

PO - CH / NL / 0535

PART A

Begins : 17/5/89.
Ends : 31/5/89.

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Chancellor's (Lawson) Papers:
Paris Club May 1989: Discussion of
Debt strategy for Mexico and the Philippines.

DD's: 25 Years

22/3/96.

PO CH | NL | 0535.
PT.A.

FROM: P MOUNTFIELD
DATE: 17 MAY 1989
EXT : 4479

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Economic Secretary
Sir P Middleton
Mr Wicks
Mr Lankester
Mr Evans
Mr Bottrill
Mr Walsh
Mr P Davis
Mrs Thomson
Mr Cassell, UKDEL

Mountfield
→ CH/EX
17/5

Ch.
Agree lines? (Points
for decision summarised in
para. 15).

17/5
C. H. L.

MAY PARIS CLUB

This note seeks your agreement to the line I propose to take at next week's meeting (which extends over the Bank holiday).

2. The context is, of course, the general debate about the Brady plan and specifically about burden sharing. There is a Fund/Board meeting on 19 May, where we will aim at securing agreement in principle on set aside, interest support and financing assurances on the lines of Mr Walsh's minute to you of 11 May.

Philippines

3. This will be the first major case following the Brady plan. The EFF will be taken by the IMF Board on 22 May, and the Paris Club rescheduling on 25 May. The financing assumptions are not set out clearly. We know that the Paris Club is expected to

reschedule 100 per cent of principal and 70 per cent of interest, in 1989 and 1990 (the same proportions as in earlier years). The contribution of the banks, even by way of rescheduling, is not quantified clearly. Although a measure of debt reduction is apparently assumed, this is nowhere specified in the papers or evaluated. Without allowing for debt reduction we have calculated, as best we can, that to maintain the respective exposures of the official sector and the banks at their 1988 levels, the Paris Club should reschedule only 100 per cent of principal, and no interest.

4. The question is whether we can make this stick (since it means less generous terms than the Fund paper assumes) and whether we should therefore go for "approval in principal" only at the IMF Board.

5. The UK is a very small Paris Club creditor in this case (number 9, after Netherlands and Belgium). By contrast, the US and Japan hold the bulk of the debt, and have already made it very clear that they have political instructions to secure a generous settlement. I have raised the question of burden-sharing three times in preliminary discussions. Each time, creditors generally have accepted the need for it in principle, but the US and Japanese Delegation have warned me privately that they will not be able to support me. Nor do I expect much help from the French Chairman or the Germans. I therefore propose, if you agree, to go on arguing for "principal only", but to be prepared to fall back, at the last moment, to rescheduling interest, upto the 70 per cent level assumed in the Fund Programme.

6. On that basis, we feel we should not insist on "approval in principle" at the IMF Board on 22 May. We think there is little chance of persuading others of this line; and if at the formal Board meeting on 19 May we have already agreed to a revised policy line (including financing assurances, set aside and interest support), then it would be odd not to agree to full approval on 22 May. Instead, we should put up a very clear marker about the need for fair burden-sharing, and say that if the Paris Club does not provide the relief assumed in the Fund Programme, other

adjustments should be made. In short, this would be "lending into a financing gap". The adjustments might take the form of a smaller reserve build, a higher degree of adjustment, more aid by the specific-rim countries, or a bigger contribution by the commercial banks: we need not specify which. Do you agree, please?

Mexico

7. Similar issues arise on Mexico, which will be taken in the Board on 25 May, and in the Paris Club on 29 and 30 May. In this case, the financing assumptions are spelt out clearly enough. Mexico seeks to reschedule only its public sector debt, and is seeking identical terms from each group of creditors: 100 per cent of principal and 60 per cent of interest. But that comparison leaves out of account the contribution from the IFIs. The logic of our burden-sharing argument should be that we offset the IFI contributions by a smaller Paris Club contribution.

8. In this case, too, the UK is a relatively small creditor (less than 10 per cent of the whole). But this is a test case for the debt strategy, and the US will (I suspect) press very hard for a generous Paris Club contribution. I therefore propose we should start by insisting on principal-only (which, taken together with the contribution of the IFIs, would produce very rough parity between the public and private sectors); but be prepared to fallback on 100 per cent of principal plus 60 per cent of interest, on the argument that this at least preserves very clear parity between the Paris Club and the banks. I would draw a sharp distinction this case and that of the Philippines, where this parity is not apparent (or, we believe, present, although we cannot prove this). Do you agree, please?

9. The remaining countries on the agenda pose no major problems, but there are some minor points I should bring to your notice.

Guyana

10. Now that the Support Group operation is completed, the Paris Club has to do its bit. This country is both poor enough and heavily enough-indebted to justify Toronto terms. However, the FRG is tied down by a Parliamentary mandate which does not allow it to provide Toronto terms outside Africa. The Canadians (charged with the support operation) have therefore proposed that we should revert to an earlier practice, and offer extended though not concessional rescheduling terms: 20 years in place of the usual 10 (or the 14 allowed for by Toronto). For forms' sake, I propose to argue for Toronto terms, but then to fallback on to the Canadian proposal. Do you agree, please?

Cameroon

11. This should be a non-contentious case. Cameroon is rich enough not to qualify for Toronto terms, but should get a conventional package. The UK interest is relatively small.

Costa Rica

12. Negotiations between the Club and Cost Rica broke down in September, because Costa Rica held out for better terms than the standard ones the Club was prepared to offer, apparently in an attempt to put pressure on the banks to match this. The Fund believe they are now negotiating seriously with the banks, and will accept a normal Paris Club package (10 years, including 5 years' grace, at commercial interest rates, and for something like 100 per cent of principal and a small amount of interest). In this case, I propose to be guided by Fund calculations on burden-sharing at the meeting, and to go up to whatever level of rescheduling of interest and previously-rescheduled debt these seem to indicate.

Cuba

13. Since Cuba is not an IMF member, the Paris Club attempts - not very successfully - to enforce its own conditionality before agreeing to rescheduling. The last round of negotiations broke down totally, because the economic reform programme proposed by Castro's Government was totally inadequate. This time there are signs that some movement may be possible, and an agreement could be reached. However, the opening position of creditors is likely to be a long way apart, given that negotiations will rely on poor data. If you agree, ECGD (who will represent us for this item) will follow any consensus which begins to emerge. Our stake in Cuba is not large, and in this particular operation only some £16 million is at stake.

Others

14. There will also be a preliminary discussion of Argentina, Brazil, Poland and Yugoslavia. In each case (though in low key, so far as Argentina is concerned) I shall be plugging the "burden-sharing" argument for all it is worth. In the case of Poland, at least, I know that I have the support of the Chair, who has invited the Barclays' Chairman of the negotiating Committee to Paris this week for 'an informal talk', with the intention of redressing the present imbalance between western banks and governments. (I met the Chairman, Peter Lucas of Barclays earlier today on the neutral ground of the Bank of England, and explained the background. I made it clear, however, that we are not in any way attempting to pressurise the banks, who will have to make their own commercial decisions on the basis of the evidence.)

15. To sum up: are you content that I may negotiate on the Philippines and on Mexico on the lines indicated above; that we should brief Mr Cassell in similar terms; that I may go out to 20 year terms for Guyana; and that ECGD should follow the consensus on Cuba?

R1

P MOUNTFIELD



FROM: J M G TAYLOR

DATE: 18 May 1989

A handwritten signature in black ink, appearing to be "JMG".

