

CONFIDENTIAL

Pl. file
Ch

CONFIDENTIAL

FROM UKDEL IMF/IBRD WASHINGTON

TO DESKBY 110800Z APRIL 86 FCO

TELNO 109

OF 102300Z APRIL 86

AND IMMEDIATE NEW YORK (FOR CHANCELLOR'S PARTY)

AND IMMEDIATE TO BONN, PARIS (AND FOR MOUNTFIELD) TOKYO AND

UKMIS GENEVA (FOR MOUNTFIELD)

IMF: INTERIM COMMITTEE - INFORMAL SESSION

1 THE INFORMAL SESSIONS REVEALED LITTLE CHANGE FROM ALREADY FAMILIAR POSITIONS. AS IN THE PLENARY SESSION, DISCUSSION WAS LOW KEY. THE CHANCELLOR'S MAIN PRESENTATION ON EXCHANGE RATES AND SURVEILLANCE IS REPORTED IN FULL IN A SEPARATE TELEGRAM.

THE DEBT STRATEGY

2 IN HIS INTRODUCTION THE MANAGING DIRECTOR STRESSED THE NEED FOR SOUND POLICIES IN DEBTOR COUNTRIES AND NOTED SOME RECENT POSITIVE DEVELOPMENTS, FOR EXAMPLE AN EASING OF CONTROLS ON INWARD CAPITAL INVESTMENT AND SOME INNOVATIVE SCHEMES TO CONVERT DEBT INTO EQUITY, WHICH SHOWED PROMISE. FOR THE CREDITOR COUNTRIES HE WELCOMED THE REFERENCES IN THE G10 COMMUNIQUE TO THE NEED TO CO-OPERATE REGARDING RESUMPTION OF EXPORT CREDIT COVER TO COUNTRIES IMPLEMENTING APPROPRIATE ADJUSTMENT POLICIES. IF DEBTORS CONTINUED THEIR ADJUSTMENT EFFORT THEN NEW LENDING WOULD EVENTUALLY BE FORTHCOMING BUT THERE MIGHT BE A RECOGNITION LAG BEFORE THE BANKS WERE CONFIDENT ENOUGH TO INCREASE THEIR COMMITMENTS. IN THIS SITUATION A FUND PRESENCE COULD BE USEFUL, EITHER A FINANCIAL ONE OR IN SOME CASES ENHANCED SURVEILLANCE. THE RECENT FALL IN OIL PRICES WOULD RESULT IN MUCH LARGER FINANCING GAPS FOR SOME COUNTRIES AND THE FLEXIBILITY OF THE CASE-BY-CASE APPROACH WOULD BE ALL THE MORE IMPORTANT.

3 BAKER (US) ALSO STRESSED THE POSITIVE FEATURES OF THE CURRENT OUTLOOK. RECENT FALLS IN INTEREST RATES WOULD SAVE DEBTOR COUNTRIES DOLLARS 11 BILLION AND THE FALL IN OIL PRICES, BY STIMULATING WORLD RECOVERY WOULD INCREASE THEIR NON-OIL EXPORT REVENUES. HE NOTED THE WIDESPREAD SUPPORT FOR HIS SEOUL INITIATIVE AND SAID THAT THIS WAS NOT INVALIDATED BY THE RECENT FALL IN OIL PRICES. HOWEVER, HE ACKNOWLEDGED THAT FINANCING NEEDS WOULD BE INCREASED. POLICY REFORMS IN DEBTOR COUNTRIES WERE CRITICAL BUT WOULD TAKE TIME TO IMPLEMENT. THE DEBT CRISIS HAD EVOLVED OVER A LONG PERIOD AND WOULD TAKE A LONG TIME TO RESOLVE. NEVERTHELESS, BAKER WAS OPTIMISTIC ABOUT THE PROGRESS BEING MADE IN A NUMBER OF DEBTORS. AND THE MULTILATERAL INSTITUTIONS WERE PLAYING A HELPFUL ROLE. FUND PROGRAMMES EXISTED OR WERE IN PROSPECT IN 11 OF THE 15 HEAVILY INDEBTED COUNTRIES. AND THE IBRD WERE MOVING FORWARD AND DEVELOPING NEW PROCEDURES. THEIR INVOLVEMENT SHOULD BE MORE IN THE FORM OF STRUCTURAL ADJUSTMENT LOANS RATHER THAN PROJECT

