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OVERSEAS DEVELOPMENT ADMINISTRATION

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18 April 1988

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*Dear Nigel*

THE CHANCELLOR'S SUB-SAHARAN DEBT INITIATIVE AND THE TORONTO SUMMIT

When you became our Sherpa you encouraged me to write to you. So I thought I would drop you a line about developments on the Chancellor's Initiative during the Development Committee meeting in Washington last week.

We succeeded in keeping the Initiative alive. The Development Committee Communiqué mentioned it once more. In his oral statement to the Committee the Chancellor said that we was prepared to consider an alternative arrangement which would have a similar impact. I attach a copy of his oral statement.

...

The Americans proved difficult. They argued that they had already examined the proposal with immense care and had consulted numerous lawyers. Their conclusion was that insuperable constitutional problems prevented them from subsidising interest on official credit. I subsequently spoke to a member of the US delegation to draw his attention to the fact that the Chancellor had now put forward an alternative route which did not appear to involve the sort of problems which the Americans had described as insuperable. He was not encouraging. But I suspect that the Americans have not really addressed their minds to this alternative and indeed have a general antipathy to the whole concept of reducing the debt service burden by tackling directly the size of interest payments. I also suspect that they do not draw a clear distinction between commercial bank debt (which is no direct business of Governments and where none of us wants to subsidise interest) and official debt (which is a direct concern of Governments).

We received very valuable and strong support from the Canadians during the course of the meeting. The Canadian Minister of

/Finance

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Finance said that a way forward simply had to be found. I suggested to him that the Toronto Summit provided a valuable opportunity for achieving this. I said that with his leadership and our advocacy we might yet win through. I subsequently suggested to one of his officials that they might in parallel with us seek to impress upon the Americans a constructive approach to the alternative proposal put forward by the Chancellor.

Subject to any views from Geoffrey Littler and Rodric Braithwaite to whom I am copying this letter I would have thought that we ought to build this into the preparations for the Toronto Summit. Besides we may find that the Canadians will be raising it at your Sherpa meetings.

Yours ever

A handwritten signature in dark ink, appearing to be 'JC' with a long, sweeping underline that extends to the right.

John Caines

cc Sir Geoffrey Littler  
Mr Braithwaite

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CHANCELLOR'S SPEAKING NOTE FOR THE  
DEVELOPMENT COMMITTEE  
FRIDAY, APRIL 15, 1988

AT THESE MEETINGS A YEAR AGO, I  
PROPOSED AN INITIATIVE TO TACKLE THE  
PROBLEMS OF THE POOREST MOST DEBT-DISTRESSED  
COUNTRIES IN SUB-SAHARAN AFRICA.

THERE IS NOW GENERAL AGREEMENT THAT THE  
PROBLEMS OF THESE COUNTRIES ARE DIFFERENT IN  
KIND AND IN SCALE FROM THOSE OF THE MIDDLE-  
INCOME DEBTORS, AND DEMAND SPECIAL  
ATTENTION.

SINCE LAST SPRING, A GOOD DEAL HAS BEEN  
ACHIEVED.



BOTH THE IMF AND THE WORLD BANK HAVE RESPONDED BY PUTTING FORWARD THEIR OWN PROPOSALS.

- THE IMF HAS INTRODUCED ITS ENHANCED STRUCTURAL ADJUSTMENT FACILITY. CONTRIBUTIONS ARE NOW NOT FAR SHORT OF THE MANAGING DIRECTOR'S TARGET OF SDR 6 BILLION. ON THE CRITICAL ELEMENT OF THE INTEREST SUBSIDY, WE HAVE PLEDGED THE LARGEST SINGLE CONTRIBUTION, SUFFICIENT TO SUBSIDISE ONE-SIXTH OF THE MANAGING DIRECTOR'S TARGET. I HOPE THAT OTHERS WILL PLEDGE CONTRIBUTIONS AS SOON AS POSSIBLE.



