

ECB



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Prime Minister

A good rate.

N.C.U.

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Dear Charles

PRIME MINISTER'S MEETING WITH PRESIDENT MITTERRAND

... I attach briefing on the debt issue.

I am copying this letter and enclosure to Lyn Parker (FCO).

Yours sincerely
J M G Taylor

J M G TAYLOR
Private Secretary

CONFIDENTIAL

HM TREASURY
PRIME MINISTER'S MEETING WITH PRESIDENT MITTERRAND
10th JUNE 1988

SUB-SAHARAN AFRICA: CHANCELLOR'S INITIATIVE

Line to Take

Eager to reach agreement at Summit on helping the poorest, most debt-distressed countries. Thank President Mitterrand for his letter. Glad he endorsed reductions in interest rates - as proposed by Chancellor - which are a positive way to help such countries. French proposal for cancellation of part of rescheduled debt also offers useful option and we shall want to study it further. US proposal for rescheduling over longer periods does not go far enough. It will be important to ensure burden-sharing between creditors. Important that we who have so much at stake in Africa should work together at the Summit to secure agreement.

Background

2. The Chancellor's initiative was announced in April 1987. He proposed that very poor debt-distressed countries - with per capita incomes of less than \$425 a year - who were carrying out adjustment programmes approved by the IMF and the World Bank should be helped by writing off aid loans, by rescheduling their other official debts over longer periods, and by cutting interest rates to prevent the compounding of debt. So far as we are concerned, for further aid loan write-off - the UK has already done this for most countries. Longer grace and rescheduling periods (over 15 and 20 years) have been allowed to 10 countries in the Paris Club. Little progress, however, has been made so far in reducing interest rates, largely because of US opposition.

3. But reducing interest rates - or an equivalent measure that actually reduces the debt burden - is essential. The bottom line is that, at present, a number of countries simply have no prospect of repaying their debts in full. Recognising this is simply enlightened realism. But for the same reason, rescheduling alone will not be enough: the burden has to be reduced in some way.

4. The US line is that they are prevented by 'political, legal and budgetary constraints' from reducing interest rates. The US Treasury Secretary, Mr James Baker, stated this at the African Development Bank conference in Abidjan earlier this month but announced that the US was "willing to extend the range of options within the Paris Club": some countries could offer concessional interest rates while others could reschedule over a longer period. This is an idea that comes from the Canadians who were hoping to produce it at the Summit as a compromise.

5. The French variant described in President Mitterrand's letter of 7 June to the Prime Minister gives creditors three options: first a new option for these countries to cancel a third of debt being rescheduled at each Paris Club exercise with repayments of the remaining two-thirds of this debt over 10 years; second, an interest rate subsidy as proposed by the UK (he suggests halving the rate) with repayments spread over 15 years; and third, a variant of the US-Canadian proposal by suggesting that countries not willing to give a subsidy by either of the first two routes should reschedule over 25 years. The French plan to pursue the first option.

6. The key issue with these three options of interest relief, longer maturities and debt cancellation will be to ensure equality of burden-sharing between creditors. The Chancellor's original proposal was for an interest reduction of perhaps 3 per cent which would provide debtors with immediate relief on their interest payments and help to prevent cumulative increases in debt from

the compounding of high interest rates; debtors would also receive a grace period of 5-10 years before repayments began. The French option of debt cancellation would also result in lower interest payments as a result of the reduced stock of debt, but principal repayments would be likely to start earlier than under the Chancellor's proposal. The US proposal for longer maturities would imply no reduction in interest payments, and the US so far has resisted lengthening maturities beyond the 20 years already granted to some African countries. It will be important that we push the Americans as hard as we can, at least to 25 years.

7. An important aspect from the creditors' point of view will be whether those who offer either lower interest rates or debt cancellation in return for early repayment will be able to have their claims given seniority in any future reschedulings. The US has resisted this so far. It will be helpful to have President Mitterrand's view on this. The French are expected to suggest that Summit leaders should agree a menu of options and remit the details to be agreed by a special Paris Club working party in July.

8. Other countries have also shown signs of movement. The Germans are considering more RTA in tranches related to IMF or World Bank conditionally. The Japanese (according to Press sources) are likely to make a proposal aimed primarily at middle income debtors. This is that the IMF set up a special trustee fund which would be used as collateral to back bonds to be issued by debtor nations. These bonds would then be swapped, at a discount to their face value, for debts owed to commercial banks.