MR MOUNTFIELD

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Wicks
Mr Lankester
Mr Evans
Mr Bottrill
Mr Walsh
Mr P Davis
Mrs Thomson
Mr Cassell UKDEL

JMGT
-Mountfield
18/5

MAY PARIS CLUB

The Chancellor was grateful for your note of 17 May. He is content that you should proceed as you propose.

A handwritten signature in black ink, appearing to be "JMG".

J M G TAYLOR

SECTION 5
DEBT

LANKESTER
MAY
PARIS CLUB
18/5

From: T P Lankester
Date: 18 May 1989

MR MOUNTFIELD

cc

PS/Chancellor - 12/2.

Mr N Wicks
Mr Evans
Mr P Davis
Mr Bottrill
Mr Walsh
Ms Thomson

Mr Cassell, UKDEL

MAY PARIS CLUB

I understand that the Chancellor has agreed to the proposals in your submission of 17 May.

2. I recognise that it would be very hard for us to hold out against an emerging consensus in favour of 70 per cent interest rescheduling for Philippines and 60 per cent interest rescheduling for Mexico. That is why you have recommended this as a fall-back and no doubt why the Chancellor has agreed to it.

3. Nonetheless, I do think we should pause a little longer before taking a final view on this, and I suggest we go over the implications with the Chancellor at his meeting on International Issues next Tuesday afternoon in advance of your departure for Paris.

4. What worries me is that, by conceding on these two cases, we are in danger of giving the whole game away on future cases - since they, and in particular Mexico, will be prayed in aid by other countries. In other words, I fear that agreement on these generous terms for these two countries may fatally damage our initiative - set out so eloquently in Harry Walsh's paper to the Paris Club - to have the Paris Club in future adopt a much more restrictive position.

5. If you were to stand out against the terms proposed, this would no doubt require explicit support from the Chancellor - and probably late into the night - but I am not sure we should necessarily back away from this. It seems to me that a row now might be justified in order to secure a better outcome on future cases.



T P LANKESTER

Attention: M Samuel-Lajeunesse
Tresor
Rue de Rivoli
PARIS

WALSH'S
PAPER
TO
PARIS
CLUB

BURDEN SHARING AND DEBT REDUCTION

I attach an informal paper that Mr Lankester suggests we might briefly discuss during the Anglo/French talks next week.

We would intend that it be circulated to the Paris Club creditors on the first day of the next Paris Club meeting, but obviously we would like to discuss it with the Tresor first.

We shall bring a couple of top copies with us when we visit you on Tuesday.

*Best regards
Henry Walsh*

H G WALSH

bcc: Mr Lankester
Mr Mountfield
Mr Bottrill
~~Mr [REDACTED]~~
Mr Kilpatrick
Mr Miles - Bank

INTERNATIONAL DEBT: LIMITING THE OFFICIAL SECTOR BURDENIntroduction

1. The Interim Committee on 3 April concluded:-

"The Committee also stressed that official creditors should not substitute for private lenders and that Fund financial participation in debt alleviation operations should be accompanied by strong financial support, including new money, from commercial banks".

This paper addresses the question of how to ensure that the public sector does not continue to bear an increasing proportion of middle income debt exposure. At the same time, it is necessary to bear in mind other objectives in the debt strategy: these include setting very clear limits on the specific involvement of the IFIs, and avoiding entanglements between the official sector and the commercial banks.

Existing Position

2. The existing position is:-

	Proportion of Exposure to the Baker 15 Countries %	
	1982	1988
Official Sector:	22	37
IMF	1	4
MDBs	6	12
Official bilateral creditors	15	21

Source: IIF

These percentage increases accord broadly with the UK's own calculations: the fact that they are the IIF's own figures should make them more credible to the banks.

3. The shift in the burden to the public sector during the Baker Plan period 1986-88 was even worse than the average for 1982-1988. The figures prepared by Husain and Mitra at the World bank show the following figures for net lending to the 17 Highly Indebted Countries (HICs):-

	\$ billion
	<u>1986-88</u> (annual average)
Official Lending (Bilateral, Multilateral, IMF)	3.9
Commercial Banks	0.2
Memo: Baker Plan targets for banks	6.7

Objective

4. The objective is to get a procedure agreed (at least within the public sector) that will lead to a limitation on the official sector exposure percentage. We would wish to limit any further increase to the extent to which we allow the banks to be credited in respect of debt reduction.

Issues

The Base

5. A number of methodological issues arise. First of all the base from which burden sharing is calculated. Should the public sector attempt to get back to the pre-crisis burden sharing proportions of 1982 or should it accept the risk transfer that has occurred in the years up to now? The argument in favour of 1982 is that is when the debt crisis first arose. It could be argued that contributions since then to protect initial stocks of debt should not be disregarded. On the other hand, on a practical basis it will be hard enough just to get the commercial banks to contribute new money on a proportionate exposure share basis for the period beyond 1988 even on a current base. The only realistic base is a current one.

6. Second, should the public sector be defined as IFIs plus Paris Club rescheduling plus new ECA lending plus aid; or should IFIs be treated as a separate category? If the IFIs are being asked to do more than in the past, the Paris Club should do rather less - even though that means that the comparison between Paris Club and banks may make the Paris Club less generous. We conclude that since governments are shareholders in the IFIs and providers of new aid and of credit, the broadest definition of public sector debt is best (this would however exclude the cumulative value of past grant aid). Nonetheless special attention needs to be placed on the burden placed on the IFIs as a sub-category of the public sector.

7. Third, current exposure shares might best be calculated on a rolling basis after allowing for debt reduction by the banks. (Debt service reduction would be allowed for by a notional writing down of principal on an NPV basis to the extent that debt service was reduced). The effect of this would be to reduce the banks' share of the base compared to their exposure before debt reduction. But where the IFIs have financed debt reduction, the amounts involved would be counted as part of the public sector's new money contribution to filling the gap after debt reduction.

8. In the short-term the financing gap under debt reduction would be increased. This base would be applied to the higher financing requirement (which would depend in part on own efforts, see paragraph 12 below). Despite the smaller share of the base the banks would hold after debt reduction, the amount of new money required from them may be higher. Over time, the falling share and (in the longer term) a lower financing gap would reduce the banks' new money contribution. The annex provides an example of how this calculation would work in practice.

9. In practice, it will be difficult to bring about financial packages that involve fully satisfactory burden sharing arrangements because the banks will retain considerable bargaining power. The official side may well have to be content with a burden sharing outcome which is considerably better than recently

experienced but less good than the proportionate equality in relation to base shares that we would like to see.

Procedure

10. The main burden-sharing problem with the present concerted lending approach is the Paris Club. This arises mainly because of its rule which states that IMF programmes must be in place before it is prepared to reschedule. Coming in at the end of the game, it tends to get assigned a residual share of the provision of new money which is well above what it should have to provide. This takes the form of the rescheduling of interest which is over and above its contribution of rescheduling 100 per cent of principal.

