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PREM 19/1200

Part 3

SECRET

A9.53

Confidential Fil…

Indebtedness of various countries and its effect on the Western Banking System.

ECONOMIC POL…

Part 1: August …

Part 3: Septembe…

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~1.9.83~~		~~13.2.84~~					
~~8.9.83~~		~~16.2.84~~					
~~20.9.83~~		~~20.2.84~~					
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PART 3 ends:-

HMT to AT 24.2.84

PART 4 begins:-

HMT to AT 5.3.84

3.49 CONFIDENTIAL

Prime Minister
To note
AT 27/2

cc NO
PP

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

24 February 1984

Andrew Turnbull Esq
10 Downing Street

Dear Andrew,

I enclose the latest in the series of reports on developments on the international financial scene, prepared by the Bank of England and revised in the light of discussions in the Treasury's interdepartmental group on debt problems.

The general picture continues to be encouraging, with signs of some restoration of confidence, due to the improved economic outlook and the satisfactory resolution of negotiations with some key debtors. There are signs that banks and other creditors are now beginning to look further ahead to the longer term prospects. On the other hand, there are still downside risks, in particular from the social and political pressures within debtor countries facing prolonged adjustment programmes.

On the general scene, the Prime Minister has already been briefed on the Quito Economic Conference by the Ecuadorian Foreign Minister. Perhaps the most important common theme of the Conference was that the major Latin American debtors, though coming under increasing political and social strain as adjustment bites deeper and lasts longer, continue to reject the idea of repudiation, whether individual or collective. Their aim appears to be both to meet their obligations and to reduce the strains on them by seeking practical improvements in the terms negotiated during debt restructuring operations. We shall want to keep an eye on these developments in view of their relevance to the June Summit. The work which the new Institute of International Finance is now setting in hand may also be relevant in that context.

Page 7 of Report

The Chancellor met the Nigerian Finance Minister on 20 February and urged him to reach an early settlement with the IMF, explaining that this must be a precondition for a multilateral agreement with other government creditors. It was also made clear that any deal must also safeguard the position of uninsured creditors. The Nigerian team will now have further discussions in Paris and Bonn.

incl BCal

Page 4 of Report

The latest position on the commercial bank loan for Argentina is that LBI are continuing to hold their line, and are not under any pressure at present to change it, although they expect pressure before too long. We shall keep you informed of any major developments.

Finally, you may like to draw the Prime Minister's attention to the Greek position. The Greek economy continues to suffer from serious imbalances and distortions. The IMF take the view that the present programme of economic adjustment is not strong enough. We do not expect a financial crisis to develop, but we should clearly be concerned both at the poor performance of another EC county and at the possibility of a call on Community funds if the position continues to deteriorate.

I am sending copies of this letter to Brian Fall (FCO), Callum McCarthy (DTI), and John Bartlett at the Bank.

Yours ever

John Kerr

J O KERR
Principal Private Secretary

INTERNATIONAL FINANCIAL SCENE

The short-term position of certain key borrowers has eased appreciably since the last Report, while a number of negotiations currently under way appear to be making progress. With day to day management becoming somewhat less difficult, there are indications that both borrowers and banks are beginning seriously to consider medium and long-term issues.

Economic developments continue to be encouraging. Growth was maintained in a number of the major economies during the last quarter of 1983, with little sign so far of renewed inflationary pressures. On preliminary estimates, GNP in the USA grew more slowly in the fourth quarter, while growth in Germany picked up sharply. The increase in GNP last year in the major seven OECD countries taken together, at 2 1/2%, was close to the rate achieved over the previous three years, and was accompanied by a rise in consumer prices of only 4 3/4%, the lowest annual increase since 1972. The external trade of these countries has also continued to recover. Non-oil commodity prices rose further in December and January (to around 10% higher than a year earlier); oil prices remain stable; LIBOR is still around 9-10%, where it has stood since the fall from 13 1/2% at the end of 1982; but the US dollar continued to appreciate in January, in spite of slightly lower US domestic interest rates.

Completion of the Brazilian Phase II package and the favourable response to Mexico's request for $3.8 bn of new money - on much improved terms for the borrower - have boosted market confidence, while indicating to borrowers that vigorous adjustment is likely to be rewarded in the form of better terms on future loans. Although still cautious and discriminating, sentiment towards some of the Eastern European borrowers may also be improving a little.

In Latin America, attention is now focused on Argentina and Venezuela, where new governments are showing signs of coming to terms with their debt problems, although negotiations with creditors will certainly be difficult. Elsewhere, there has been some progress in negotiations with Yugoslavia and, to a lesser degree, with Poland. Nigeria's initial discussions with official creditors have gone fairly well, with the new government appearing to accept the need for a multilateral approach and for a link between debt negotiations and an IMF programme. On the other hand, little progress has been made on the acute problems in the Philippines; and there are signs that banks are beginning to reappraise risk on lending to Greece, which, in spite of its EEC credentials, may encounter market resistance on future borrowing.

The latest figures from the BIS (up to September 1983) confirm that lending to developing countries was severely cut back in 1983, and there seems little prospect of a recovery this year. Only a few borrowers, mainly in the Far East, continue to have ready access to the depressed syndicated credit market; and the international bond markets, which have remained active, will offer no more than a limited amount of funds for certain developing countries. The bulk of medium-term lending will therefore continue to be unspontaneous.

The banks' cautious attitude will be reinforced by efforts to strengthen their balance sheets in response to recent difficulties. For example, provisions made by major banks in 1983 against their international lending are likely to be higher than in 1982. Supervisory authorities have generally sought to strike the difficult balance between encouraging banks to improve balance sheets without discouraging them from continued participation in international lending. In this context, the prudential regulations governing international lending by US banks, which were attached to the IMF Bill, have proved in the event to be less restrictive than had earlier been thought, and have given the US regulatory authorities adequate room for manoeuvre.

With the prospect of managed lending continuing for some considerable time, there are growing indications that banks are beginning seriously to consider longer-term issues. A meeting of the Institute of International Finance earlier this month agreed to establish four working parties to examine questions such as terms on new lending and initiatives which banks might take to assist developing countries

a forum established by commercial banks
for discussion of lending issues

in covering future financing gaps (the banks wish to keep the existence of these groups secret). One outcome of such "initiatives" might be a collective demarche to the official sector.

Meanwhile, Latin American borrowers are coming closer to formulating a co-ordinated view on matters such as terms on new lending and the maximum proportion of export earnings to be earmarked for debt repayment. To judge by the outcome of the Quito conference in January, the present spirit is one of collaboration with a view to co-operation with creditors, rather than of cartelised confrontation. Nevertheless, a co-ordinated approach to debt problems seems to be gathering momentum and will reportedly be further considered in other fora which bring together Latin American countries.

A rather more detailed assessment of the current position in major debtor countries is given below.

(i) Latin America

Immediate concern about Brazil's debt position eased perceptibly after the signature of the Phase II financing package on 27 January; and the country's liquidity will improve when the first drawings (totalling \$3 bn) of the \$6.5 bn new money facility are made towards the end of February. But there is still a degree of uncertainty about the \$2.5 bn of new official export credits: for the present, the Advisory Committee are satisfied with de Larosiere's assurances that the credits will be made available, but it is still not clear which countries (apart from the US) will be contributing, nor whether the funds can be fully utilised this year.

Further new money from banks should not be required this year, provided that international interest rates or oil prices do not rise, and that the projected trade surplus of \$9 bn is broadly met.

The spotlight has now turned on Argentina, where the new government has begun serious discussions with banks and the IMF. With the current Fund programme broken down, an IMF staff mission has started to negotiate a new Standby arrangement, which will certainly not be easy, given the degree of adjustment likely to be demanded. Meanwhile, the authorities are seeking disbursement of the remaining $1 bn of the banks' medium-term loan agreed last August. Most groups of banks appear willing to tie disbursement to the mere signature of a new Letter of Intent, but UK banks consider that a new Fund programme should first be in place. As this is not likely to occur before April at the earliest, repayment of the banks' bridging loan (amounting to $750 mn) would need to be further postponed and arrears of interest would continue to accumulate, putting pressure on US banks in particular, because of their need to report "non-performing" loans on 31 March.

Mexico successfully met the IMF's performance criteria throughout 1983; and against this background, the Advisory Committee are currently seeking commitments from creditor banks towards the 1984 new money requirement of $3.8 bn, on much improved terms compared with last year. Commitments have now reached $3.2 bn, and signature is expected around the end of February. The commercial bank rescheduling schemes are progressing smoothly, and the Paris Club recently cleared the way for restructuring of $1.9 bn of officially-guaranteed private sector debt.

Progress has been made in the second round support operations for some of the smaller Latin American borrowers, although many problems remain. Peru has now signed a Letter of Intent to the IMF for a new Standby arrangement to replace the EFF which was formally abandoned after major deviations from performance criteria. This has enabled the authorities to obtain much better terms in their agreement with the Advisory Committee over rescheduling 1984 and 1985 maturities. However, with mounting political pressures to depart from IMF austerity policies, it remains to be seen whether the IMF programme can be successfully implemented ahead of next year's Presidential elections. In Chile, the authorities have concluded negotiations with a Fund mission which have led to some relaxation of the Standby programme this year to alleviate the effects of the recession. Meanwhile, discussions have begun with the Advisory Committee about this year's new money requirement of around $800 mn.

