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Prime Minister



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

Agree that the BIS
deadline may be extended
as proposed in

Yes

para 5?

PRIME MINISTER

I imagine you will have serious
reservations about the export credits proposal.

Shall I arrange a meeting with

BRAZIL

As you know, I shall be attending with the Governor an informal meeting of EC Finance Ministers in Greece this weekend. Debt issues, not least Brazil, will be on the agenda then, and at the BIS meeting in Basle next Monday and Tuesday. I thought, therefore, that you should have in advance an up-to-date assessment of the Brazilian situation, taking account of private discussions between G5 officials and the Fund in Washington earlier this week. I apologise for its length.

the
Chancellor,
Governor
and
P Middleton?

MCS 9/9

2. The Fund are clearly convinced that they have now secured Brazilian commitment to a thorough adjustment programme which will reverse the inflationary spiral and effect the necessary structural changes in the economy. Key features of the programme are a targetted reduction in inflation from around 150% at the end of this year to 55% at the end of 1984; and a halving of the budgetary deficit this year, moving to a small surplus next year. The reduction in inflation will be achieved by tight monetary control and - crucially - ratification by the Brazilian Congress of the law on wage de-indexation. The Fund maintain that even if Congress reject this, the President and Delfim Netto are now so politically committed to the Fund programme that they will bring it into effect by administrative means. Budgetary control is being restored by a package of fiscal measures (spending cuts, tax and price increases, and withdrawal of subsidies) which will be closely monitored. Some of the fiscal measures have given a temporary boost to inflation, but the latest data for the first half of this year are consistent with the planned reduction in the budget deficit for the whole year.

Yes
P
net



3. All this is, of course, pretty speculative; but there seems to be increasing evidence that the screw applied in July is working, and that the Brazilian Government are now seriously committed. The Americans at any rate seem to accept this, and their representative made it clear at the talks in Washington this week that they are prepared to find extra finance to back the Fund programme, and are looking to their allies to be prepared to chip in also.

4. So far as the Fund are concerned, the course of events seems likely to be as follows. The Managing Director hopes to be able to agree the Brazilian letter of intent before the end of this week. He will then inform the banks of this agreement so that negotiations with them (and separately with governments) on financing the programme can begin as soon as possible. The programme will not, however, be considered by the Executive Board for approval until the end of October or early November when the wage deindexation measure has been secured. The Fund representative at this week's meeting made it clear that implementation of the programme, and disbursement of funds under it, would be absolutely conditional on implementation of the wage deindexation measure and assurances that the necessary funds from banks and official sources to finance the programme would be forthcoming. Progress will also, of course, depend on the outcome of the BIS meeting and the rescheduling negotiations due to begin in the Paris Club on 15 September.

5. So far as the BIS is concerned, the immediate issue is whether to roll forward informally the de facto deadline of 15 September set in July for the repayment of the overdue instalments of the bridging facility granted last December. De Larosière will urge that it be rolled forward. The fact is, of course, that Brazil will not be in a position to meet the deadline; and given the progress on the Fund programme following the turning of the screw in July I see little advantage in the BIS invoking the



substitution agreement next week and thus, in effect, declaring no confidence in Brazil's commitment to the Fund programme. I think the sensible course might be to extend the deadline to the December BIS meeting, or the formal ratification of the Fund programme, whichever is the earlier. This would enable the negotiations in train to be completed within a year of the original extension of the facility. But the Governors may want to retain some discretion on this, and they will certainly want to forge a strong link between extension of the facility and continuing commitment by the Brazilians to the requirements of the Fund programme.

6. In the course of the Washington talks the Fund revealed more details of the proposed financing of their programme. In brief, taking into account disbursements under the programme itself and the likely outcome of rescheduling, the Fund are looking to the banks to produce a new 'jumbo' loan of \$7 billion, and to official sources to cover a remaining "financing gap" of some \$2 billion. This approach is worrying; and our representative and his French, German and Japanese colleagues made it clear that they could make no commitment or offer any hope of being able to do so. Substantial official support will already be provided through the Fund itself and (subject to negotiation) the Paris Club rescheduling; and the main problem arises on availability of funds from the banks, although in some cases their ability to lend may now be constrained for prudential reasons.