Options for the Paris Club

11. Ideally, the IMF staff would test out its financing assumptions on the public sector providers before putting a programme to the Executive Board. In the case of aid flows, where relevant, it would as now take account of the results of any recent consultative group, and/or of the intentions of major bilateral donors. For new export credit, it would (again as at present in many cases but not all) check the intentions of the major ECAs concerned, directly. (There is no collective machinery for coordinating the provision of export credit, which in any case depends upon success in winning contracts: experience suggests the need for a substantial realism discount.) For rescheduling, there are two options:-

- i. If time allowed, the staff should discuss its assumptions in some detail with the Paris Club during one of its regular Tour d'Horizon sessions. It should set out its estimate of the financing requirement, and the projected contributions of the various parties, relating these to their respective shares in the stock of debt. It should state clearly what this would require, by way of rescheduling arrears (if any) new maturities of principal, and - only if absolutely necessary - of interest; probably indicating rather

narrow bands (eg in the case of principal 85-90 per cent) rather than precise numbers. The Paris Club could then give provisional approval to these broad numbers, subject to detailed negotiation with the creditor later. In this way, the Staff could then present this part of its financing assumptions to the Board with a high degree of confidence.

ii. But Paris Club meetings do not always, or even usually, fit neatly into the timetable of IMF negotiations. If time did not allow for this iterative approach, therefore, IMF Management should be given a clear statement of the Club's general future policy for middle-income countries. Such a statement could contain two elements:

- (a) the Paris Club will not normally be prepared to reschedule interest in future. It will only reschedule arrears in exceptional cases. It will not do either unless it is clear that this is necessary to preserve overall equality of treatment between the public sector as a whole and the private sector.
- (b) the Paris Club will in all cases need to be satisfied that the level of rescheduling assumed by the Staff is that necessary to bring the total public sector contribution up to its proportionate share (as defined in the rest of this paper) of the total financing burden.

The Staff would be asked, by the Executive Directors representing the regular Paris Club creditor countries, to work on these assumptions in preparing cases for the Board, noting that these EDs would not normally be prepared to approve programmes inconsistent with those principles. Such a statement would need to be agreed in advance by the Paris Club and communicated to the Staff by the G7 Executive

Directors. Since it would be a statement of the intentions of those Executive Directors, rather than a statement of Fund policy, it would not need clearance by the Executive Board as such, though its contents would no doubt become known to the other members. The channel of communication for interpreting the general rule would be the Paris Club Secretariat.

Arrears

12. The IMF paper on financing assurances (EBS/89/79) differentiates between co-operative and non-co-operative creditors. Especially if it is argued that the Paris Club's part in a co-operative approach should, except in exceptional circumstances, be to reschedule principal only and not interest, financing gaps are bound to arise into which the IMF would be disbursing.

13. There are various options for defining co-operative and non-co-operative creditors and various measures for ensuring that arrears accrue only to the non-co-operative ones. If the rule for principal only assumed rescheduling at the Paris Club (and other bilateral official debt) is accepted, and the IMF and World Bank reach a view as to the amount they wish to contribute to a given package, the gap would be defined after allowance was made for efforts by the country itself to raise finance eg by liberalising direct investment rules, repatriating capital flight, debt/equity swaps and other debt or debt service reduction. It would usually be assumed that the banks would be asked to fill all the rest of the gap, but the IMF staff would make some assessment of what the contribution by the commercial banks would be in new money terms on the basis of base exposures post debt reduction and it could be, in some cases, that the Paris Club would have to reschedule some interest.

14. Any gap remaining will leave a financing deficiency in the programme, which means that it is likely to be blown off course before it is completed unless arrears are allowed to build up. It is unsatisfactory that such arrears should build up to co-

operating creditors who have contributed adequately to the package. An issue is how to allow arrears to build up to the commercial banks but not to official creditors - where the official side had played its full role. (There is also the subsidiary question of how to cater for co-operating banks where others are not co-operating, but this question is not dealt with in this paper).

15. There are two main options for directing arrears at non-co-operative creditors. The first is to make it either a debtor statement of intent (or preferably) a performance criterion of IMF programmes that co-operative creditors should be fully serviced by means, for instance, of deposits placed in an IMF escrow account. If this failed to happen, disbursements under the programme would cease. This involves some extension of effective non-legal preferred creditor status beyond the IMF and World Bank and to the Paris Club. It could be argued that this would be difficult to get agreed in the IMF and World Bank Boards as it dilutes their status, and moreover the commercial banks may use it to raise the legal point that IMF and World Bank preferred creditor status itself has no proper basis and to utilise the panoply of legal remedies that they currently hold in reserve. We must avoid, in any attempt to get the Paris Club second preferred creditor status, a downgrading of IMF and World Bank first preferred status.

16. But there should be less objection in the Boards to the Paris Club being a second preferred creditor after the IFIs than having equal status, and the banks would have to go to court to enforce co-equal status with the Paris Club - which would be costly and could damage their relations with both debtors and IFIs. This would act as a disincentive for them to take such action. Debtor countries might object to being compelled to give the Paris Club second preferred status but this could be made a condition of eligibility for debt reduction.

17. The alternative more formal legal method is to use IMF Article VIII to make "exchange contracts" unenforceable in member states. But it is unlikely that this Article by itself, which can

be used to approve arrearages arising to all creditors, could be used to distinguish between different creditors. Legislation or regulations in the debtor country itself would have to be designed to impose exchange controls against some creditors but not against others. And even this very elaborate approach gives rise to problems of principle. The UK for instance does not wish Article VIII to be used at all to limit the enforceability of loan contracts since we and our courts do not recognise it as applying to loan contracts as opposed to exchange contracts specifically. If it were extended to loan contracts (and deposits) there could be implications for the extension of IMF Board - approved US asset freezes extraterritorially in respect of dollar transactions, thus damaging the London market. Therefore the use of Article VIII is unacceptable to us. The statement of intent/performance criterion option is the better one, perhaps including the setting up of escrow accounts at the IMF.

Trade Lines

18. The bargaining position of the banks is strong relative to the Paris Club because they can withhold trade credit lines and other essential credit if a debtor country does not service its medium term debt. In effect, this can give them status senior to the Paris Club. But this ignores the fact that a major debtor can choose not to repay trade lines, thus imposing losses on banks, and that there will always be some banks willing to provide trade lines at a price.

Conclusions

19. The following are the main conclusions:-

- i. A current base should be used as the base period for judging appropriate burden-sharing post debt reduction as between the private and official sectors. This gives the banks full credit for debt reduction. Despite this their absolute contribution may have to be higher to fill financing gaps in the short run.

IFI contributions to DROPs would be counted as helping to fill the gap which would exist post debt reduction;

- ii. In practice it may be necessary to concede to the banks that their contribution to financing major debtors will not be fully proportionate to their outstanding exposure but a proportionate approach would be the starting point;
- iii. The Paris Club contribution to financing packages should usually be simply to reschedule 100 per cent of principal and not to reschedule interest. The contribution of new money from the official sector should generally come from the IFIs or voluntary new export credit only. The amount of Paris Club rescheduling shown in IMF programmes would be restricted to this in the absence of any alternative assumptions agreed in advance by Paris Club creditors.
- iv. Arrears could be directed to non-co-operative creditors by means of making servicing of Paris Club debt a statement of intent by debtors undertaking IMF programmes or (preferably) an actual performance criterion, which could be administered through the deposit of funds in an IMF-administered escrow account. But the trigger for withholding further finance should be weaker and more discretionary than for the IFIs, making the Paris Club a second preferred creditor after the IFIs. IMF staff would be consulted about ways of achieving this.

20. The UK proposes that this subject should be discussed at the next Paris Club meeting. We shall also be raising it in Washington with EDs representing the main creditor countries.

IF1 Division
12 May 1989

ANNEX

BURDEN-SHARING UNDER DEBT REDUCTION: HYPOTHETICAL EXAMPLE

In the worked example below it is assumed that the initial balance of debt is \$60 bn owed to banks and \$40 bn to the public sector and that the initial financing requirement (met by new money) is \$5 bn. Before debt reduction takes place burden-sharing implies that the banks provide new money of \$3 bn and the public sector \$2 bn.