The second round support operation for Ecuador has been hampered by the Presidential elections: banks have refused to reach an agreement covering the whole of 1984 until the outcome of the second round of the elections becomes known in May and a new Standby has been negotiated with the IMF. As regards Venezuela, the banks have had little option but to grant a further 90-day extension to the moratorium which expired on 31 January. The first formal meeting between the Advisory Committee and the new Administration is expected shortly. The replacement of the previous Central Bank President and the appointment of a new foreign debt co-ordinator have been taken as likely to facilitate negotiations.

(ii) Far East

In the Far East, there has been little material progress towards assembling a support package for the Philippines, where negotiations with the IMF have been complicated by doubts about the reliability of external statistics and a sharp acceleration in monetary growth. A Fund team is in Manila to settle the statistical question and to re-open discussions on a Letter of Intent. Meanwhile, the debt moratorium has been extended for a further 90 days, to 15 April. Elsewhere in the region, both South Korea and Indonesia continue to show a steady improvement, and the latter is now approaching the market for a major loan ($500 mn) - the first of this order since the Philippine crisis broke.

(iii) Eastern Europe

Sentiment towards Eastern Europe may be improving a little, although it remains essentially cautious and discriminating. The USSR has negotiated a fine margin of only 5/8% over LIBOR on its first syndicated borrowing ($150 mn over five years) for general balance of payments purposes since 1979. Both Czechoslovakia and Hungary (which recently entered into a further Standby arrangement with the IMF) can be expected to come to the market again this year, although terms and timing will need to be carefully pitched, with the margin very much higher than in the Soviet case. Elsewhere in Eastern Europe, the GDR continues to meet payments on time, despite its undoubtedly tight liquidity; and Romania seems likely to avoid rescheduling this year, after the resolution of its differences with the IMF and release of the remaining drawings under the now terminated Standby arrangement.

Meanwhile, both official creditors and commercial banks have agreed in principle to reschedule Yugoslavia's medium and long-term maturities falling due in 1984 over seven years, including four years' grace. Final agreement is conditional upon the satisfactory conclusion of current negotiations with the IMF on a one-year Standby arrangement. The banks are considering the possibility of a multi-year rescheduling arrangement for Poland. Negotiations on the number of years to be included and on the possible provision of trade credit began in Warsaw on 16 and 17 February. Official creditors met in Paris on 6 February and agreed to consider the possibility of rescheduling overdue principal and interest arrears in conjunction with a settlement of the arrears under the 1981 agreement. They agreed to inform the banks that in future they would be seeking comparability of treatment (which had been in abeyance while official creditors were providing 100% of de facto relief). A meeting with the Poles is tentatively scheduled for the week beginning 19 March.

(iv) Southern Europe

In Portugal, where domestic demand is being progressively squeezed, the current account deficit was almost halved last year to \$1.7 bn (some \$300 mn below the target set under the Standby arrangement); and a further, though smaller, improvement is in prospect this year.

Last year, the Greek economy was characterised by high inflation, a large public sector deficit, and another current account deficit of nearly \$2 bn. At the same time, external debt is estimated to have risen by some \$1 1/4 bn and the debt service ratio to nearly 17%. No perceptible improvement is in prospect this year: a generous incomes policy, which has recently been announced, is likely to impair competitiveness and sustain inflation at a rate some three times faster than the Community average. Reserves stand at only 4-5 weeks' imports. The IMF staff have indicated that, in the absence of stronger adjustment, a further sizable increase in the debt service ratio is likely over the next few years. Although no immediate crisis seems in prospect, there are signs that international banks are beginning to take a less sanguine view of Greek risk.

Further measures to stabilise the position in Israel have been announced, including a 4% cut in government expenditure in the fiscal year commencing 1 April and a tightening of exchange controls.

In Nigeria, recent IMF figures show that medium and long-term debt outstanding is rather larger than was previously thought, as are capital repayments due to be made this year and next. Meanwhile, the Nigerians have recently resumed discussions with the IMF on the possibility of an extended facility and have had talks with official and private creditors in the UK, France and Germany. It has been made clear to the Nigerians that the consolidation of their debt to, or guaranteed by, official agencies must take place in a multilateral framework along Paris Club lines. Indications are that the Buhari regime intends to approach Nigeria's acute liquidity problem responsibly and is willing to accept the IMF's medicine, though the degree of exchange rate adjustment required is likely to prove contentious.

14 February 1984

Econ Pol: Indebtedness pt. 3.

International debt file

Foreign and Commonwealth Office

London SW1A 2AH

PERSONAL

24 February 1984

cc AW

Andrew Turnbull Esq
10 Downing Street

Dear Andrew,

Thank you for sending over a copy of Alan Walters's piece on Key Economic Issues for the American Enterprise Institute. I was very interested to see it, and in particular the passage on the last page about selling liabilities. It was that to which the Prime Minister referred in her conversation with Sir Robert Muldoon.

This idea has long interested me, and I know that one or two merchant banks have been playing with it. For what it is worth I tried it on some people from the Bank of England the other day. They thought that in some respects sale of liabilities could be illegal. But I will pursue it, and if I hear anything of interest will let you know.

Yours ever

Crispin Tickell

Crispin Tickell

CONFIDENTIAL

SECRETARY OF STATE FOR TRANSPORT

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Prime Minister (2)
To note this difficulty
AT 23/2

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

22 February 1984

Dear Nigel

NIGERIA: ECONOMIC RELATIONS

Adam Thomson came to see me on 20 February to emphasise how serious is the situation British Caledonian face in Nigeria where they have currently some £60m of remittances blocked. You know the background from the letter which Trevor Boud, their Finance Director, sent to you on 13 February.

They have perhaps been less than prudent to allow the situation to build up to this point, but of course they reckon to operate with some degree of special protection under the terms of the Air Services Agreement and they claim to have had what they regarded as satisfactory assurances of a reasonable flow of payment up to and even beyond the time of the coup. They received £14m as recently as December; but it has become clear in the last couple of weeks that the assurances they had received were without adequate authority or foundation.

CONFIDENTIAL

They are already taking some steps to help themselves, notably by co-operating with the Nigerian authorities in stopping the sale of air tickets for Naira to non-residents; and they are in close touch with IATA who are negotiating on behalf of all the international airlines in Nigeria. But such measures are unlikely to be sufficient in present circumstances.

I understand that the arrangements you are negotiating for the whole range of trade creditors will not directly cover British Caledonian, though anything which puts Nigeria's finances back on to a sounder footing must have a beneficial effect for everyone doing business there. Nevertheless I hope you will feel able to give priority to the special position of airlines, particularly in relation to the resumption of remittances on a current basis and an understanding that any backlog of outstanding remittances will be guaranteed against devaluation. For our part we shall be discussing with BCAL what action may be open to us within the framework of the Air Services Agreement and will let you know of any action which may seem appropriate. In all this what we must bear in mind is the political importance of supporting British Caledonian. They are essential to our plan for introducing more competition into civil aviation, both domestically and internationally, and we must therefore take every reasonable measure to ensure that they remain a healthy and vigorous company. We cannot afford to let them go to the wall in circumstances where they could say that the Government have some responsibility to help them as signatories of the Air Services Agreement.

Copies of this letter go to the Prime Minister, the Foreign Secretary, and the Secretaries of State for Defence and for Trade and Industry; and also to the Governor of the Bank of England and to Sir Robert Armstrong.

NICHOLAS RIDLEY

Econ Pol. Pt 3
Indebtedness

23 JAN 1984

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10 DOWNING STREET

From the Private Secretary

20 February 1984

Nigeria: Economic Relations

The Prime Minister has seen the Chancellor's minute of 16 February reporting on the line he proposes the Government should take on the handling of the Nigerian debt problem. She has also seen minutes from the Secretary of State for Trade and Industry and the Foreign Secretary. She endorses the approach suggested and has noted that, while the UK might be expected to give a lead on terms in the debt restructuring, negotiations on this will take place in the Paris Group with the French in the chair as normal.

I am copying this letter to Peter Ricketts (Foreign and Commonwealth Office), Callum McCarthy (Department of Trade and Industry), Dinah Nichols (Department of Transport), John Bartlett (Governor of the Bank of England's office) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

John Kerr Esq
HM Treasury

CONFIDENTIAL

cc. NO

PM/84/30

PRIME MINISTER

Nigeria: Economic Relations

1. The Chancellor of the Exchequer copied to me his minute of 16 February on the handling of the Nigerian debt problem.

2. I agree with his proposals, particularly that our officials should take the lead in discussing terms of a possible debt restructuring arrangement with Nigeria. Our own financial interest in this case is so considerable (arrears owing to ECGD of up to £800 million, with perhaps a further £1 billion due to uninsured British creditors) that we must clearly do everything possible to obtain an early settlement on the basis described in the Chancellor's minute.

3. I am copying this minute to the Chancellor of the Exchequer, the Secretaries of State for Defence, Trade and Industry, and Transport and the Governor of the Bank of England and Sir Robert Armstrong.

Foreign and Commonwealth Office

20 February, 1984

CONFIDENTIAL

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PRIME MINISTER

NIGERIA : ECONOMIC RELATIONS

On balance, I agree with the line that Nigel Lawson proposes in his minute of 16 February to you, on the understanding that other Governments and private creditors will also be expected to carry their full share of the burden.

2 I am of course reluctant to see Nigeria's debts repaid over such a long period of time for fear that it will encourage other countries to be equally financially imprudent. And we will get considerable criticism from the insured creditors. If this solution is reached they will no doubt be dismayed that they will be required to offer the same relief. However, it is the normal rule for Paris Club operations that the burden should be shared equitably between all creditors.