CONFIDENTIAL

/LENDING

CONFIDENTIAL

LENDING. IBRD INVOLVEMENT WITH PRIVATE CREDITORS WAS ALSO PROMISING. BAKER DISAGREED WITH THOSE WHO ARGUED FOR MORE FLEXIBILITY IN THE FUND'S LENDING POLICIES AND FOR AN EARLY GCI. ON THE LATTER, THE BANK COULD INCREASE ITS LENDING BY DOLLARS 2-2.5 BILLION PER ANNUM OVER THE NEXT FEW YEARS WITHOUT A GCI. AS FOR THE FUND IT SHOULD WORK WITH DEBTORS TO PROMOTE BETTER POLICIES RATHER THAN MAKE SPECIAL CONCESSIONS. ACCESS LIMITS WHICH SHOULD BE ASSESSED ON A CASE-BY-CASE BASIS ALREADY CONTAINED ADEQUATE FLEXIBILITY. AND THERE WAS NO NEED FOR A REVIEW OF THE CFF OR ITS ACCESS LIMITS. THERE WAS NO NEED TO ACCELERATE THE NEXT QUOTA REVIEW.

4 SILVA HERZOG (MEXICO) STRESSED THE SACRIFICES THAT DEBTOR COUNTRIES HAD HAD TO MAKE IN RECENT YEARS. DEBT SERVICING HAD BEEN AT THE EXPENSE OF GROWTH. THE EFFECT OF RECENT FURTHER FALLS IN DEBTOR COUNTRIES' TERMS OF TRADE WAS FOUR TIMES GREATER THAN THE BENEFITS ARISING FROM LOWER INTEREST RATES. THE BANKS REMAINED UNRECEPTIVE AND INDUSTRIAL COUNTRY GOVERNMENTS WERE NOT PULLING THEIR WEIGHT EITHER. EXPORT CREDIT COVER WAS SUSPENDED AT THE FIRST HINT OF RESCHEDULING AND CREDITOR GOVERNMENTS INSISTED ON A FUND PROGRAMME FOR A PARIS CLUB RESCHEDULING. AND THE REGULATORY ENVIRONMENT CONSTRAINED BANK LENDING. HERZOG AGREED WITH THE NEED FOR SOUND POLICIES IN DEBTOR COUNTRIES BUT THIS WOULD NOT ON ITS OWN BE SUFFICIENT TO STEM CAPITAL FLIGHT. THIS RELIED ON IMPROVED CONFIDENCE. FURTHER REDUCTIONS IN INTEREST RATES WOULD BE NEEDED TOGETHER WITH A REDUCTION IN SPREADS. AND A MORE FLEXIBLE REGULATORY ENVIRONMENT WOULD ALLOW THE BANKS TO CONSIDER INTEREST RATE CONCESSIONS WHICH MIGHT BE THE EASIEST SOLUTION TO PRESENT DIFFICULTIES. EXPORT CREDIT AGENCIES SHOULD MAINTAIN COVER TO COUNTRIES THAT WERE RESCHEDULING. THE PROBLEMS OF HIGHLY INDEBTED OIL PRODUCING COUNTRIES MERITED SPECIAL ANALYSIS. THE CASE-BY-CASE APPROACH HAD BEEN APPLIED IN FAR TOO STANDARD A FASHION ACROSS COUNTRIES.

5 PRESSED BY RUDING (CHAIRMAN) AS TO WHAT HE MEANT BY INTEREST RATE CONCESSIONS HERZOG REFERRED TO BELOW MARKET RATES OF INTEREST BUT CLEARLY DID NOT EXPECT THE BANKS TO CONCEDE THIS. WHAT HE SEEMED TO HAVE IN MIND WAS THE FINANCING IN SOME WAY OF THE DIFFERENCE BETWEEN MARKET RATES AND WHAT DEBTOR COUNTRIES COULD AFFORD. IN THE CASE OF OIL PRODUCING COUNTRIES HE SUGGESTED LONG-TERM BONDS LINKED TO THE PRICE OF OIL.