2. The next step assumes \$2 bn of IFI funds are used for DROPs, yielding \$5 bn in debt reduction at a price of debt of 40 cents in the dollar. The burden sharing ratio faced by banks showing in (i), now falls to 58 per cent (from 60 per cent). Similarly, that of the public sector rises.

3. The effect of using IFI funds for debt reduction on the finance gap is shown in (ii). While interest savings of \$0.5 bn are achieved, the \$2 bn of IFI funds used for DROPs (and therefore no longer available to purchase imports) increases the financing requirement. The net effect is to raise the finance gap from \$5 bn to \$6.5 bn.

4. Applying the debt reduction burden sharing ratios in (i) to the higher financing requirement implied in (ii) gives the relative new money contributions of the banks and public sector: \$3.8 bn and \$2.7 bn respectively. Of the \$2.7 bn provided by the public sector, \$2 bn is accounted for by funds for DROPs.

5. The effects of on debt stocks are shown in (iv). The debt reduction case limits the increase in the stock of debt. (It does not fall straight away because of the higher initial financing requirement). If repeated over a number of years, the absolute amount of debt outstanding may decline, with the effect of reducing new money requirements below that otherwise needed.

(i) <u>Base</u>	<u>No Debt Reduction</u>		<u>Debt Reduction †</u>	
	\$ bn	Share (%)	\$ bn	Share (%)
Banks	60	60	55	58
<u>Public</u>	<u>40</u>	<u>40</u>	<u>40</u>	<u>42</u>
<u>Total</u>	<u>100</u>	<u>100</u>	<u>95</u>	<u>100</u>

† Assumed IFI funds of \$2 bn used to reduce debt by \$5 bn at a price of 40¢ per dollar

(ii) Finance Requirement

	<u>No Debt Reduction</u>	<u>Debt Reduction</u>
Initial Financing Need	5	5
<u>less</u> Interest on Debt Reduced		-½
<u>plus</u> Finance used up for Debt Reduction	—	<u>2</u>
<u>Finance Gap</u>	<u>5</u>	<u>6½</u>

(iii) New Money

Banks	3.0	3.8
Public	2.0	2.7
(o/w for DROPS)	(-)	(2.0)
(o/w for other)	(<u>2.0</u>)	(<u>0.7</u>)
<u>Total</u>	<u>5.0</u>	<u>6.5</u>

(iv) Debt Stocks after year 1

	<u>No Debt Reduction</u>	<u>Debt Reduction</u>
Banks	63	58.8
<u>Public</u>	<u>42</u>	<u>42.7</u>
<u>Total</u>	<u>105</u>	<u>101.5</u>

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IMF: FUND INVOLVEMENT IN THE DEBT STRATEGY - FURTHER
CONSIDERATIONS

PART ONE OF TWO

SUMMARY

1. CAMDESSUS POSTPONES SUMMING UP UNTIL 22 MAY, GIVEN LACK OF CONSENSUS IN THE BOARD ON EXTENT OF ADDITIONALITY. UK, SUPPORTED BY GERMANY, NORDICS, NETHERLANDS, AUSTRALIA, SAUDI ARABIA AND, POSSIBLY, THAILAND ARGUE FOR LESS THAN 40 PER CENT ADDITIONALITY. ELIGIBILITY CRITERIA AND GUIDELINES ON FINANCING ASSURANCES BROADLY ENDORSED. LESS AGREEMENT ON PRECISE MODALITIES OF FUND SUPPORT. NON-FUNGIBILITY OF SET ASIDE ENDORSED BY ALL G7 BUT NO OTHER CHAIRS.

DETAIL

2. THE EXECUTIVE BOARD MET TODAY TO DISCUSS IN FORMAL SESSION THE MODALITIES OF THE FUND'S SUPPORT FOR DEBT REDUCTION OPERATIONS (DROPS) AND THE FUND'S POLICY ON FINANCING ASSURANCES. I SPOKE SECOND AND CLOSELY IN LINE WITH TELNO 88.

OTHER G7 INTERVENTIONS

3. PLOIX (FRANCE) SAID THAT THE CRUCIAL TEST OF ELIGIBILITY SHOULD BE THE EXISTENCE OF A STRONG AND COMPREHENSIVE FUND PROGRAM INCORPORATING MEASURES TO ENCOURAGE THE REPATRIATION OF FLIGHT CAPITAL (E.G. INTEREST RATE AND EXCHANGE RATE POLICIES). AN ASSUMED IMPROVEMENT IN CAPITAL FLOWS SHOULD BE BUILT IN TO THE MACROECONOMIC PERFORMANCE CRITERIA OF THE PROGRAM.

4. PLOIX REITERATED HER AUTHORITIES' STRONG PREFERENCE FOR INTEREST SUPPORT OPERATIONS - THESE WOULD, IN HER VIEW, PROVIDE 'THE MOST HIGHLY-LEVERAGED APPROACH'. HOWEVER, MORE QUANTIFICATION ON THIS WAS REQUIRED FROM THE STAFF.

TELE-GRAMS

5. PLOIX SAID SHE THOUGHT THAT THE SET ASIDE SHOULD AMOUNT TO ABOUT 25 PER CENT OF ACCESS AND SHOULD BE FOR DEBT REDUCTION ONLY. SHE COULD ACCEPT THAT THE SET ASIDE WOULD BE NON-ADDITIONAL. THE USE OF ADDITIONAL RESOURCES SHOULD BE CONFINED TO INTEREST SUPPORT. ACCESS FOR THIS PURPOSE OF 'UP TO 40 PER CENT' WOULD BE APPROPRIATE - THE RESOURCES SHOULD BE HANDLED IN AN ADMINISTRATIVE ACCOUNT. HER FIRST PREFERENCE WOULD BE TO HOLD THIS ACCOUNT IN THE FUND. IT WOULD BE 'HIGHLY DESIRABLE FOR THE DEBTOR COUNTRY ITSELF TO CONTRIBUTE TO THE INTEREST SUPPORT FUND'. THIS FUND SHOULD BE SUFFICIENT TO BACK AT LEAST TWO YEARS OF INTEREST (ON A ROLLING BASIS). AS FAR AS DISBURSEMENTS OF FUND RESOURCES WERE CONCERNED, PLOIX THOUGHT THAT NORMALLY COUNTRIES SHOULD ONLY BE ALLOWED TO USE THE MONEY AFTER THE BOARD HAD REVIEWED THE COUNTRY'S DEBT REDUCTION AGREEMENT. HOWEVER, 'IN SOME CASES' THE FUND SET ASIDE COULD BE DISBURSED AT THE OUTSET (WITH SOME FRONTLOADING).

6. MASSE (CANADA) EMPHASISED THAT THE FUND'S MAIN RESPONSIBILITY AND ROLE WOULD CONTINUE TO BE TO DESIGN STRONG PROGRAMS. ITS FINANCING ROLE WOULD BE STRICTLY LIMITED. ON ELIGIBILITY, MASSE BROADLY AGREED WITH THE STAFF PROPOSALS.