3 But I believe that there are strong financial and trading reasons why we should be sympathetic to the Nigerian request for debt relief. Failure to deal with its economic problems might lead to the collapse of the present moderate regime. This in turn might result in severe disruption of the oil market and a risk of default on current debts owed to UK firms. ECGD alone has an exposure of over £3 billion

on the market and at the present time, no interest is being paid by the Nigerians on these outstanding payments. Also action to settle the arrears is necessry to remove a major obstacle to trade with Nigeria.

4 A multilateral refinancing arrangement on the lines proposed by Nigel Lawson would assist the Nigerians to overcome their immediate debt structure problem and should enable them to meet their future debt obligations promptly. As I see it this would not represent any easy option for the Nigerians. They will have to submit to IMF disciplines and pay a commercial interest rate on the refinancing loan. We must insist especially on the latter point on which the Nigerians have so far shown some reluctance.

5 Last, and perhaps most importantly, a settlement must be achieved to enable ECGD to avoid meeting claims totalling some £600 million over the next year which is obviously important from the PSBR viewpoint. I also understand that other Governments and private creditors would also be expected to carry their full share of the burden.

6 Copies of this go to the recipients of Nigel's minute.

NT

N T

17 February 1984

Department of Trade and Industry

17 JAN 1984

Prime Minister (1)
Agree Chancellor's approach?
SS/TI supports and Foreign Secretary is likely to as well. Chancellor is avoiding putting UK in position of leading creditors group - France will be in chair as normal.
AT 17/2

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

PRIME MINISTER

Yes - we have little alternative MT

NIGERIA: ECONOMIC RELATIONS

In my minute of 18 January I reported on the handling of the Nigerian debt problem. The issues for decision now are:-

i. the line to take in the IMF;

ii. whether to agree to a multilateral debt restructuring under French chairmanship;

iii. the line to take with the Nigerians (I see the Finance Minister on 20 February); and

iv. how to deal with uninsured creditors.

2. i. At the IMF, it seems clear that we should argue that Nigeria must adopt sensible adjustment policies, and that rapid progress, and an early agreement, is required.

ii. On debt restructuring, a multilateral approach is clearly essential for all creditors must take their share. I think it right that the French should take the chair as is normal (hence the "Paris Club"), in spite of our prominent share of the debts, and of Nigerian preferences.

iii. As the largest creditor we shall be expected by the others to give a lead on terms. The proposal, agreed inter-departmentally at official level, is that we should envisage:-

/a. a

a. a restructuring of 80 per cent of the £600 million to £800 million arrears on short-term debt which matured before 31 December 1983; making it repayable over six years, with a 2½ year grace period, and covered by a refinancing loan raised by British banks, guaranteed by ECGD, and carrying a fully-commercial rate of interest including ECGD's premium;

b. payment of the remaining 20 per cent over two years.

Other creditors are likely to consider these terms broadly appropriate.

iv. The agreement would not cover uninsured creditors including Unilever and British Caledonian. Like all creditors they will have to accept delays in payment. We must do our best to help them, but we cannot secure preferential treatment for them.

3. Subject to your views, I would be content for officials to set out to the Nigerians next week the terms at 2 (iii) above, emphasising of course that our willingness to proceed on that basis will depend not only on the outcome of the multilateral negotiations, but also on their concluding a satisfactory agreement with the IMF.

4. Copies of this minute go to the Foreign Secretary and the Secretaries of State for Defence, Trade and Industry, and Transport; and also to the Governor of the Bank of England and Sir Robert Armstrong.

NL

N.L.
16 February 1984

ECON POL: Indebtedness Pt3

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CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

16 February, 1984.

Argentina: Commercial Bank Lending

The Prime Minister has seen your letter to me of 14 February and the Bank of England note which was attached to it. She agrees that this matter can rest, now that the Bank and LBI are fully aware of the need to keep Government fully informed of developments relating to Argentine debt.

Andrew Turnbull

John Kerr, Esq.,
HM Treasury.

CONFIDENTIAL

CT.

3.8 ~~cc NO~~ CONFIDENTIAL

Prime Minister

Agree this can rest, now that LBI and Bank are fully aware of need to keep Government fully informed?

AT 15/2

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

14 February 1984

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew.

ARGENTINA: COMMERCIAL BANK LENDING

In his minute of 17 January to the Prime Minister the Chancellor mentioned that he would be pursuing the question of why the Bank of England's contacts with Lloyds Bank International did not bring to light earlier the expiry date of the draw-down period for the medium-term loan to Argentina.

I now enclose an explanatory note prepared by the Bank at the Treasury's request. It appears that the Bank were not informed of this provision by LBI until shortly before the Argentine Working Committee meeting in New York on 9-10 January, and that they decided not to pass the information on to the Treasury until they knew whether the matter had been discussed at that meeting. In the event, the Working Party did not discuss the point, and the Bank informed the Treasury on 12 January.

The Chancellor is surprised that the Bank's note suggests that they have still not seen a copy of the loan agreement. His firm view that Ministers should have been told of the expiry date provision as soon as it came to light has been conveyed to the Bank. He very much agrees with the Prime Minister - your letter of 19 January - that Ministers could, through not knowing of the provision, have found themselves in an embarrassingly false position. On his instructions, officials have impressed on the Bank the importance of keeping the Treasury closely and promptly informed of all developments relating to the loan agreement and the Argentine debt situation.

Yours ever,

J O Kerr

J O KERR
Principal Private Secretary

CONFIDENTIAL

ARGENTINA'S $1.5 BN LOAN

The Bank of England learned in the following way that the banks' commitment to make disbursements under the Loan Agreement with Argentina was due to terminate on 31 January 1984 and could only be extended thereafter on the unanimous vote of the 313 participating banks.

2 A meeting of the Argentine Working Committee on which Lloyds Bank International represents the British banks, was called for 9-10 January - the first meeting since 24 November. As usual, there was a preliminary meeting shortly beforehand of the main British banks, with the Bank of England represented, to consider what attitude should be taken in the Working Committee towards any Argentine requests that might be put forward by the Argentine Economic Minister, Grinspun, in relation to the $1.5 bn loan. The discussion brought to light the important fact of the Termination Date.

3 Since the Bank understood that the Working Committee would be discussing this point in a preliminary way, as well as hearing at first-hand from Grinspun what kind of programme the new Argentine Government was proposing to adopt, it seemed right to wait to convey this new information to the Treasury until its significance could be assessed in the light of the outcome of these discussions in New York and of the attitude of the other banks in the Working Committee. This the Bank did as soon as the LBI representative had debriefed us immediately on his return from New York (though it emerged that the Working Committee had not in fact discussed this point at all).

4 Next comes the question why LBI had not thought it necessary to notify the Bank earlier of the Termination Date. This is explicable in the light of the conditions under which the banks, and especially the LBI, had been operating. The negotiation of the loan itself and of the single drawdown that in the event has been made under it,

had been dogged by delays and difficulties almost wholly of the Argentines' own making. Every stage has involved great complications, some technical, many sensitive. This is not surprising, since the Bank have been told that the Loan Agreement and its related documentation, which is exceedingly complex, runs to some 90 pages of the Agreement itself plus as many again of schedules and exhibits. For the first drawing to take place, 15 pre-conditions, it seems, should have been met and we understand that 20 potential Events of Default are listed in the Agreement. As a result, the first drawing in early December (and even then a last-minute technical hitch almost prevented it) took place after the third and last drawing should normally have occurred. This would have been over two months before the Termination Date for the drawings which was, therefore, in some sense a formality in the Agreement at the time it was drawn up.

5 Nevertheless, LBI have been fully aware of the political importance attaching to this loan and they have striven to keep the Bank properly informed about the slow progress of the original negotiations leading up to the signature of the loan and any material subsequent developments. What they knew, however, was that for wider international reasons HMG had acquiesced in the British banks' participation in the original bridging loan of December 1982 and the subsequent IMF-backed loan package. HMG's concerns in August 1983 and thereafter had been to ensure that this participation, on the one hand, could be used as a lever to remove Argentine discriminatory restrictions against the UK and, on the other hand, should be firmly linked to an IMF agreement, since that body's seal of approval was the best assurance available to HMG and the banks that the Argentine Government was pursuing responsible economic and fiscal policies and therefore making proper and justifiable use of any moneys it received from the banks' loan. LBI were not privy to HMG's examination of ways by which the British banks might positively be prevented from lending to Argentina and therefore they had no reason to suppose that HMG expected them to look for ways of actually withdrawing from the loan.

6 They would have been confirmed in this view by the fact that at the time of the December drawing a way was open to them to prevent disbursement, since their consent was needed for a waiver on certain conditions attaching to the earlier bridging loan. They gave their waiver with HMG's knowledge. From the banks' point of view, therefore, the Termination Date was not a material element in their consideration of their actions vis-a-vis Argentina until early 1984 because it did not become operative until 31 January; and in the earlier period there were numerous other issues relating to the loan which needed to be immediately dealt with in one way or another and these had been the focus of their attention.

7 It is also relevant that the leading figures in the Working Committee on Argentina are also key members of the Advisory Group on Brazil. These members were engaged almost continuously between the end of November and mid-January, either individually or as a group, in their ultimately successful efforts to put together the Brazilian new money loan of $6.5 bn. During that period the new democratically-elected Argentine Government was finding its feet and in no position to discuss with the banks and the IMF how they would cope with the mess the Junta had bequeathed to them. It was therefore to be expected that the banks put the immediate problems of Argentina out of their minds during this time.