6 SOURROUILLE (ARGENTINA) MADE MANY OF THESE SAME POINTS INCLUDING THE NEED FOR INTEREST RATE CONCESSIONS AND BETTER TERMS OF TRADE. ANALYSIS OF DEBTOR COUNTRIES SHOULD BE FOCUSED ON THE MEDIUM-TERM AND HOW TO GET THERE RATHER THAN ON SHORT-TERM FIRE FIGHTING. THE BAKER INITIATIVE WAS A STEP IN THE RIGHT DIRECTION BUT THE FINANCING INVOLVED WAS NOT ENOUGH. IF THE INTERIM COMMITTEE COULD NOT FIND A SOLUTION TO DEBTORS' PROBLEMS THEN A SEPARATE WORKING GROUP OF THE INTERIM AND DEVELOPMENT COMMITTEES SHOULD BE SET UP. FUNARO (BRAZIL) ALSO TOOK UP THIS POINT BUT STOLTENBERG (GERMANY) SAID THAT SUCH MATTERS SHOULD BE LEFT TO THE EXECUTIVE BOARD. RUDING AGREED.

CONFIDENTIAL

7 NOUIOUA (ALGERIA) SAID THAT DEBTOR COUNTRIES NEEDED EXCEPTIONAL TREATMENT. ON INTEREST RATES, HE NOTED THAT EXPORT CREDIT AGENCIES OFTEN CHARGED HIGHER THAN MARKET RATES AND THAT THEIR RATES TENDED TO LAG BEHIND CHANGES IN MARKET RATES.

8 SINGH (INDIA) WARNED THAT BECAUSE OF BANKS' RELUCTANCE TO LEND TO HEAVILY INDEBTED COUNTRIES SOME MORE CREDIT-WORTHY COUNTRIES WERE BEING PRESSED TO TAKE ON MORE EXPENSIVE DEBT WHICH THEY COULD NOT AFFORD.

9 RUDING REMARKED ON THE CHANCELLOR'S HAVING SIGNED THE MIGA CONVENTION THAT MORNING AND RECOMMENDED THAT OTHER COUNTRIES FOLLOWED SUIT.

THE EXCHANGE RATE SYSTEM AND SURVEILLANCE

10 THE CHANCELLOR OPENED THIS SOMEWHAT MORE LIVELY DEBATE. (SEE MIFT). THOSE G10 MINISTERS WHO SPOKE RESTATED THE POSITIONS TAKEN AT THE G10 MEETING. BAKER STRESSED THAT THE SYSTEM COULD BE IMPROVED. IT SHOULD FEATURE SYMMETRY IN SURVEILLANCE - OF SURPLUS AND DEFICIT COUNTRIES, LARGE AND SMALL

COVERING THE WHOLE RANGE OF POLICIES WHICH AFFECTED EXCHANGE RATES. THE SYSTEM SHOULD ALSO BE FLEXIBLE BUT THE PRESENT SYSTEM WAS ARGUABLY TOO FLEXIBLE. THIS SUGGESTED THE NEED FOR GREATER AUTOMATICITY. A FINAL REQUIREMENT WAS THE POLITICAL WILL TO TAKE THE NECESSARY ACTION WHEN REQUIRED.

11 PRESSED BY THE CHANCELLOR AS TO WHAT HE MEANT BY GREATER AUTOMATICITY, BAKER SAID HE DID NOT ENVISAGE ACTION BEING TRIGGERED BY, SAY, OBJECTIVE INDICATORS BUT BY PEER GROUP PRESSURE. HOWEVER, SUCH INDICATORS COULD BE A FOCUS FOR SUCH PRESSURE.