7. MASSE SAID THAT THE NEED FOR ADDITIONALITY SHOULD BE DETERMINED ON A CASE-BY-CASE BASIS - NOT ALL DEBTORS WOULD REQUIRE ADDITIONAL RESOURCES FOR DEBT SERVICE REDUCTION. DUE REGARD WOULD NEED TO BE GIVEN TO THE FUND'S LIQUIDITY POSITION, BUT, AS A BENCHMARK, ADDITIONAL RESOURCES OF 'AROUND 40 PER CENT' SEEMED APPROPRIATE. CONTRIBUTIONS FROM DEBTOR COUNTRIES TO AN INTEREST SUPPORT FUND SHOULD BE ENCOURAGED AND MIGHT IN SOME CASES BE A CONDITION OF IFI SUPPORT. HOWEVER, IN OTHER CASES THIS WOULD NOT BE POSSIBLE. MASSE STRESSED THAT HIS AUTHORITIES' CURRENT POSITION WAS THAT THERE WAS MERIT IN 'NON-FUNGIBILITY' AS FAR AS THE SET ASIDE WERE CONCERNED. THE SET ASIDE SHOULD BE AROUND 25 PER CENT OF ACCESS. TURNING TO THE MODALITIES OF DISBURSEMENTS, MASSE SAID THAT SET ASIDE MONIES SHOULD BE DISBURSED PARI PASSU WITH OTHER FUND RESOURCES AND PUT INTO THE COUNTRY'S RESERVES. FINALLY, ANY ESCROW ACCOUNT TO SUPPORT INTEREST PAYMENTS SHOULD BE HELD OUTSIDE THE BANK AND THE FUND.

8. ON FINANCING ASSURANCES, MASSE AGREED WITH THE STAFF GUIDELINES BUT THOUGHT THAT A REVIEW WOULD BE REQUIRED BEFORE SECOND DISBURSEMENT.

9. DALLARA (US) THOUGHT THAT THE STAFF'S ELIGIBILITY CRITERIA WERE BROADLY RIGHT - BUT HE HAD SOME RESERVATIONS ABOUT THE FUND GETTING TOO DEEPLY INVOLVED IN WHETHER DROPS WOULD REPRESENT AN EFFICIENT USE OF SCARCE RESOURCES - PROVIDED A STRONG MACROECONOMIC PROGRAM WERE IN PLACE FUND MONEY IN SUPPORT OF DROPS WOULD BE WELL DEPLOYED. STRONG PROGRAMS WERE INDEED A CENTRAL REQUIREMENT OF THE NEW STRATEGY. IT WAS PARTICULARLY IMPORTANT TO EMPHASISE MORE STRONGLY THE NEED TO ENCOURAGE CAPITAL INFLOWS AND THE REPATRIATION OF CAPITAL FLIGHT. PROGRESS IN THESE AREAS DID NOT NEED TO BE A FORMAL PERFORMANCE CRITERION - BUT SHOULD BE MONITORED CLOSELY.

10. DALLARA EMPHASISED THE IMPORTANCE OF DEBT REDUCTION - IN PARTICULAR THE PSYCHOLOGICAL AND POLITICAL IMPACT OF BEING ABLE TO SHOW THAT THE DEBT STOCK HAD BEEN REDUCED. THE SET ASIDE THEREFORE NEEDED TO BE USED EXCLUSIVELY FOR DEBT REDUCTION. THIS SHOULD AMOUNT TO ''AROUND 25 PER CENT''. SUPPLEMENTAL ACCESS OF ''AROUND 40 PER CENT'' OF QUOTA COULD BE USED FOR INTEREST SUPPORT IN CONJUNCTION WITH EITHER DEBT SERVICE REDUCTION OR DEBT/BOND EXCHANGES. IFI SUPPORT FOR THE BACKING OF INTEREST PAYMENTS SHOULD BE BASED ON ONE YEAR'S INTEREST. HOWEVER, THERE MIGHT BE A NEED TO SUPPORT MORE THAN ONE YEAR'S INTEREST. THIS HIGHLIGHTED THE IMPORTANCE OF CONTRIBUTIONS FROM THE DEBTORS THEMSELVES. ANY ESCROW ACCOUNT SHOULD BE HELD OUTSIDE THE FUND AND THE BANK, PERHAPS AT THE BIS. (NB: CAMDESSUS MADE IT QUITE CLEAR THAT HE SAW NO REASON WHY ANY ESCROW ACCOUNT SHOULD NOT BE HELD IN THE FUND.)

11. AS FAR AS DISBURSEMENTS WERE CONCERNED, SOME FRONTLOADING WOULD BE APPROPRIATE ''IN MANY CASES'' - THE SET ASIDE AND INTEREST SUPPORT RESOURCES POTENTIALLY AVAILABLE DURING A YEAR MIGHT, FOR INSTANCE, BE MADE AVAILABLE AT THE OUTSET. HE WAS PROBABLY HAPPIEST WITH THE IDEA OF MAKING

DISBURSEMENTS OUTRIGHT (RATHER THAN ALLOWING A COUNTRY'S RIGHT TO PURCHASE FUND RESOURCES TO ACCUMULATE). HOWEVER, THIS WOULD ONLY BE POSSIBLE IF FIRM ASSURANCES COULD BE OBTAINED THAT THE DISBURSED MONEY WOULD ONLY BE USED TO SUPPORT DROPS. THE FUND DID CERTAINLY NOT NEED TO REVIEW ON A TRANSACTION-BY-TRANSACTION BASIS EACH CONCLUDED DEBT REDUCTION AGREEMENT.

12. AS FAR AS FINANCING ASSURANCES WERE CONCERNED, DALLARA FOUND THE STAFF GUIDELINES ABOUT RIGHT. HE STRESSED THAT IT WOULD GIVE THE WRONG SIGNALS TO START 'APPROVING IN PRINCIPLE' THE FIRST FEW PROGRAMS IN THE NEW REGIME. HE ALSO POINTEDLY STATED THAT DEBTORS SHOULD NOT ASSUME THAT THE FUND WOULD BE PREPARED TO DISBURSE INTO BANK (AND CERTAINLY NOT OTHER) ARREARS.

13. GOOS (GERMANY) RECEIVED HIS INSTRUCTIONS HALFWAY THROUGH THE DISCUSSION AND GAVE A VERY TOUGH INTERVENTION. ON ELIGIBILITY, HE SAID THAT HE COULD ACCEPT THE STAFF'S PROPOSALS, BUT STRESSED THE IMPORTANCE BOTH OF THE EXISTENCE OF A VERY STRONG ADJUSTMENT PROGRAM (WITH A SUBSTANTIAL STRUCTURAL ELEMENT) AND OF THE NEED TO ENSURE THAT RESOURCES WERE BEING USED EFFICIENTLY (HE EXPLICITLY REJECTED DALLARA'S 'HANDS-OFF' APPROACH ON THIS). GOOS ALSO EXPLICITLY ENDORSED MY VIEW THAT WAYS HAD TO BE FOUND TO PROTECT THE PARIS CLUB CREDITORS FROM THE BUILD UP OF ARREARS.

14. GOOS EXPRESSED STRONG RESERVATIONS ABOUT FUND SUPPORT FOR THE BACKING OF INTEREST PAYMENTS. HE WAS HOWEVER 'PREPARED TO CONSIDER LIMITED ADDITIONAL SUPPORT' PROVIDED SOME CONDITIONS WERE MET: FIRST, THE MONEY SHOULD GO INTO AN ACCOUNT WHICH WAS HELD OUTSIDE THE IFIS, SECOND, THERE SHOULD BE A MANDATORY REQUIREMENT THE DEBTORS WOULD CONTRIBUTE TO ANY INTEREST SUPPORT FUND - AN APPROPRIATE NORM MIGHT BE A 50:50 SPLIT IN THE FINANCING OF THE FUND, THIRD, ACCESS SHOULD BE LOWER THAN 40 PER CENT - PERHAPS OF THE ORDER OF 25 PER CENT. HE COULD CONSIDER THE POSSIBILITY OF PROVIDING SUPPORT FOR TWO YEARS' INTEREST PAYMENTS.