BANK OF ENGLAND
February 1984

Econ Pol: Indebtedness
Pt3

Indebtedness

S E C R E T

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10 DOWNING STREET

From the Private Secretary

13 February 1984

NIGERIAN DEBT: POSSIBLE FURTHER COUP

The Prime Minister has seen the Foreign and Commonwealth Secretary's minute of 10 February. She recognises that the point made in the minute is a valid one but has drawn attention to the opposite danger - to allow fear of a coup to justify a very weak programme of adjustment.

I am copying this letter to John Kerr (H.M. Treasury), Callum McCarthy (Department of Trade and Industry), John Bartlett (Bank of England) and Richard Hatfield (Cabinet Office).

ANDREW TURNBULL

Peter Ricketts, Esq.,
Foreign and Commonwealth Office.

S E C R E T

CONFIDENTIAL

N BPM

AT 14/2

Foreign and Commonwealth Office

London SW1A 2AH

13 February 1984

Dear Andrew,

Argentina: Commercial Bank Lending

Sir Geoffrey Howe has seen John Kerr's letter of 9 February to you.

He agrees with the Chancellor that the pressure is off for the moment to decide whether we should raise the stakes with the British banks. Nevertheless, he notes from the Chancellor's earlier minute that the US and other banks may return to the charge. Sir Geoffrey Howe thinks it is important that we should have as much advance warning as possible of this. If the British government has to take up a position, he would like to be consulted at an early stage on the foreign policy aspects. We have told our friends and allies of our initiative to normalise relations with Argentina, and we do not want to give them the impression that we might be pursuing divided policies. Nor do we want to give the Argentinians any excuse at all for not responding to our approach in a reasonable fashion.

I am copying this letter to John Kerr (HM Treasury), John Bartlett (Bank of England) and Richard Hatfield (Cabinet Office).

Yours ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

A Turnbull Esq
10 Downing Street

CONFIDENTIAL

Econ Pol Indebtedness Pt 3

10 DOWNING STREET

From the Private Secretary

Prime Minister (2)

Valid up to a point but we ought to guard against the opposite danger of allowing fear of a coup to justify a toothless programme of adjustment.

I would want to know whether an NCO coup, led by Sergeant Doe Jerry Rawlings types, would produce a government hostile to the West, though I concede it might be less sophisticated in financial matters

AT 10/2

MT

 Prime Minister (2) 5

PM/84/26

MT

PRIME MINISTER

Nigerian Debt: Possible Further Coup

1. The Chancellor of the Exchequer copied to me his minute to you of 18 January about Nigerian indebtedness. I entirely agree with him on the need for a rapid agreement on multilateral restructuring of the arrears of short-term commercial debt, subject to an agreement also with the IMF.

2. Since his minute there have been a number of reports from various sources of continued plotting against Buhari's government amongst more radical middle-ranking officers and there does seem to be a risk of a further coup in the next few months if the present government does not convince people that it has picked the right economic policies. Any successor regime would almost certainly be less sympathetic to British (and more general Western) interests, particularly in the financial and economic fields. At best negotiations with the IMF and creditors would be delayed; at worst it might seek to renege on its debts.

3. This underlines the need for rapid progress in the negotiations with the IMF. We have repeatedly urged speed on the Nigerians at all levels, including Buhari himself. But it is also important that the Fund understands the limited freedom of manoeuvre the present government has on what are highly emotive issues domestically. Clearly any Fund programme must be soundly based; but it must also take account of the political realities especially resulting from the inflationary impact of devaluation and removal of food and petrol subsidies.

4. Our Executive Director to the Fund has already made these points. But I believe it would be useful if the

/Chancellor

Chancellor were to speak personally to M de Larosiere, in the margins of the G5 Ministers' meeting in Paris next week.

5. Officials in the Treasury, Bank of England and Foreign and Commonwealth Office have already done some work to assess the implications of a further coup in the financial and economic field. I understand that this question will be covered at the next meeting of the Treasury's group on international debt problems which regularly reports to you.

6. I am copying this minute to the Chancellor of the Exchequer, Secretary of State for Trade and Industry, the Governor of the Bank of England and Sir Robert Armstrong.

GEOFFREY HOWE

Foreign and Commonwealth Office

10 February 1984

ECON POL: Indebtedness: Pt 3

CONFIDENTIAL

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

9 February 1984

Andrew Turnbull Esq
No 10 Downing Street
LONDON SW1

Dear Andrew,

ARGENTINA: COMMERCIAL BANK LENDING

The Chancellor mentioned, in his minute of 7 February, - with AT that the British banks would probably be deciding this week how to respond to a recommendation to reinstate the draw-down period of the medium term loan to Argentina.

As I told you earlier today, we now understand from the Bank of England that they have decided not to withdraw the condition advocated by the British (LBI) representative in last week's New York discussions. They have, therefore, replied to the effect that any further loan disbursements must be conditional on a satisfactory agreement with the IMF. We also understand that they reached this conclusion not only in the light of their awareness of HMG's views, but because they are concerned about evidence that Argentina is not pursuing negotiations with the Fund as seriously as they would wish.

ie a letter of intent would not suffice.

The question of raising the stakes in order to stiffen the banks' resolve, which was discussed in the Chancellor's minute and the Foreign Secretary's response yesterday, is therefore now academic, at least for the present.

Copies of this letter go to Brian Fall (FCO), John Bartlett (Bank of England) and ~~to~~ Richard Hatfield (Cabinet Office).

Yours ever,

John Kerr.

J O KERR

Econ Pol. Pt 3

Indebtedness

File

PRIME MINISTER

ARGENTINA: COMMERCIAL BANK LENDING

No action is required at present but at some stage HMG might be required to choose between:

(i) leaning on British banks to block the loan, with HMG taking the blame; or

(ii) allowing the loan to go ahead with HMG distancing itself.

For the time being, the commercial judgement of British banks is in favour of tougher conditions so the choice does not arise. The Chancellor and Foreign Secretary would have preferred (ii) as being more consistent with the current policy of trying to normalise commercial relations with Argentina.

AT

9 February 1984

PM/84/25

PRIME MINISTER

Argentina: Commercial Bank Lending

1. Nigel Lawson sent me a copy of his minute of 7 February to you and sought my comments.

2. I agree that in present circumstances there would be no advantage in raising the stakes. To press the banks further to continue to stand out against the consensus of other banks would be inconsistent with the policy of normalising relations with Argentina. At OD on 25 January we agreed that the banks should be encouraged to insist that any disbursement under existing loan arrangements should be linked to Argentina's implementation of the IMF programme now under negotiation. The Chancellor's minute makes clear that LBI have fought the battle hard. But I think the Chancellor's report of the round of recent negotiations shows that raising the stakes would stand little chance of success given the need of the banks themselves to put their own books in order. Isolation on this question would almost certainly be to their commercial disadvantage.

3. I also see nothing to be gained by criticising the banks publicly should it become known that they had participated in extending the draw-down period of the loan. I believe that we should rest on the line we have taken in the past, namely that this is a matter for their own commercial judgement. I think this is a perfectly sensible and consistent position.

/4. I

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4. I am copying this minute to the Chancellor of the Exchequer, the Governor of the Bank of England and Sir Robert Armstrong.

GEOFFREY HOWE

Foreign and Commonwealth Office
9 February 1985

ECON POL: Indebtedness Pt 3

19 FEB 1984

CONFIDENTIAL

BF with FCO response AT 8/2

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

PRIME MINISTER

ARGENTINA: COMMERCIAL BANK LENDING

In my minute of 17 January I reported that I proposed to ask the Bank of England to press the British banks to insist that an extension of the draw-down period of the current medium-term bank loan to Argentina should be granted only on condition that further drawings were conditional on Argentina reinstating its IMF programme (and being in conformity with it at any time when drawings on the loan were made).

2. The Bank of England have reported the following further developments. The Working Committee of banks meeting in New York last week failed to reach agreement, so the draw-down period has now technically lapsed. They are, however, envisaging the issue of a message to all the banks concerned recommending its reinstatement. The British representative (from Lloyds Bank International) has at the Bank's request argued very strongly that reinstatement should only be agreed on the conditions I had proposed. But I am told that, whereas he was at first supported by 3 or 4 other banks, he is now isolated, and that a looser linkage, to a letter of intent by the Argentine Government rather than to the actual reinstatement of the Fund programme, would command general acceptance, for there is general concern that failure to reinstate the draw-down period could cause the whole of the existing financial package to unravel. The US banks in particular are anxious to be able to make further disbursements before the end of March, so that interest arrears due to them may be repaid out of the proceeds, thus preventing their own assets from becoming classified as "non-performing".

3. I have asked the Bank of England to continue to press Lloyds Bank International to hold the line. They will, however, probably have to decide later this week what to do when the crunch comes. I am advised that a unanimous recommendation from the Committee is required, so LBI would in practice be able to block any further disbursements of the loan. If, on the other hand, they acquiesce in the majority view, this would not necessarily commit the other British banks, but they would be likely to follow the LBI recommendation.

4. If LBI hold out, they will no doubt make it clear that their action reflected the wishes of the British Government. If they acquiesce, we should equally feel free publicly to criticise the British banks' action as contrary to our wishes, should we find it necessary to do so.