12 BAKER MADE NO MENTION OF AN INTERNATIONAL MONETARY CONFERENCE. HOWEVER, THIS PARTICULAR FLAG WAS TAKEN UP BY CAMDESSUS (FRANCE) WHO FORCEFULLY RESTATED FRENCH ARGUMENTS IN FAVOUR OF TARGET ZONES (AFTER A NOTICEABLE RECENT RETICENCE BY THE FRENCH ON THIS SUBJECT: THIS MAY INDICATE THAT BALLADUR HAS BEEN PERSUADED TO SUPPORT THEM). HE CITED THE EXAMPLE OF THE EMS WHICH, QUITE THE OPPOSITE OF PROVIDING A ONE WAY BET TO SPECULATORS (AS THE CHANCELLOR HAD SUGGESTED), HAD ACTUALLY REDUCED SPÉCULATION. IN CONTRAST THE PRESENT SYSTEM, WITH NO RULES FOR OPERATORS, PROVIDED AN INCENTIVE FOR SPECULATORS. BUT THE CHANCELLOR, STOLTENBERG AND SUMITA (JAPAN) WERE ALL CATEGORICALLY OPPOSED TO TARGET ZONES. STOLTENBERG AND ALSO RUDING SAID THAT THERE WERE OTHER EXPLANATIONS FOR THE SUCCESS OF THE EMS AND THAT IT COULD NOT AUTOMATICALLY BE EXTENDED BEYOND THE EEC. BAKER TOO SAID HE DID NOT SUPPORT TARGET ZONES. SINGH AND NEBBIA (ARGENTINA) BOTH SPOKE IN FAVOUR OF TARGET ZONES AS DID KHAN (CHAIRMAN OF THE DEVELOPMENT COMMITTEE, OBSERVING). THEY AGREED THAT THE EXCHANGE RATE SYSTEM SHOULD BE FLEXIBLE BUT THIS WAS NOT PRECLUDED BY TARGET ZONES. THEY ARGUED FOR SETTING UP A SPECIAL JOINT COMMITTEE OF IC/DC DEPUTIES TO LOOK INTO THE QUESTION OF THE EXCHANGE RATE SYSTEM. HOWEVER, THIS IDEA WAS EFFECTIVELY SQUASHED BY BAKER AND STOLTENBERG AND RUDING TOO (WHO STRESSED THE COMPARATIVE ADVANTAGE OF THE INTERIM COMMITTEE IN THIS AREA).

CONFIDENTIAL

13 IN CONTRAST TO THE SHARPLY DIVERGENT VIEWS ON THE MERITS OF TARGET ZONES THE NEED FOR MORE EFFECTIVE SURVEILLANCE OF INDUSTRIAL COUNTRIES' POLICIES WAS UNANIMOUSLY AGREED. ALL AGREED THAT THE G5 PLAZA MEETING AND MORE RECENTLY THE CO-ORDINATED REDUCTION IN INTEREST RATES WAS A STEP IN THE RIGHT DIRECTION BUT G24 MINISTERS FELT SUCH SURVEILLANCE SHOULD BE FORMALISED WITH REFERENCE TO OBJECTIVE INDICATORS INCLUDING THE EXCHANGE RATE. THE MANAGING DIRECTOR, IN HIS INTRODUCTORY REMARKS, NOTED THE REFERENCE IN THE G10 COMMUNIQUE TO A STUDY BY THE EXECUTIVE BOARD OF HOW OBJECTIVE INDICATORS MIGHT FACILITATE THE SURVEILLANCE PROCESS AND THIS STUDY WAS DULY COMMISSIONED. BAKER SAW OBJECTIVE INDICATORS AS A WAY OF STIFFENING THE RESOLVE OF NATIONAL GOVERNMENTS TO SUBMIT TO INTERNATIONAL SURVEILLANCE BY MAKING PUBLIC KNOWLEDGE THEIR COMMITMENTS TO SELECTED INDICATORS AND THEIR SUCCESS OR FAILURE IN ACHIEVING THEM. HE ALSO SPOKE IN FAVOUR OF PUBLISHING A BRIEF STATEMENT FROM THE MD AT THE CONCLUSION OF IMPORTANT ARTICLE IV CONSULTATIONS. HOWEVER, NO ONE ELSE FAVOURED THIS IDEA. THE CHANCELLOR'S SPECIFIC SUGGESTIONS TO PUT MULTILATERAL SURVEILLANCE IN A MEDIUM-TERM FRAMEWORK WERE WELL RECEIVED. STOLTENBERG AND SUMITA, WHILE PREPARED TO GO ALONG WITH THE G10 LINE ON OBJECTIVE INDICATORS MADE CLEAR THAT AGREEMENT TO STUDY THEM WAS NOT A COMMITMENT TO IMPLEMENT THE FINDINGS OF ANY STUDY. STOLTENBERG REPEATED WHAT HE SAID AT THE G10 MEETING ABOUT SUCH A STUDY BEING A BACK DOOR TO TARGET ZONES AND SUMITA COULD ONLY SUPPORT THE STUDY AS AN ANALYTICAL TOOL. WHITELAW (AUSTRALIA) ALSO RAISED A NUMBER OF PRACTICAL OBJECTIONS.