7. However, it is clear that the Americans are determined to provide further support. They have already (with Brazil in view) sought Congressional authority to make up to a further \$1.5 billion of trade credit available from the Eximbank. And I suspect that, when it comes to the crunch, the Germans and French will agree to make some further commitment, and that the Japanese will fall into line. So the Americans may press us pretty hard - and I imagine that the President may raise the issue with you later in the month.



8. A further - and to some extent offsetting - point to emerge from the Washington talks was that neither the Fund nor the Americans are now proposing that the "financing gap" should be filled by a new cash injection. Instead, the proposal now is that additional export credits (to the sum of some \$2 billion) should be provided on some agreed basis of allocation between the G5 and other creditor countries (including Canada, Switzerland, Italy and Saudi Arabia).

9. So far as the new commercial bank loan is concerned, we can keep our distance. This is the banks' business and they must sort it out. Our direct concern will be with the Paris Club rescheduling and the new proposal for additional export credits described above. (1) (2)

10. On the rescheduling, we shall have little option but to let the normal Paris Club procedures take their course. We shall need to consider carefully to what extent, and subject to what safeguards, the rescheduling arrangements should extend beyond the end of 1984, but otherwise I do not anticipate any special difficulties here. The important thing will be not to let anyone lose sight of the fact that the rescheduling will itself be a significant source of new official funds for Brazil.

11. The so-called "financing gap" presents much greater difficulties. We must clearly hold fast to the acceptance in Washington that no new cash provision from official sources can be involved. I see objections in principle and in practice too to committing ourselves to any specific share of additional export credit cover. If, however, the Americans continue to press strongly, and our principal partners are willing to fall into line, I suspect that it would be difficult for us to refuse to play any part. One possible alternative worth considering would be agreement to maintain at least some limited export credit cover for Brazil after the rescheduling. This would be contrary to our normal practice (and that of most of

(rescheduling
could add about
£200m to
the PSBR
in 1983-84
and 1984-5

(MS)



our major partners) of automatic suspension of cover on rescheduling, and thus would represent a specific and unwelcome policy departure. But it would set a less specific and damaging precedent for "gap filling" from official sources. And if we followed this course we should certainly need to ensure that:-

- we only participated as part of a joint relaxation of normal cover policy in this particular case by our major partners;
- our share was a ^{very} modest one, taking into account our relatively small share (about 3½%) of exports to Brazil and the substantial contribution we shall make from the rescheduling;
- the arrangement was linked closely and strictly to satisfactory compliance by Brazil with the agreed Fund programme.

12. We do not need to take immediate decisions on this. There will be further discussion by the G5 deputies towards the end of next week and among Finance Ministers at the Fund meetings in Washington later in the month. Much must also depend on the progress of the Fund's negotiations with the banks and on continuing and convincing demonstration of Brazilian commitment to the Fund programme. But if, as I expect, the Americans maintain their pressure for some additional element of official support, as the price of getting a sensible adjustment programme going, I think it would be difficult to resist considering some limited arrangement of this kind provided it is closely linked to execution of the programme.

13. In discussion with Community Finance Ministers over the weekend, I shall not reveal willingness to consider any concession on export credits unless it is clear that my colleagues are themselves considering doing so. The emphasis must remain



on concentrating official support through the Fund, and linking all support tightly to Brazilian compliance with the adjustment programme.

14. I am copying this minute to the Foreign & Commonwealth Secretary and to the Governor.

J. Kew

PP. NIGEL LAWSON

8 September 1983

(Approved by the Chancellor)

-9 SEP 1983

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COMPUTER

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