5. The question now is whether we need to stiffen them further. I have not so far spoken to Sir Jeremy Morse though the Bank have made my views very clear to LBI, and LBI appear so far to have argued the case for tight conditionality very strongly. My instinct is against raising the stakes, but I would welcome your views, and those of Geoffrey Howe.

5. Copies of this minute go to him, and to the Governor of the Bank of England, and Sir Robert Armstrong.

NL

N.L.

7 February 1984

Econ Pol: Indebtedness
Pt 3

File

Argentina
[illegible]

INTERNATIONAL DEBT - ARGENTINA, BRAZIL AND MEXICO

Line to Take

Argentina's current debt problems are of her own making. It is for her, as for other debtor countries, to put her own house in order by making the necessary adjustments in line with the IMF programme and by removing obstacles to agreement with the commercial banks. Meanwhile, international loans, from the IMF and the banks, remain frozen.

2. On Brazil, welcome the recent signature of the IMF letter of intent. Hope it will be backed up by the measures necessary to reinstate the IMF programme. In the provision of financial support, HMG will play its part both in the IMF and in the forthcoming rescheduling of official debts. Beyond this, the introduction of economic adjustment measures under a convincing IMF programme is the crucial step in restoring international confidence in Brazil.

3. Mexico continues to make encouraging progress helped by domestic economic adjustment, the IMF programme and the growth in the world economy.

4. In general, any durable solution to country debt problems must depend above all on economic adjustment by debtor countries. Developed countries' best contribution is non-inflationary growth and avoidance of protectionism.

5. Support the role of the IMF and World Bank in promoting sound adjustment policies, by ensuring they have the necessary resources.

6. Governments contribute through the IMF, BIS and official rescheduling, and should not normally be expected to make further contributions to the financing burden. To do so could weaken the discipline on creditors and debtors and involve unacceptable increases in public spending or financial exposure. It is up to the debtor

countries to regain the confidence of commercial banks and other creditors by pursuing sound adjustment policies.

Background

7. The general outlook for the international debt scene has been improved by the economic recovery which is now clearly under way in the major industrial countries. Most notably the Mexican economic recovery appears to be continuing. However the Brazilian situation remains critical and certain other countries are facing increasing difficulties, including Argentina where debt service payments appear to have ceased, bringing closer the prospect of a complete default.

8. The largest single problem is Brazil. The revised letter of intent to the IMF has now been signed but the Managing Director has not been prepared to recommend the programme to the Executive Board until the position is clearer on the new Brazilian wages law and until he is satisfied that sufficient financing has been committed in support of the programme. There are now renewed doubts over the Brazilian Government's intentions on wage deindexation and uncertainty about the adequacy of financing. In addition to \$6.5 billion to be raised by the commercial banks (including British banks) and up to \$2 billion from official Paris Club rescheduling, the Managing Director looks to export credit and other official sources for a further, say, \$2½ billion. The USA have indicated a willingness to participate by providing export credit facilities of \$1.5 billion through Exim Bank, but have made it a condition that other govnerments should also contribute. HMG have refused to do so, on the premise that, in general terms, debt problems are primarily a matter for the debtor countries as borrowers and the commercial banks as lenders, who should together bear a continuing responsibility for their past decisions.

9. On Argentina drawings of IMF funds are suspended because of arrears and the need for further adjustment measures as the IMF programme drifts increasingly off course. Drawings of the comercial

banks loans are also suspended mainly because of the breakdown in debt rescheduling caused by judicial rulings on the Aerolineas Argentinas agreements, intended to serve as a model. The Argentines have responded by suspending foreign currency payments to protect dwindling reserves.

10. The Mexican economic recovery appears to be progressing well. The detailed application of debt rescheduling is being negotiated and implemented and the Mexican authorities are confident they will not need further money from the banks in 1983. Requirements for 1984 remain at some $4 billion, but this is as originally expected.

Total undertaking 9 ws to UK banks.

ANNEX

CURRENT IMF FACILITIES

		SDR billion
Argentina	15 month standby expiring April 1984	1.5
	Compensatory Financing Facility (CFF)	0.5
Brazil	3 year Extended Fund Facility (EFF) expiring February 1986	4.6
	CFF	1.0
Mexico	3 year EFF expiring December 1985	3.6

CONFIDENTIAL

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

7 February 1984

A J Coles Esq
10 Downing Street
LONDON SW1

A. J. C. 7/2

Dear John,

ARGENTINA: DEBT RESCHEDULING

The Chancellor has seen Peter Ricketts' letter of 3 February about the possible Argentine approach to the Paris Club. He agrees that debt statistics should be supplied to the IMF and Paris Club in the usual way, without prejudice to the decisions to be taken by Ministers in due course.

I am sending copies of this letter to Peter Ricketts (FCO), Callum McCarthy (DTI) and John Bartlett (Bank of England).

Yours ever,
John Kerr.

J O KERR
Principal Private Secretary

ECON POL : Indebtedness : Pt 3.

CONFIDENTIAL

file

BoE

10 DOWNING STREET

From the Private Secretary

6 February 1984

Argentina: Debt Rescheduling

Thank you for your letter of 3 February.

The Prime Minister has noted that, if there is a preliminary discussion of Argentina at the Paris Club meeting this week, and we are asked about out attitude, you intend to say that we are supplying the information requested by the IMF and the Paris Club in the normal way, but that we shall not be drawn further about our attitude.

We have further noted that you will consult the Prime Minister again if and when a definite Argentine request is received.

I am copying this letter to John Kerr (HM Treasury), Callum McCarthy (Department of Trade and Industry) and John Bartlett (Governor of the Bank of England's office).

A. J. COLES

Peter Ricketts, Esq.,
Foreign and Commonwealth Office

CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

Prime Minister (1)

An Argentine request for debt rescheduling remains on the cards.

Content with the line at X overleaf, on the basis that you will be consulted again if a definite request is received?

DMB 3/2

3 February 1984

Dear John,

Argentina: Debt Rescheduling

In his minute of 17 January, the Chancellor of the Exchequer referred to the possibility that Argentina would request a rescheduling of official debt through the Paris Club. Although a definite request has not yet been made, we now have some more details of which the Prime Minister should be aware.

The IMF and the Paris Club secretariat have asked creditor governments to supply figures for Argentine debt in preparation for a possible Argentine application. I understand ECGD and the Treasury are supplying this information in the normal way. The Swiss have also reported an approach to them by the Argentine government asking whether they would be prepared to represent British interests at any Paris Club negotiations. We have not replied to this approach. The Swiss are prepared to act in accordance with our wishes although the arrangements proposed would be unprecedented. But we are under no pressure to come to a decision on this point, not least because a definite Argentine request to the Paris Club is still some time away. We should of course consult the Prime Minister when a decision becomes necessary. Our inclination at this stage is to reject the approach through the Swiss on the grounds that we do not wish to see the Paris Club politicised and that as a creditor we have every right to take part in the negotiations.

/Although an

A J Coles Esq
10 Downing Street

Although an immediate request for rescheduling is not likely, creditors may have a preliminary discussion of Argentina at the Paris Club meeting next week. There is no need to volunteer anything at this stage about our attitude. But if asked we think we should say that we are supplying the information requested by the IMF and the Paris Club in the normal way, but refuse to be drawn further about our attitude. We should consult the Prime Minister again if and when a definite Argentine request is received. In deciding our substantive attitude and tactics we should take account of the Argentine response to our proposals for the normalisation of bilateral relations, particularly in the economic and commercial fields. This would be consistent with our attitude of not politicising the Paris Club. X

Any agreement by the Paris Club to reschedule Argentina's debts would be dependent on prior agreement with the IMF in conformity with normal Paris Club procedures.

I am copying this letter to John Kerr (HM Treasury), Callum McCarthy (DTI) and the Private Secretary to the Governor of the Bank of England.

Yours ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

Econ Pol: Indebtedness pt. 3

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG

Prime Minister (2)
To note X and Y in particular.

The Rt Hon Paul Channon MP
Minister for Trade
Department of Trade & Industry
1 Victoria Street
LONDON
SW1H QET

2 February 1984

Dmcs 3/2

Is it not possible to persuade the Germans not to offer credit to Libya?

Dear Minister,

CREDIT FOR LIBYA

I have seen your letter of 12 January to Geoffrey Howe and Richard Luce's reply of 23 January about the problems that could arise in our relations with the Americans over a decision to offer credit to Libya.

The foreign and trade policy judgement I am content to leave to you and Richard Luce but I would suggest that in view of the potential that the extention of medium term credit to Libya has for causing difficulties in our relations with the Americans ECGD, should consider excluding from cover US goods or technology as they currently do for the USSR. Like you, I am reluctant to see a cash market turned to credit but I understand that the Germans have offered credit for the Sirte fertilizer project. I am prepared to agree that we should do the same but I hope that it will be possible to limit cover to credit only and avoid any interest subsidies.

X

Y

It will be necessary to impose tight limits on credit provided to this market. ECGD's unhappy experience on claims on short term business in this market, though not directly relevant to medium term business means that Libya must, with justification be regarded as one of their riskier markets.

I am sending copies of this letter to the other members of OD and to Sir Robert Armstrong.

Yours sincerely

PETER REES

(approved by the Chief Secretary & signed in his absence)

CONFIDENTIAL

Econ. Pol : Indebtedness A3

c. LCO
FCO
HMT
LPO.
MOD
LPSO
CDL
CO

10 DOWNING STREET

From the Private Secretary

30 January 1984

Credit for Libya

The Prime Minister has seen Mr. Channon's minute of 12 January and Mr. Luce's minute of 23 January about the provision of credit for Libya.