15. ON THE SET ASIDE, GOOS SAID THIS SHOULD BE 25 PER CENT OF ACCESS AND SHOULD BE USED SOLELY FOR DEBT REDUCTION. THE MONEY COULD BE DISBURSED ONLY AFTER A REVIEW HAD BEEN

CONCLUDED BY THE BOARD OF THE ACTUAL DEBT REDUCTION AGREEMENT. THERE WOULD HAVE TO BE A SUBSTANTIAL DEBT REDUCTION TO JUSTIFY DISBURSEMENT.

16. ON FINANCING ASSURANCES, EXISTING RULES SHOULD CONTINUE TO APPLY WHERE FEASIBLE. HE DID NOT WANT TO SEE ARTICLE VIII 2(B) ACTIVATED. DISBURSEMENTS SHOULD NOT TAKE PLACE INTO A FINANCING GAP UNLESS THERE WERE A CLEAR EXPECTATION THAT NEGOTIATIONS WOULD BE CONCLUDED AT AN EARLY STAGE. SECOND, DISBURSEMENTS WOULD BE CONDITIONAL ON A PRIOR REVIEW.

17. YAMAZAKI (JAPAN) SAID THAT STRONG ADJUSTMENT MEASURES WERE THE KEY TO THE NEW DEBT STRATEGY - THE EXISTENCE OF AN EFF WAS A PRECONDITION. ''CASH BUYBACKS WOULD NOT BE THE MAIN MENU ITEM.''

18. YAMAZAKI SAID THAT HE COULD NOT SUPPORT FUNGIBILITY AT PRESENT - BUT DID NOT FEEL STRONGLY ABOUT THIS. THE SET ASIDE MONEY SHOULD BE DRAWN PARI PASSU WITH OTHER RESOURCES AND USED AT THE CONCLUSION OF A DEBT REDUCTION AGREEMENT. PENDING USE, THE MONEY SHOULD BE PUT IN A SEPARATE ACCOUNT. ON THE SUPPORT FOR INTEREST BACKING, YAMAZAKI THOUGHT IT WAS INAPPROPRIATE TO STATE A PRIORI HOW MUCH MONEY WAS NEEDED - BUT 40 PER CENT SEEMED ROUGHLY APPROPRIATE. CONTRIBUTIONS FROM THE DEBTORS WERE DESIRABLE BUT SHOULD NOT BE A PRECONDITION. THE FUND SHOULD NOT INTERFERE WITH THE NEGOTIATIONS BETWEEN BANKS AND DEBTORS - BUT IT SHOULD MAKE EVERY EFFORT TO ENSURE THAT DEBTORS DID NOT DISCRIMINATE BETWEEN BANKS.

19. YAMAZAKI SAID THAT THE EXIMBANK WOULD DISBURSE WHEN:

- A COUNTRY HAD AGREED A MEDIUM-TERM PROGRAM,
- FINANCING FROM THE IFIS FOR DROPS HAD BEEN AGREED,
- WAIVERS AND FINANCING HAD BEEN AGREED WITH THE BANKS,

OR THERE WAS ''SUFFICIENT ASSURANCE'' THAT SUCH AGREEMENTS WOULD BE FORTHCOMING.

20. FILOSA (ITALY) STRESSED THE IMPORTANCE OF INTEREST REDUCTION. AS FAR AS THE SET ASIDE WAS CONCERNED HE COULD GO

ALONG WITH THE IDEA THAT THIS SHOULD BE 25 PER CENT OF ACCESS, NON-ADDITIONAL AND NON-FUNGIBLE. THE SET ASIDE MONEY SHOULD ONLY BE DRAWN AFTER THE BOARD HAD REVIEWED A CONCLUDED DEBT REDUCTION AGREEMENT

21. FOR INTEREST SUPPORT, ADDITIONALITY OF 'UP TO 40 PER CENT' WAS REQUIRED BUT THIS MIGHT CAUSE PROBLEMS OF EQUALITY OF TREATMENT BETWEEN ELIGIBLE AND NON-ELIGIBLE COUNTRIES (NB: CAMDESSUS SENT THE LAWYERS AWAY TO LOOK AT THIS QUESTION). FILOSA THOUGHT THAT DEBTORS SHOULD BE ASKED TO CONTRIBUTE SOME OF THEIR OWN RESOURCES TO THE INTEREST SUPPORT FUND - BUT THIS WOULD NOT ALWAYS BE POSSIBLE.

22. ON FINANCING ASSURANCES, THE STAFF'S PROPOSALS WERE FINE, BUT ARREARS TO THE PARIS CLUB SHOULD NOT BE TOLERATED.

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IMF: FUND INVOLVEMENT IN THE DEBT STRATEGY - FURTHER
CONSIDERATIONS
PART TWO OF TWO

OTHER INTERVENTIONS

23. EVANS SAID THAT HIS AUSTRALIAN AUTHORITIES DID NOT SUPPORT ANY ADDITIONALITY, WHILE HIS PHILIPPINE AUTHORITIES DID. HE WAS WITH THE LATTER BUT HE HAD NOT HEARD A STRONG ARGUMENT IN FAVOUR OF 40 PER CENT - HE PREFERRED SOMETHING NEARER 25 PER CENT. EVANS ALSO PLACED CONSIDERABLE EMPHASIS ON THE IMPORTANCE OF THE BOARD'S STICKING FIRMLY TO THE STATED ELIGIBILITY CRITERIA. HE DID NOT SUPPORT NON-FUNGIBILITY.

24. HOGEWEG (NETHERLANDS) ALSO DID NOT ACCEPT NON-FUNGIBILITY AND SAID HE WAS 'MOST RELUCTANT' TO GO ALONG WITH ADDITIONAL ACCESS OF 40 PER CENT FOR INTEREST SUPPORT. HE THOUGHT THAT INDICATING AN EXPLICIT LEVEL OF ADDITIONALITY AT THE OUTSET MERELY RAISED EXPECTATIONS. HOGEWEG WAS NOT IN FAVOUR OF FRONTLOADING OR DISBURSING BEFORE A BOARD REVIEW OF THE TERMS OF A DEBT REDUCTION AGREEMENT.

25. OVI (NORDICS) WAS CRITICAL OF THE ELIGIBILITY CRITERIA WHICH HE FOUND VIRTUALLY MEANINGLESS. IF ADDITIONAL RESOURCES WERE TO BE INVOLVED THERE WOULD BE A NEED BOTH FOR STRONGER PROGRAMS AND FOR COUNTRIES TO USE THEIR OWN RESOURCES. HE COULD NOT IN ANY EVENT ACCEPT ADDITIONAL RESOURCES OF 40 PER CENT - PERHAPS A MAXIMUM OF 25 PER CENT. ADDITIONALITY WAS INEXTRICABLY BOUND UP WITH THE QUOTA REVIEW. OVI ALSO EMPHASISED THAT HIS AUTHORITIES COULD IN NO CIRCUMSTANCES ACCEPT A BUILD UP OF ARREARS TO OFFICIAL CREDITORS.