- THE WORLD BANK IS NOW TAKING FORWARD ITS SPECIAL PROGRAMME OF ASSISTANCE FOR SUB-SAHARAN AFRICA OVER THE NEXT THREE YEARS. THIS HAS ATTRACTED \$6.4 BILLION FOR COUNTRIES WHICH ARE FOLLOWING AGREED ADJUSTMENT PROGRAMMES IN ASSOCIATION WITH THE WORLD BANK. THE UK ALREADY SUPPORTS SUCH PROGRAMMES AND WILL BE CONTRIBUTING NOT FAR SHORT OF \$1/2 BILLION OVER THE NEXT THREE YEARS.

BUT THESE WELCOME DEVELOPMENTS WILL NOT BE SUFFICIENT BY THEMSELVES. THE CASE FOR THE THREE SPECIFIC PROPOSALS I MADE LAST SPRING IS AS STRONG AS EVER.



THERE HAS BEEN SOME USEFUL PROGRESS ON THE FIRST OF THESE: CONVERTING AID LOANS INTO GRANTS. THE UK ALONE HAS WRITTEN OFF GETTING ON FOR \$1/2 BILLION OF AFRICAN AID LOANS SINCE 1979. MANY OTHER DAC COUNTRIES HAVE DONE THE SAME. I HOPE THAT ~~THOSE~~ <sup>OTHERS</sup> COUNTRIES WHICH HAVE ~~NOT YET CONVERTED THEIR~~ <sup>WILL FOLLOW</sup> AID LOANS TO GRANTS WILL DO SO SHORTLY.

MY SECOND PROPOSAL WAS TO RESCHEDULE OFFICIAL DEBT OWED TO EXPORT CREDIT AGENCIES OVER MUCH LONGER PERIODS, TO GIVE THE DEBTORS A REAL BREATHING SPACE. I AM GLAD TO SEE THAT, UNDER SKILFUL CHAIRMANSHP, THE PARIS CLUB HAS NOW AGREED TO GIVE LONGER GRACE AND REPAYMENT PERIODS TO EIGHT DEBTOR COUNTRIES IN AFRICA.



MY THIRD PROPOSAL WAS TO REDUCE INTEREST RATES ON OFFICIAL DEBT. THERE HAS BEEN PROGRESS HERE TOO. A NUMBER OF CREDITOR COUNTRIES HAVE ACCEPTED THIS PROPOSAL AND I WAS PARTICULARLY ENCOURAGED BY THE ENDORSEMENT GIVEN TO IT BY THE COMMONWEALTH HEADS OF GOVERNMENT AT VANCOUVER.

SOME CREDITOR COUNTRIES, HOWEVER, STILL FIND IT DIFFICULT TO AGREE. I SUGGEST THAT THOSE WHO FIND ABSOLUTELY COMPELLING REASONS FOR NON-PARTICIPATION IN AN EXPLICIT INTEREST RELIEF <sup>SCHEME</sup> SHOULD INITIALLY PROVIDE EQUIVALENT HELP BY RECYCLING SOME OF THE MORATORIUM INTEREST IN THE FORM OF ADDITIONAL AID GRANTS OR CONCESSIONAL LOANS. BUT THESE WOULD HAVE TO BE GENUINELY



ADDITIONAL, AND SEEN TO BE SO, AND THERE MIGHT BE A ROLE FOR THE IFI'S IN ENSURING THAT THIS IS SO.

HOWEVER WE DEAL WITH THIS, THE CASE FOR RELIEF IS PAINFULLY SIMPLE. ALL OF US KNOW THAT THERE IS NO WAY IN WHICH THE POOREST COUNTRIES CAN MEET THEIR INTEREST PAYMENTS. WITHOUT SOME RELIEF, THEIR PROBLEMS CAN ONLY BE COMPOUNDED. UNPAID INTEREST HAS TO BE CAPITALISED AND ROLLED FORWARD, ATTRACTING YET MORE INTEREST ON THE RESCHEDULED DEBT. THE INTEREST BURDEN THUS MOUNTS EXPONENTIALLY ~~AND~~ AND THE POOREST COUNTRIES ARE ~~THUS~~ CAUGHT IN A VICIOUS CIRCLE.

IT IS FRANKLY UNREALISTIC TO IMAGINE THAT THEIR DEBTS WILL EVER BE SERVICED AND



REPAID IN FULL AT MARKET RATES OF INTEREST. THE CHOICE IS BETWEEN GIVING SOME RELIEF NOW, IN AN ORDERLY WAY, OR WAITING UNTIL THE SITUATION BECOMES VERY MUCH WORSE.