Subject to any views which other members of OD may express, the Prime Minister reluctantly agrees that if our trade competitors offer credit to Libya, we should in principle be prepared to match their offers.

I am copying this letter to the Private Secretaries of members of OD and Sir Robert Armstrong.

A. J. COLES

Jonathan Rees, Esq.,
Department of Trade and Industry.

Foreign and Commonwealth Office

London SW1A 2AH

From The Minister of State

23 January 1984

Richard Luce MP

Prime Minister (2)

FCO and DTI reach contingent agreement that credit should be offered to Libya if other countries force our hand.

Content with this line?

Dominic 27/1

Reluctantly - Yes

MT

Dear Paul,

Thank you for your letter of 12 January to Geoffrey Howe about the provision of credit for Libya. I share your reluctance to see a cash market turning to credit but clearly, if our trade competitors make such a move, we must be able to match them if we are to build on our already substantial exports to Libya.

You ask whether the Americans will react badly to the extension of UK credit to Libya. Given their view of Gadhafi, which we do not fully share, they are bound to be critical. As you know we already have plans afoot to tackle with the Americans some of the problems we are having with them over trade with Libya. An extension of credit would no doubt have to feature in any such discussions. But meanwhile I do not consider that we should put ourselves at a competitive disadvantage by delaying action on this particular issue pending agreement with the Americans on the broader question.

Richard

The Rt Hon Paul Channon MP
Minister for Trade
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

cc: Members of OD

Econ Pol: Indebtedness A3.

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File

10 DOWNING STREET

From the Private Secretary

19 January 1984

ARGENTINA: COMMERCIAL BANK LENDING

The Prime Minister has seen the Chancellor's minute of 17 January and the paper attached to it. She accepts the Chancellor's proposal that the Bank of England should press British banks to insist that an extension of the current loan agreement should be granted only on condition that further drawings are conditional on Argentina reinstating its IMF programme and being in conformity with it at any time when drawings on the loan are made.

The Prime Minister has noted with concern that the account given in earlier papers of the provisions of the loan agreement was not accurate. Though, in practice, it did not happen, she could easily have reported this misinformation to the House. She knows that the Chancellor will be seeking to establish what went wrong and she looks forward to an account in due course.

BF

I am sending copies of this letter to Brian Fall (Foreign and Commonwealth Office) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

John Kerr, Esq.,
H.M. Treasury.

SH

Prime Minister ②

To note

AT 19/1

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

PRIME MINISTER

NIGERIA - DEBT

Though no early decisions are required, you might like a brief report on financial relations with Nigeria.

2. The Nigerian attitude appears to be "business as usual", and they seem anxious to negotiate a quick agreement with the IMF. There have been no serious problems on the banking side: all payments due have been honoured.

3. The most serious difficulty concerns guaranteed debt, where ECGD's exposure is some £3 billion, about £600 million of which, already in arrears or falling due shortly, the Nigerian Government wish us to reschedule or refinance. Our response has been that any such deal must be multilateral; must provide for broad comparability of treatment with other classes of creditor; must be contingent on a satisfactory IMF agreement; and must be confined to short-term debt (there is little case for any longer term relief). The Nigerians are reluctant to put in an application to the "Paris Club" because of the impact on their credit rating and future availability of loans and export credits. But there will have to be a rapid and effective Paris Club-type operation, perhaps under IMF auspices, to avoid ultimate default. A Nigerian team of officials will be here next week; and the importance of following procedures along Paris Club lines will be explained to them.

4. Despite the size of the problem, it is essentially a short-term one, and therefore much less serious than those we have

recently faced with other countries. Total Nigerian short term arrears are some $4-5 billion.

5. Copies of this minute go to the Foreign and Commonwealth Secretary (whose officials are working closely with mine and ECGD on these issues) and to the Secretary of State for Trade and Industry (whose officials are handling the problems of unguaranteed trade creditors); and also to other Cabinet colleagues, the Governor of the Bank of England, and Sir Robert Armstrong.

N.

(N.L.)
18 January 1984

Indebtedness

SUBJECT

cc MODUS + Ops

T

file MJ

cc f20

10 DOWNING STREET

THE PRIME MINISTER

18 January 1984

PRIME MINISTER'S PERSONAL MESSAGE SERIAL No. T12A/84

Excellency,

I promised on 8 December to send a further reply to your letter of 2 November about the cancellation or conversion of Liberian debts.

I welcome and share your sentiments about the long history of friendship between our two countries. The British technical co-operation programme is a continuing token of British concern and interest in Liberia.

Since my earlier letter, the Paris Club has agreed in principle to re-negotiate payments on official credits concluded before 1 January 1983, with an original maturity of more than one year. The British representative, from our Export Credits Guarantee Department, signed the agreed minute after hearing the detailed explanation of present economic circumstances in Liberia given by your Minister of Finance and Minister of Planning and Economic Affairs, and after hearing the positive assessment of the International Monetary Fund.

/I am glad

I am glad that we have been able to make a contribution to your economic adjustment programme in this way.

Yours sincerely

Margaret Thatcher

His Excellency Commander-in-Chief Samuel K. Doe.

(1).

10 DOWNING STREET

Prime Minister

(i) It is most unsatisfactory that the advice of the Bank, endorsed by Treasury, FCO and Solicitor General, was so wide of the mark.

(ii) Although we could try to lean on UK banks not to renew the facility after 31 January, Chancellor recommends acting as in para 7.

Agree? Reluctantly.

AT 18/1

Perhaps we can enquire how I came to be given the wrong 'facts'. I could have repeated them to the House or

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

PRIME MINISTER

ARGENTINA: COMMERCIAL BANK LENDING

At your meeting on 22 December you asked me to prepare a further note clarifying the conditions under which Argentina might make further drawings on the commercial banks' $1.5 billion medium term loan, dealing in particular with the way in which future drawings might be dependent on the establishment of a new IMF programme.

2. I enclose a note prepared by my officials, in consultation with those of the FCO and the Bank of England, which sets out the position in detail.

3. As the note shows, the banks could make further money available in advance of progress between the IMF and Argentina on a new programme (or re-establishment of the old one), by waiving the loan conditions for further drawings, as they did for the 2 December drawing. However, the overall impression following last week's meeting between Grinspun, the Argentine Economy Minister, and the banks' Working Committee in New York is that the commercial banks are not disposed at present to allow early release of a second tranche, though the position could change if banks worried about the build up of payment arrears saw advantage in releasing a further sum tied to the settlement of payments due to them.

4. At your meeting on 22 December we accepted (on the basis of assurances which the Bank of England had obtained from Lloyds

Bank International), that the loan agreement was legally binding. We concluded that participation by the British banks could only be stopped by primary legislation. It transpires now that we had not been given the full facts, and that a means of stopping the bank loan does in fact exist. As paragraph 10 of the note explains, the drawdown period for the loan will expire on 31 January, and a positive decision is needed by all banks if the remaining $1 billion is to remain available after then.

5. It is of course wholly unsatisfactory that the Bank's contacts with LBI did not bring this to light earlier: I shall be pursuing that separately.

6. We now have to consider whether to take advantage of this opportunity and bring pressure to bear on the British banks to end their participation and abort the loan agreement. I understand that the banks themselves are likely to want to extend the drawdown period. I myself think that on balance it would be wrong for us to try to force "foreclosure", particularly if we might want to seek some limited improvement in other areas of Anglo-Argentine relations. But I am quite sure that we should take the opportunity to strengthen the conditional links between drawings under the loan agreement and a new IMF programme.

7. Subject to your views, I therefore propose to ask the Bank of England to press the British banks to insist that an extension should be granted only on condition that further drawings are conditional on Argentina reinstating its IMF programme (and being in conformity with it at any time when drawings on the loan are made).

8. Finally, you will wish to know that Grinspun indicated to the commercial banks that Argentina intends to seek debt relief from the Paris Club, possibly in the first half of this year, although

the IMF representative at the Paris Club last week maintained that a final decision had not been taken. The paper we discussed on 22 December set out the main considerations, and I shall put forward proposals in due course.

9. I am sending copies of this minute to the Foreign and Commonwealth Secretary, and Sir Robert Armstrong.

N.L.

17 January 1984

ARGENTINE $1.5 BILLION LOAN CONDITIONS

Note by Treasury officials

This note sets out the main conditions under which drawings on the commercial banks' $1.5 billion medium term loan can be made and their relationship to the establishment of a new IMF programme.

Drawing of 2 December 1983*

2. For the first advance, released on 2 December, the original loan documentation imposed conditions of which the main ones required:

(a) the elimination of arrears,

(b) progress on public sector debt rescheduling including the completion of the agreement with the state airline, intended to serve as a model for the rest,

(c) the availability of foreign exchange for interest payments on foreign debt, and

(d) a certificate of good standing from the IMF confirming, in particular, that the first two advances had been made under the IMF standby.

3. The last of these conditions was met. The others were waived under the provisions, contained in the agreement, for amending the original terms.

Further drawings

4. Similar conditions are associated with the second and third (ie final) tranches of the loan eg a certificate stating that there are no interest arrears due to banks (subsequent to a date to be agreed) and a requirement on foreign exchange availability as in para 2(c) above. Further progress on public sector rescheduling is also required for the second tranche and, for the final tranche, completion of substantially all agreements.