26. KIRIWAT (THAILAND, ETC.) THOUGHT IT WOULD BE PREMATURE TO MAKE A FIRM JUDGEMENT THAT ADDITIONAL RESOURCES OF UP TO 40 PER CENT WOULD BE APPROPRIATE, GIVEN THE UNCERTAINTIES INVOLVED AND THE IMPLICATIONS FOR FUND LIQUIDITY. KIRIWAT

ALSO TOUCHED ON A THEME WHICH PROVOKED A LIVELY DISCUSSION IN THE MORNING SESSION AMONG LDC CHAIRS - NAMELY, THE QUESTION OF WHETHER ONLY THOSE COUNTRIES WHOSE DEBT WAS TRADING AT A SIGNIFICANT DISCOUNT SHOULD BE ELIGIBLE FOR FUND SUPPORT. KAFKA (BRAZIL), FELDMAN (ARGENTINA), JALAN (INDIA), NIMATALLAH (SAUDI ARABIA), FINAISH (LIBYA), AND DAI (CHINA) ALL FELT THAT A DEEP DISCOUNT WAS NOT NECESSARY AND THAT, INDEED, TO CONFINE FUND SUPPORT TO COUNTRIES WITH DEEP DISCOUNTS ON THEIR DEBT WOULD NOT ONLY BE INEQUITABLE BUT ALSO WOULD PROVIDE PERVERSE INCENTIVES.

27. NIMATALLAH ROUNDED UP THE DISCUSSION BY EXPRESSING SUPPORT FOR THE NEW STRATEGY AND AGREEING TO ADDITIONAL RESOURCES OF UP TO 25 PER CENT.

28. THIS PROMPTED CAMDESSUS TO STATE THAT IN HIS VIEW IF THE FUND DECIDED TO AGREE TO ADDITIONALITY OF ONLY 25 PER CENT THIS WOULD SEND A VERY ADVERSE SIGNAL TO THE FINANCIAL COMMUNITY - IT WOULD, INDEED, DESTROY THE CREDIBILITY OF THE FUND'S SUPPORT FOR THE NEW STRATEGY. 25 PER CENT WOULD REPRESENT ONLY A 'TOKEN'.

29. NIMATALLAH DISAGREED, ARGUING THAT THE BANKS WOULD BE PERFECTLY SATISFIED WITH FUND SUPPORT OF UP TO 25 PER CENT. I THEN INTERVENED TO ARGUE THAT 25 PER CENT ADDITIONALITY WAS NOT A TOKEN AMOUNT - IT WAS ACTUALLY A VERY SIGNIFICANT CONTRIBUTION INDEED.

30. DALLARA TOOK THE FLOOR TO MAKE IT CLEAR THAT THE US REGARDED THE 40 PER CENT FIGURE AS A NORM NOT A MAXIMUM. INDEED, IT WAS PERFECTLY POSSIBLE THAT IN SOME CASES MORE THAN 40 PER CENT OF QUOTA WOULD BE NECESSARY. YAMAZAKI ENDORSED THE 40 PER CENT FIGURE, TOO, ARGUING THAT INTEREST SUPPORT WAS ABSOLUTELY CRITICAL.

31. PLOIX, MASSE AND FILOSA IN TURN REITERATED THEIR SUPPORT FOR 'UP TO 40 PER CENT' ADDITIONALITY - WITH MASSE ARGUING THAT THE DIFFERENCE BETWEEN 25 PER CENT AND 40 PER CENT WAS DE MINIMIS IN TERMS OF THE FUND'S LIQUIDITY, AND WITH FILOSA SUGGESTING THAT ANYTHING LESS THAN 40 PER CENT WOULD FAIL TO MEET THE BANKS' EXPECTATIONS.

32. OVI THEN REITERATED HIS BELIEF THAT 25 PER CENT ADDITIONALITY WAS VERY SUBSTANTIAL, PARTICULARLY IN RELATION

TO THE AVERAGE ANNUAL ACCESS OF FUND PROGRAMS (WHICH WAS 40 PER CENT).

33. IN AN ATTEMPT TO FORMULATE A COMPROMISE GOOS SAID THAT HE MIGHT BE ABLE TO MOVE UP TO A HIGHER FIGURE THAN 25 PER CENT IF HIS ''CONDITIONS'' COULD FIND MAJORITY SUPPORT. HE COULD ALSO SOFTEN HIS CONDITIONS - HE SAID IT WAS PROBABLY ''TOO TOUGH'' TO INSIST ON MANDATORY DEBTOR CONTRIBUTIONS AND TO INSIST ON A 50:50 SPLIT IN CONTRIBUTIONS. EVANS ALSO CAME IN AGAIN TO ADVOCATE A COMPROMISE OF ADDITIONALITY OF 33 1/3 PER CENT OF QUOTA IN EXCHANGE FOR G7 FLEXIBILITY ON FUNGIBILITY.

34. AFTER FURTHER DISCUSSION CAMDESSUS BROUGHT MATTERS TO A HALT ARGUING THAT A LITTLE MORE WORK WAS NEEDED BEFORE DECISIONS COULD BE TAKEN WHICH COMMENDED A CONSENSUS. HE PROPOSED TO CONSULT WITH VARIOUS DIRECTORS ON MONDAY MORNING, BEFORE PRESENTING A SUMMING UP OF THE DISCUSSION AT 3.00 ON MONDAY AFTERNOON. HE URGED DIRECTORS TO SHOW SOME FLEXIBILITY IN THIS ''EXPERIMENTAL STAGE''. HE CONCLUDED, HOWEVER, BY SAYING THAT HE DID HAVE STRONG MAJORITIES ON MOST ISSUES.

35. FINALLY, IN RESPONSE TO A QUESTION FROM ME, WHITTOME SAID THAT OFFICIAL CREDITORS THAT WERE ''COOPERATING'' IN THE FINANCING OF A PROGRAM COULD BE PROTECTED UNDER THE PROGRAM. OVI, NIMATALLAH AND FINAISH ALL CAME IN IMMEDIATELY TO STRESS THAT ALL OFFICIAL CREDITORS WOULD HAVE TO BE PROTECTED.

COMMENT

36. ON THE KEY ISSUE OF ADDITIONALITY THE BOARD IS SPLIT INTO 3 CAMPS, WITH DIFFERENT GROUPS SUPPORTING ADDITIONALITY OF:

''AROUND 40 PER CENT'',
''UP TO 40 PER CENT'',
''LESS THAN 40 PER CENT''.

37. IT IS DIFFICULT TO BE SURE WHETHER THERE IS A FIRM DISTINCTION BETWEEN THOSE IN THE FIRST TWO CAMPS. HOWEVER, THERE IS A CLEAR DISTINCTION BETWEEN THOSE FAVOURING ''UP TO OR AROUND'' 40 PER CENT AND THE OTHERS, INCLUDING OURSELVES. IN THE UK CAMP, WE HAVE, AT LEAST AT PRESENT, (WITH VOTING SHARES) OURSELVES (6.63), NIMATALLAH (3.44), HOGEWEG (4.31),

EVANS (3.55), OVI (3.45), GOOS (5.79) AND, POSSIBLY, KIRIWAT (2.89). THIS AMOUNTS TO A VOTING BLOC OF 30.06 PER CENT, JUST SUFFICIENT TO BLOCK GENERAL INCREASE IN ACCESS TO ORDINARY RESOURCES IF INDEED SUCH AN INCREASE REQUIRES A SPECIAL MAJORITY (WE HAVE NOT YET BEEN ABLE TO PIN THIS DOWN - AND THE STAFF HAVE NOT VOLUNTEERED THE INFORMATION).

38. WE WILL BE MAKING EVERY EFFORT TO KEEP THESE CHAIRS ON SIDE.

39. FCO PLEASE PASS TO PS/CHANCELLOR, MR. WICKS, MR. LANKESTER, MR. EVANS, MR. BOTTRILL AND MR. WALSH (HMT), MR. CROCKETT AND MR. WARE (BOE) AND MR. RICHARDSON (ERD).