14 G24 DIRECTORS URGED THAT THE EXECUTIVE BOARD COMPLETE A STUDY OF THE ROLE OF THE FUND BEFORE THE NEXT INTERIM COMMITTEE MEETING.

INTERNATIONAL LIQUIDITY AND THE ROLE OF THE SDR

15 THE FINAL INFORMAL SESSION DEGENERATED EVENTUALLY INTO A REVIEW OF THE PROS AND CONS OF AN SDR ALLOCATION. THERE WERE NO CHANGES IN PREVIOUSLY ESTABLISHED POSITIONS. BAKER, STOLTENBERG, SUMITA AND LEIGH-PEMBERTON ALL SAID THEY REMAINED UNCONVINCED THAT THE CASE FOR AN SDR ALLOCATION HAD BEEN PROVED. WILSON (CANADA) SAID HIS CONSTITUENCY WAS UNABLE TO REACH A CONSENSUS AS CANADA WAS NOT IN FAVOUR ALTHOUGH THE OTHER MEMBERS WERE.

16 BAKER IN PARTICULAR REMAINED FIRMLY OPPOSED. HE EMPHASISED THE CHANGES THAT HAD OCCURRED IN THE MONETARY SYSTEM SINCE THE INCEPTION OF THE SDR NOTABLY THE CHANGE TO FLOATING EXCHANGE RATES AND THE GREATLY INCREASED ROLE OF THE INTERNATIONAL CAPITAL MARKETS. ALTHOUGH HE RECOGNISED THERE WERE WEAKNESSES IN THE PRESENT SYSTEM, IT WAS IMPORTANT NOT TO UNDER-ESTIMATE ITS STRENGTHS. RENEWING SDR ALLOCATIONS MIGHT NOT INCREASE STABILITY IF IT REDUCED THE DISCIPLINE IMPOSED ON COUNTRIES BY THE NEED TO RETAIN CREDIT-WORTHINESS. THE US WAS WILLING TO EXAMINE WAYS TO INCREASE THE USEFULNESS OF THE SDR BUT WERE YET TO BE CONVINCED THAT ANY OF THE PROPOSALS WOULD IMPROVE THE FUNCTIONING OF THE INTERNATIONAL MONETARY SYSTEM. STOLTENBERG EMPHASISED THAT THE SDR WAS A MONETARY INSTRUMENT

CONFIDENTIAL

JAND

CONFIDENTIAL

AND NOT A VEHICLE FOR THE TRANSFER OF RESOURCES FOR DEVELOPMENT. THIS WAS SUPPORTED BY OTHERS AND USEFULLY REFLECTED IN THE COMMUNIQUE. ALL THE OTHERS WHO SPOKE ARGUED IN FAVOUR OF RENEWED SDR ALLOCATIONS. GIVEN THE CONTINUING OPPOSITION OF SOME MEMBERS, THEY EMPHASISED THE POSSIBILITIES RAISED BY THE VARIOUS REFORM SCHEMES PUT FORWARD TO TARGET SDR ALLOCATIONS ON THE MOST NEEDY COUNTRIES AND ENCOURAGE LDCS TO RETAIN SDRS IN THEIR RESERVES RATHER THAN SPENDING THEM (RECONSTITUTION). SEVERAL ALSO PICKED UP A SUGGESTION MADE AT THE START OF THE MEETING BY LAROSIERE THAT FURTHER WORK SHOULD BE DONE TO CONSIDER WAYS TO IMPROVE THE ATTRACTIVENESS OF THE SDR AS HE FELT THAT PART OF THE RESISTANCE TO RENEWED ALLOCATIONS REFLECTED SOME OF THE INDUSTRIALISED COUNTRIES' UNWILLINGNESS TO HOLD ADDITIONAL SDRS IN THEIR RESERVES.

17 THE COMMUNIQUE ASKED THE FUND BOARD TO CONTINUE CONSIDERING THE ROLE OF THE SDR IN THE INTERNATIONAL MONETARY SYSTEM.

16 FCO PLEASE ADVANCE TO PS/CHANCELLOR AND LAVELLE, PS/SIR P MIDDLETON (HMT), PS/GOVERNOR (BANK OF ENGLAND), PS/SIR C TICKELL (ODA) AND MAUD (ERD).

LANKESTER

MONETARY
ERD

-5-

CONFIDENTIAL