WHAT IS IMPORTANT IS THAT, IN ONE WAY OR ANOTHER, ALL CREDITOR COUNTRIES JOIN IN GIVING RELIEF FROM THE PRESENT INTEREST BURDEN. I HOPE THE PARIS CLUB WILL WORK OUT THE DETAILS SO THAT WE CAN FIND AN ACCEPTABLE SOLUTION BY THE TIME OF THE ANNUAL MEETINGS IN BERLIN THIS AUTUMN.

EVEN IF WE SUCCEED, SOME AFRICAN COUNTRIES, PARTICULARLY SUDAN AND ZAMBIA, HAVE ARREARS TO THE FUND WHICH ARE SO HEAVY THAT THEY HAVE NO HOPE OF PAYING THEM OFF FROM THEIR OWN RESOURCES. UNDER PRESENT RULES, THIS EFFECTIVELY CUTS THEM OFF FROM



FURTHER SUPPORT FROM THE INTERNATIONAL FINANCIAL INSTITUTIONS. THIS IS A SERIOUS PROBLEM FOR THE COUNTRIES CONCERNED AND THE IMF ALIKE. I BELIEVE WE NEED SPECIAL MEASURES TO BREAK THE IMPASSE. THE OBJECTIVE SHOULD BE TO MOVE, OVER TIME, TO A POSITION WHERE ARREARS TO THE FUND CAN BE CLEARED, WITH HELP FROM OTHER SOURCES OF FINANCE.

I THEREFORE PROPOSE THAT THE COUNTRIES CONCERNED SHOULD, WITH THE HELP OF THE FUND, DEVISE AND IMPLEMENT STRONG SHADOW PROGRAMMES. ONCE THESE HAVE RUN SUCCESSFULLY FOR, SAY, AT LEAST A YEAR, BUT NOT BEFORE, THE COUNTRIES SHOULD BE ELIGIBLE FOR DRAWINGS ON THE ESAF, BACKDATED SO AS TO GIVE CREDIT FOR PERFORMANCE UNDER THE SHADOW PROGRAMMES. IN OTHER WORDS, IF THE



COUNTRIES CONCERNED PUT THE RIGHT POLICIES IN PLACE, AND SHOW THEY CAN STICK TO THEM OVER A SUFFICIENT PERIOD OF TIME, THEN <sup>THE</sup> IMF WOULD ~~THEN~~ RESPOND WITH CONCESSIONAL FINANCE.

REF TO ~~DATA~~ CONABLE  
 FINALLY, I WOULD LIKE TO ADD A WORD ABOUT THE IMPORTANCE OF DIRECT INVESTMENT FOR ALL DEVELOPING COUNTRIES. THIS DOES NOT ADD TO THE DEBT BURDEN. IT OFTEN PROVIDES A WELCOME INJECTION NOT ONLY OF FINANCE BUT ALSO OF TECHNOLOGICAL AND EXPORT TRADING EXPERTISE. <sup>KNOWLEDGE</sup> DIRECT OVERSEAS INVESTMENT FROM BRITAIN <sup>TO DEVELOPING COUNTRIES</sup> HAS INCREASED SIGNIFICANTLY IN RECENT YEARS. IN FACT, OVER THE MOST RECENT THREE-YEAR PERIOD FOR WHICH FIGURES ARE AVAILABLE, THE VALUE OF BRITAIN'S DIRECT PRIVATE INVESTMENT TO THE DEVELOPING COUNTRIES, AT OVER \$2 BILLION A YEAR, HAS



EXCEEDED THAT FROM ALL OTHER EUROPEAN  
COUNTRIES PUT TOGETHER. REGRETTABLY, A  
NUMBER OF DEVELOPING COUNTRIES STILL SEE  
FOREIGN INVESTMENT AS A THREAT TO THEIR  
SOVEREIGNTY. <sup>IT IS NOT</sup> ALL COUNTRIES SHOULD WELCOME  
AND ENCOURAGE THE PRIVATE SECTOR'S POTENTIAL  
CONTRIBUTION TO GROWTH AND DEVELOPMENT.