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NNNN

CHANCELLOR

FROM: A R H BOTTRILL
DATE: 25 MAY 1989
EXT: 4720
cc Sir P Middleton
Mr Wicks
Mr Lankester
Mr H P Evans
Mr H G Walsh
Mrs Thomson (or)

Ch.
OK?
OK
25/5

PARIS CLUB: THE PHILIPPINES

Mr Mountfield telephoned this evening from Paris. The UK is - as expected - isolated in the Paris Club discussions with the Philippines over the rescheduling of their debts. At Mr Mountfield's insistence, the first offer to the Philippines is in line with your instructions ie the Club would only reschedule principal but not interest. Creditors other than the UK, however, are prepared to be more generous and the Filipinos are expected to reject this first offer. Mr Mountfield, therefore, will inevitably be invited to seek further instructions.

2. He has already discussed the issue with Trichet, the Paris Club chairman, who believes that a consensus might be achieved on the basis of rescheduling principal for all four years of the programme but limiting the rescheduling of interest to 60-70 per cent in 1989 but nothing in subsequent years - although it might be necessary to cover the early months of next year in the last resort. Mr Lankester and I consider that this would be a satisfactory outcome. We would have registered our concerns forcefully and have secured an important point of principle as regards interest rescheduling by the Paris Club from 1990 onwards. Are you content that Mr Mountfield should agree to a settlement along these lines?

AB Bottrill

A R H BOTTRILL



FROM: J M G TAYLOR

DATE: 25 May 1989

A large, stylized handwritten signature in the top right corner of the page.

MR BOTTRILL (AEF)

cc Sir P Middleton
Mr Wicks
Mr Lankester
Mr H P Evans
Mr H G Walsh
Mrs Thomson

PARIS CLUB: THE PHILIPPINES

The Chancellor has seen your note of 25 May. He is content for Mr Mountfield to agree to a settlement along the lines proposed.

A smaller handwritten signature, likely of J M G Taylor, located below the main body of text.

J M G TAYLOR

CHANCELLOR

This is v. sad. Mr M can be suggested, makes sense with the reluctance to provide a clear path to the 80% provision.

FROM: A R H BOTTRILL
DATE: 26 MAY 1989
EXT: 4720
cc Sir P Middleton
Mr Wicks
Mr Lankester
Mr H P Evans
Mr H G Walsh
Mrs Thomson

PARIS CLUB: PHILIPPINES

Mr Mountfield telephoned again from Paris this morning. **Trichet, the Paris Club chairman, has been unable to deliver the deal with the Philippines which he offered us last night.**

2. **The Filipinos have asked to reschedule 100 per cent of both current principal and interest for the period up to February 1991 followed by 100 per cent of principal and 80 per cent of interest including previously rescheduled debt up to May 1992. These terms are even more extreme than those assumed by the Fund staff which are already likely to lead to a substantial burden shift to the public sector.**

3. **None of the creditor representatives wants to reschedule previously rescheduled debt. Trichet wants to offer the Filipinos a rescheduling of 100 per cent of current principal and 70 per cent of interest up to mid 1991 followed by a rescheduling of principal but no interest in the final year to mid-1992. This would be closely in line with the IMF's assumptions with merely a gesture to our position in the final year. Mr Mountfield is seeking your authority to settle on this basis, or if this is not possible to go as far as necessary to obtain the best settlement possible. Are you content?**

4. **There is apparently little or no support among other creditors for taking account of either the contribution of the international financial institutions or of new credits from governments and their export credit agencies in calculating burden-sharing. Most creditors want to compare the Paris Club operations**

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with any bank package in isolation from other official contributions. This intellectually incoherent approach seems likely to lead to a substantial shift of risk to the public sector. It suggests we still have a massive education job to do in both the IFLs and the Paris Club. We may also need to reconsider our policy on new export credits to countries which insist on rescheduling interest in the Paris Club.

ARH

A R H BOTTRILL



FROM: J M G TAYLOR

DATE: 26 May 1989

A handwritten signature in the top right corner of the page.

MR BOTTRILL

cc Sir P Middleton
Mr Wicks
Mr Lankester
Mr H P Evans
Mr H G Walsh
Mrs Thomson**PARIS CLUB: PHILIPPINES**

The Chancellor has seen your note of 26 May.

2. He has commented that this is very bad indeed. He is content for Mr Mountfield to proceed as suggested, provided that he makes clear that he is doing so with the greatest reluctance, and provided that he ensures that the UK's profound misgivings are formally noted. He must also insist that this is not quoted as a precedent.

A handwritten signature in the bottom right area of the page.

J M G TAYLOR

FROM: A R H BOTTRILL
DATE: 26 MAY 1989
EXT: 4720
cc Sir P Middleton
Mr Wicks
Mr Lankester
Mr H P Evans
Mr H G Walsh

CHANCELLOR

Ch.
Content with line? (I will
assume you are - + so with Mr
Mountfield - makes you ring me over the w/e
to say you are not.)

PARIS CLUB: MEXICO

26/5

The unfortunate turn of events in the Philippines negotiations in the Paris Club makes it necessary for us to seek further instructions from you for Mr Mountfield for the negotiations with Mexico on Monday.

2. The Mexicans have now tabled their request as follows:
- Rescheduling of 100 per cent of all principal and interest, including previously rescheduled debt, up to end-1992.
 - A grace period of 7 years with 13 years to repay making a total of 20 years.
 - Export credit cover to be maintained but premiums to be reduced.

This request goes well beyond that assumed by the IMF for the programme being discussed in Washington today. This assumed the Paris Club would only need to reschedule 100 per cent of current principal and 60 per cent of interest ie excluding rescheduled debt.

3. The Fund's assumptions were based on an attempt to share the financing burden fairly with commercial banks being expected to provide \$6 billion a year in new money. You will be aware that the banks present offer is said to be equivalent to about \$1 billion a year. Bill Rhodes is apparently to table a further offer over the weekend - although it is likely to fall well short of the Fund figures!

4. In these circumstances, we suggest that Mr Mountfield attempts to secure a linkage between the effectiveness of any Paris Club deal and a satisfactory contributions from the banks. His negotiating tactics would be:

- Reject rescheduling of previously rescheduled debt and moratorium interest. ^{Accept} / rescheduling of 100 per cent of current principal but suggest 60 per cent of interest is too high in view of the shortfall in banks' contribution.
- If others insist on rescheduling interest, then the Paris Club deal should only become effective when Mexico has achieved a financing deal with the banks satisfactory to the Club. We would interpret this as 'at least approaching the figures suggested by the IMF'.
- If others refuse to accept this link, then we should agree to reschedule 100 per cent of current principal and 60 per cent of interest without condition. We should not agree to reschedule previously rescheduled debt.

5. Mr Lankester is content with this approach. Mr Mountfield has asked for some discretion in the precise terms of the link. Are you content with this approach?

ARH

A R H BOTTRILL



FROM: J M G TAYLOR

DATE: 31 May 1989

A handwritten signature in black ink, appearing to be "JMG".

MR BOTTRILL

cc Sir P Middleton
Mr Wicks
Mr Lankester
Mr H P Evans
Mr H G Walsh

PARIS CLUB: MEXICO

The Chancellor was grateful for your note of 26 May.

2. He is content for Mr Mountfield to proceed as proposed.

A handwritten signature in black ink, appearing to be "JMG".

J M G TAYLOR