*$0.5bn

The most important requirement is for a new certificate of good standing from the IMF, before the next drawing, confirming:

(a) that the standby continues in effect,

(b) that, subject to the terms of the standby, Argentina remains eligible to make purchases from the Fund, and

(c) that a further drawing (the third) under the standby has been made.

5. The IMF is in no position to issue such a certificate at present. The Argentine programme has broken down and the most likely course now is that it will be replaced by a new programme and a new standby facility. There is no possibility of an IMF mission to Argentina until late January or early February. The negotiating process is bound to take some months, quite possibly extending into the Summer; even then the IMF certificate would relate to the new agreement, rather than the old as is strictly required by the loan conditions. This would presumably cause the banks no difficulties if the general effect were the same. Even if the present standby can be reinstated, the process will take time.

6. It is open to the banks to amend or waive the original loan conditions and the loan documentation contains provisions specifying the procedures for doing so. For the $1.5 billion medium term loan most amendments require the consent of banks whose exposure is at least two-thirds of the total and a few require the support of all banks. Moreover, changes to the medium term loan may also require parallel changes to the $1.1 billion short term bridging loan agreed in December 1982 eg the timing of bridging loan repayments might need to be amended to match the timing of drawings on the IMF and/or the availability of advances on the new facility. The requirement for the short term loan is 100 per cent agreement to any amendments, ie all participating banks must give their consent.

Effectively amendments or waivers may therefore depend on a 100 per cent acceptance by participating banks. Provided, therefore, that there were sufficient support, the commercial banks could decouple the next tranche under the medium term loan from the establishment of a new IMF programme.

7. The UK clearing banks are believed to have taken a view that no further advance should be made until the existing IMF programme is reinstated or until a new IMF programme has been approved by the Board.

8. At last week's meeting between the Argentine Economy Minister and the leading international bankers, the general impression was that Grinspun had not given a very effective presentation of the Argentine position and of its need for early and substantial help. Led by LBI, a number of banks questioned the sense of going ahead with any further release of bank money in advance of much clearer progress with the IMF. There was also protest, again led by LBI, against the implied blackmail in hints that help with urgent trade credits might be linked to payment of interest. Such a link appears to have been dropped for the moment.

9. Nevertheless many, especially American, banks were worried about keeping payments from falling too far behind, even though the end year balance sheet pressures which weighed heavily on the US banks have receded for the moment. But the banks might at any time see advantage in releasing a further sum strictly tied, as with the 2 December tranche, to the settlement of payments due to themselves including a $350 million instalment under the bridging loan.

Time limit on drawing

10. The drawdown period under the medium term loan agreement technically expires on 31 January. Beyond that date the obligation of the banks to provide funds to Argentina under the medium term loan agreement would cease, unless an extension is agreed by all participating banks. The banks have not yet discussed this; they will need to do so in the week beginning 23 January but are likely to conclude in favour of extension

on the following grounds:-

(a) the existence of a sizeable undrawn amount under the facility gives them leverage over the Argentines which may reduce the risk of pushing Argentina into default;

(b) if the present agreement was scrapped and fresh negotiations had to be started from scratch, not only would all the past time and effort have been wasted but, more important, the Argentines would be able to reopen the whole 1983 package, including the rescheduling of public sector debt, and the banks might find themselves having to agree to less favourable terms.

11. The existence of this condition offers scope, in theory, for intervention by the Government (on the lines discussed by Ministers on 22 December) to end participation by British banks by preventing them from agreeing to an extension. But, given that no new drawing is likely in the immediate future and that the link with IMF conditionality is maintained, UK interests would not be served in forcing British banks to "foreclose" this loan, if there is general support for an extension. It would however be possible to take the opportunity of pressing British banks to agree to extension only on condition that further drawings are conditional on Argentina agreeing a new and satisfactory IMF programme and being in conformity with it at any time when drawings on the bank loan are made.

Conclusion

12. Our conclusion is that there is little likelihood of an early drawing from the medium term loan in advance of a new IMF programme. The commercial banks will shortly need to decide whether to extend the drawdown period of the medium term loan beyond 31 January. They seem likely to do so. There would be little advantage in preventing the British banks agreeing to this. And as a quid pro quo they might be

able to use extension to secure firm agreement to the line they have already taken, resisting any further release of bank money in advance of a reinstatement of a satisfactory IMF programme. This would strengthen the links which already exist between drawings and a satisfactory IMF programme.

ERM 10L
Indebtedness
Part 3

18 JAN 1990

Foreign and Commonwealth Office

London SW1A 2AH

16 January, 1984

Type letter pl.

A.J.C. 16/1.

Dear John,

Liberia: Debts

The Prime Minister wrote on 8 December to the Head of State of Liberia. She promised to send a substantial reply to his letter of 2 November about renegotiation of Liberian debt.

/ I now enclose a further draft letter for the Prime Minister's signature.

We understand that Commander in Chief Doe sent a similar letter to President Reagan in November, to which a reply in similarly general terms was sent.

Yours ever,

Peter Ricketts

(P R Ricketts)
Private Secretary

A J Coles Esq
10 Downing Street

D R A F T   L E T T E R

His Excellency Commander in Chief
Samual K Doe
Head of State and Chairman
People's Redemption Council
The Executive Mansion
Monrovia.
LIBERIA

1. I promised on 8 December to send a further reply to your letter of 2 November about the cancellation or conversion of Liberian debts.

2. I welcome and share your sentiments about the long history of friendship between our two countries. The British technical cooperation programme is a continuing token of British concern and interest in Liberia.

3. Since my earlier letter, the Paris Club has agreed in principle to re-negotiate payments on official credits concluded before 1 January 1983, with an original maturity of more than one year. The British representative, from our Export Credits Guarantee Department, signed the agreed minute after hearing the detailed explanation of present economic circumstances in Liberia given by your Minister of Finance and Minister of Planning and Economic Affairs, and after hearing the positive assessment of the International Monetary Fund.

4. I am glad that we have been able to make a contribution to your economic adjustment programme in this way.

~~Prime Minister~~

PDMAAH

From PO
Indebtedness
Pt 3

16 JAN 1984

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 5144
(Switchboard) 215 7877

From the Minister for Trade

Rt Hon Sir Geoffrey Howe QC MP
Secretary of State
for Foreign & Commonwealth Affairs
Foreign & Commonwealth Office
London SW1

12 January 1984

Await reply from FCS.

A.J.C. 13/1.

Dear Geoffrey,

CREDIT FOR LIBYA

Over the last few months there have been growing signs that Libya which until now has been a cash market for our exports, might begin to request and receive credit from our international competitors for at least some major projects. I understand our officials in the Export Guarantees Committee have considered whether we should be prepared to match such moves by others to grant credit and have concluded that in principle we should do so, although the precise terms on which credit would be made available have yet to be settled.

Our interest is in supporting a number of potentially quite substantial bids for two plants involving on the one hand Wimpey and on the other a number of UK companies, including Sim-Chem and John Brown Engineering. So far we understand that the Germans have decided that they will be ready to provide credit to Libya and there are indications that the Japanese and Italians may well do so. Although clearly I am reluctant to see any cash market turned to credit, once such a move takes place there is little to be gained from our refusing to match others' positions and I am therefore very much in agreement with the decision in principle taken by EGC.

However, I am concerned that in granting credit we should not be seen as making a gesture towards Libya which in a wider context might be seen as unhelpful, particularly in terms of our relations with the Americans. I understand that the Foreign Office view is that this would not be so, but nonetheless on such a potentially sensitive issue I should be grateful for your views. I am copying this letter to other members of OD and to Sir Robert Armstrong.

Yours,

Paul

PAUL CHANNON

cc Members of OD
PS/SoS
PS/Sir A Rawlinson
Secretary ECGD (AO)
Mr Roberts
Mr Twyford ECGD
Mr Foxall "
Mr Titchener OTS
Mr Benjamin PEP
Mr Breach ECGD
Mr Cunningham "
Mr Packer "

13 JAN [illegible]

CONFIDENTIAL

GRS 530
CONFIDENTIAL
FM LAGOS 121245Z JAN 84
TO IMMEDIATE FCO
TELNO 50 OF 12 JANUARY
AND TO IMMEDIATE ECGD.
INFO IMMEDIATE BANK OF ENGLAND, TREASURY.

MY TEL NO 40 AND YOUR TELNOS 36 AND 37: NIGERIAN DEBT

1. AS ARRANGED, I CALLED TODAY (12 JANUARY) ON THE PERMANENT SECRETARY, MINISTRY OF FINANCE, AND TOOK OPPORTUNITY TO HAND OVER TEXT OF ECGD LETTER.

2. THE PERMANENT SECRETARY WAS CLEARLY DISTURBED BY THE TEXT. HE DESCRIBED ECGD'S ACTION AS BEING ''UNCALLED FOR'' AND ''UNFAIR'', ADDING THAT THE NEW MILITARY ADMINISTRATION INTENDED TO ENSURE THAT IN FUTURE THE ECONOMY WAS CONTROLLED AS IT SHOULD BE. THE NIGERIA OF TODAY WAS NOT THE NIGERIA OF YESTERDAY, AND SHOULD NOT BE SEEN AS A BAD RISK. HE OBJECTED IN PARTICULAR TO THE DECISION TO INCREASE THE PREMIUM SURCHARGE TO 100%, AND EXPRESSED RESERVATIONS ABOUT THE EFFECT ON NIGERIA'S IMAGE OF THE MOVE FROM SECTION ONE TO SECTION TWO. THE WHOLE AIM OF THE COUP HAD BEEN TO MAKE SURE THAT RESPONSIBLE PEOPLE TOOK OVER. ECGD AND THE BRITISH GOVERNMENT WERE GETTING OFF TO A BAD START.

