.) Not only necessary to promote vigorous private sector on which ultimate success of adjustment strategy depends. But administration of such systems confers large financial rents for those operating them. Given rapid rise in aid for general import financing in support of adjustment programmes, an important issue of aid effectiveness at stake. Careful attention in programme design to ensuring genuine poor are protected also critical to pace of adjustment.

9. Therefore, <u>would like to see fuller discussion</u> in programmes coming before the Boards of Fund and Bank <u>of assumptions</u> underlying proposed pace of adjustment <u>in these and other critical policy areas.</u>

10. All evidence points to necessity of strong fiscal and monetary policies to underpin progress in other policy areas: eg bringing down inflation crucial to exchange rate reform, achievement of positive real interest rates, and protection of the poor. Structural measures, whether designed by Fund or Bank, must be consistent with macroeconomic stability.

11. Close Fund/Bank collaboration from early stages of programme design essential for three reasons: (a) uniformity and consistency of advice; (b) to ensure comprehensive policy packages covering stabilisation as well as structural-cum-growth aspects falling within Bank's competence. For large majority of the poorest countries (including SAF/ESAF countries) adjustment without growth (implying decline in par capita living standards) not sustainable. It has also become difficult in Latin America given debtors' fatigue, (c) to ensure complementarity between macro-sectoral policy reforms and public investment programmes. Fund should draw on Bank's expertise in structural reform to avoid duplication of effort and friction between the two institutions. Welcome thrust of proposals in recent G10 report.

Background

12. There are encouraging signs that adjustment lending by the Fund and Bank has helped to improve policies in reforming countries and that these are bearing fruit in terms of faster growth and/or improved external payments positions in a number of countries. In sub-Sharan Africa (SSA) there has been a general improvement in economic performance since 1984 with GDP growth averaging over 2% pa in 85-87 compared with negative growth in 80-84. But evidence that strong adjusters have grown more is weaker than that showing they have exported more. The recovery was led by agriculture which grew strongly in 85 and 86 helped by good weather but also by policy changes. As a consequence food production has broadly kept up with population growth since 1984. Non-oil export volumes increased, reversing a persistent loss of market share since the 70s.

13. Some 30 countries in SSA are pursuing adjustment programmes of which 19 of the poorest and most debt-distressed are included in the **Special Programme of Assistance** (SPA - see Brief No 3). There has been a major shift of aid to adjusting countries in SSA: real net oda to these countries grew by nearly 20 per cent pa during 1985-87.

14. Adjustment policies in Latin America have been successful in a number of areas. The current account deficit for the region as a whole has fallen by 80 per cent since 1982. In part this improvement has been owing to improving world conditions and a sharp upturn in terms of trade last year, but it also reflects an increasing trend in many countries towards trade and exchange rate liberalisation and a drive to improve non-traditional export performance. Significant progress has also been made on financial sector reforms and external debt management.

15. However the experience of Latin America in the 1980s has illustrated the importance of adopting macroeconomic policies which support adjustment measures. The growth performance of the region as a whole weakened considerably in 1988 compared to 1984-87, as a result of the widespread re-emergence of inflation, which was the result in many cases of public sector disequilibrium.

16. Although a number of countries have made efforts to reduce their public sector expenditure, these efforts have tended to concentrate on capital rather than current spending. Furthermore the financing of public sector deficits has in many instances proved either inflationary or resulted in the crowding out of private investment. It is for these reasons that the IMF and World Bank have emphasised the importance of improved public sector management, the reduction of distortionary public sector pricing and the need to raise the domestic level of savings. The implementation of coherent and consistent macroeconomic policies and the removal of pricing interest rate and exchange rate distortions would not only help to improve public sector management but would also help to create the right conditions for a return of flight capital.

17. The experience with policy reform nevertheless shows a mixed picture. There has been relative progress in eliminating pricing distortions including real effective exchange rate depreciation and improved agricultural pricing. But there has been more patchy progress on inflation, fiscal policy (tax reform and expenditure rationalisation), trade liberalisation, financial reform, industrial policy, and public enterprises. Institutional reforms have generally proved very difficult. Earlier gains have sometimes later been reversed showing the fragility of the adjustment process.

18. Review of experience by both Fund and Bank points up importance of strong fiscal and monetary policies to underpin reforms in other areas; failure to ensure this complementarity was at least a partial cause of programme failure in

a number of cases. But lack of political commitment, inadequate internal concensus building, and piecemeal reform across an insufficiently broad front have been other causes. In Africa civil wars have also obviously played a part. While there are genuine social costs involved in adjustment, vested interests among those benefiting from the status quo are clearly a powerful factor in some countries. In particular, there are considerable "rents" to be obtained from the combination of a rapid rise in general import financing and administered import licensing and foreign exchange allocation systems.