3. I EXPLAINED THAT ECGD'S ACTION WAS IN NO WAY CONNECTED WITH THE CHANGE OF GOVERNMENT IN NIGERIA. IT FOLLOWED DIRECTLY FROM THE VISIT BY ECGD OFFICIALS IN NOVEMBER 1983. WE VERY MUCH HOPED THAT AGREEMENT WOULD BE REACHED ON REFINANCING SHORT TERM TRADE DEBTS BUT, UNTIL THAT HAPPENED, ECGD WERE STILL FACING VERY HEAVY CLAIMS. THEIR PRESENT ACTIONS HAD TO REFLECT THIS FACT. ECGD'S AIM WAS TO ENSURE THAT COVER COULD CONTINUE, IN SPITE OF THE LARGE ARREARS PRESENTLY OUTSTANDING. THE DECISION TO MAKE COVER AVAILABLE UNDER SECTION TWO, THE NATIONAL INTEREST ACCOUNT, REFLECTED THIS. THE INCREASE IN THE PREMIUM SURCHARGE MIGHT LEAD TO SOME INCREASE IN THE PRICES OF BRITISH MADE GOODS BUT THIS WOULD BE VERY SMALL INDEED. MORE GENERALL- I STRESSED THAT THE GOOD INTENTIONS OF THE NEW GOVERNMENT WERE WELL RECOGNI-ED. BUT THEY HAD TO BE PUT INTO EFFECT. -- WERE TRYING TO HELP IN THIS PROCESS.

4. THE PERMANENT SECRETARY DID NOT SEEM ALTOGETHER CONVINCED. HE WOULD WANT TO TALK TO ME ABOUT THIS AGAIN WHEN HE HAD MORE TIME. I SAID THAT I WAS AT HIS DISPOSAL. HE SAID THAT HE WOULD ALSO WISH TO DISCUSS IT WITH YOU WHEN HE NEXT CAME TO LONDON (THIS MAY NOW BE DELAYED: NO MINISTER HAS YET BEEN APPOINTED AND HE SAID THAT HE DID NOT NOW EXPECT THIS TO HAPPEN UNTIL NEXT WEEK. HE WOULD THEN WANT TO HAVE A FEW DAYS WITH HIM BEFORE TRAVELLING ABROAD.)

CONFIDENTIAL

/ 5. COMMENT

5. COMMENT

THE PERMANENT SECRETARY'S REACTION WAS SOMEWHAT SURPRISING AND UNDERLINES THE SENSITIVITY OF THE NEW REGIME TO ACTIONS TAKEN BY BRITAIN. WE SHOULD BE ABLE TO CONVINCE HIM THAT ECGD'S ACTION IS STRICTLY COMMERCIAL BUT VISITING PRESSMEN (FINANCIAL TIMES ARE DUE TO SEE HIM TODAY) MAY GET SOME OF THE BACKWASH AND REPORT IT. ECGD SHOULD BE PREPARED TO PUT OUT SOME REASSURING EXPLANATION.

6. GRATEFUL FOR TELEGRAPHIC SUMMARY OF ANY COMMENT WHICH MAY APPEAR IN THE BRITISH PRESS (PAPERS ARE NOT REACHING US) TOGETHER WITH ANY PRESS GUIDANCE WHICH ECGD MAY THEMSELVES BE ISSUING.

WHYTE

STANDARD/MONETARY
WAD
OADS

COPIES TO:
EWAD/ODA
OPD/DEPT OF ENERGY

10 DOWNING STREET

Prime Minister (4)

To note this report on Nigerian debt. It was written before the coup, but Treasury advise that new regime is picking up where old regime left off eg with IMF, so the issues raised are still valid.

AT
6/1

SOLICITOR GENERAL

MS

Prime Minister (1)

PRIME MINISTER

ARGENTINA: ARMS SALES AND BANK LENDING

At your meeting on 22 December, you asked me to consider whether a general instruction could be issued by the Bank forbidding lending by UK banks to a country in a state of hostilities with the UK.

I have now looked further into this question and can advise that in principle a recommendation (and a direction to give effect to it) could be issued by the Bank along these lines without being in conflict with s.4(3)(a) of the Bank of England Act 1946, which provides as follows:

> "The Bank, if they think it necessary in the public interest, may request information from and make recommendations to bankers, and may, if so authorised by the Treasury, issue directions to any banker for the purpose of securing that effect is given to any such request or recommendation; provided that no such request or recommendations shall be made with respect to the affairs of any particular customer of a banker."

There are however important qualifications to be made to this advice: (1) It is for the Bank, and not for the Treasury, to determine whether a recommendation is "necessary in the public interest". We know that the Bank have received legal advice that "if the dominant factor in the public interest is political rather than financial, it would not be apt for recommendations to be made by the Bank under s.4(3)". This advice was based on the view that the only public interest with which the Bank were concerned was financial. It is therefore improbable that the Bank would make a recommendation in circumstances where the public interest was considered by them to be political. We cannot require the Bank to issue a recommendation.

SOLICITOR GENERAL

(2) If the recommendation, and the direction to give effect to it, were to be issued in general terms at a time when they could in fact apply only to a specific Government with which a banker had a banker/customer relationship (which might well be held to exist if at the material time there was an outstanding loan with Argentina, or negotiations were in train in relation to a new loan), there is a substantial risk that the banker might obtain a declaration from the courts that the direction was ultra vires.

(3) On the technical level, there will have to be:

(a) a definition of "state of hostilities";

(b) an opportunity given to the bankers to make representations;

(c) an order made under s.4(6) of the 1946 Act declaring who are bankers for the purposes of the section. We shall have to explain why we are making this order.

I am copying this minute to the Chancellor of the Exchequer and the Foreign Secretary.

Patrick Mayhew

30 December, 1983

Law Officers' Department
Royal Courts of Justice

Econ Pol,
Indebtedness,
Pt 3

30 DEC 1983

FROM: J.G.LITTLER
DATE: 22 DECEMBER, 1983

CHANCELLOR

cc Chief Secretary
Economic Secretary
Mr.Middleton
Mr.Unwin
Mr.Mountfield
Mr. Lavelle
Mr. Monck
Mrs.Case
Mr. Beastall
Mr. Hall
Mr. Portillo

NIGERIAN DEBT

There has been a rush of activity on Nigeria this week. I think you should have a brief note on it before the holiday break, during which there may well be occasional press reports, although we are not expecting further substantive action until early in the New Year.

2. Nigeria has for some time been marked as a potential serious debt problem, and we have known that the UK position would be difficult, because we stand as the major creditor (political connections and long-standing trade links). The essence of the problem is that Nigeria built up on its oil earnings of a few years ago a level of expenditure and imports which cannot now be sustained.

3. The main action is on two fronts:-

(a) IMF discussions. We are of course encouraging agreement on a satisfactory programme, but there is still some way to go. Any other action must in our view be contingent on a satisfactory IMF agreement.

(b) Rescheduling or restructuring of debt, and for the moment primarily we are concerned with officially guaranteed debt (negotiations with bankers are going on separately).

4. The recent activity has been concerned with officially guaranteed debt. The Nigerian authorities have approached us to attempt a preliminary negotiation. They have plainly wanted to pick off the creditors one by one, and have hoped that the Commonwealth connection would induce us to react sympathetically and set a helpful pattern.

5. We have had some contact with French, German and American colleagues who share our views, but understandably in view of our position as main creditor would be very ready to accep~~t our taking the~~ lead in

coordinating a multilateral operation of the Paris Club type. (The French usually - but not invariably - take the lead, and put their resources at the disposal of the Group if there is some other Chairmanship). I think we shall probably find it difficult, given the Commonwealth connection, our own leading creditor position, and pressure from Nigeria, to resist taking the lead on this particular case. There will be an opportunity at a meeting with other creditor countries in Paris early in January to settle suitable arrangements.

6. The scale of the operation is bound to be substantial. As far as the UK is concerned, ECGD is exposed to a little over £1 billion of short-term debt falling due in 1984, and a high percentage of the total will have to be rescheduled or refinanced. ECGD also have exposure of some £2.5 billion on medium-term credit, but this is for later payments and not part of our immediate problem. The whole pattern of Nigerian debt is rather different from that of some other countries, because until about 1980 they tended to pay cash rather than take credit at all. Other creditors are likely to reflect a similar pattern.

7. I have mentioned both rescheduling and refinancing, which are alternative approaches. My own view, and I think this will be shared by other departments, is that we should try for refinancing, which extends the ECGD guarantee, but minimises the immediate cash claim on them. It will not be inappropriate by past standards, and the advantage in protecting the PSBR next year will be considerable.

Conclusion

8. Three points to conclude:

- Nigeria is now very much an active debtor problem and one in which there will be strong pressure, which we probably should not resist, for the UK to take the coordinating lead among creditors;

- the Prime Minister is already aware in general terms of the Nigerian problem (Mr.Kerr's recent periodic reporting letter on international debt); in case of press stories, it might be sensible for Mr. Kerr to mention to Mr.Turnbull the likely pressures for the UK to take the lead;

- we shall want to be very cautious about any new credit for Nigeria until prospects are clearer, and will be writing to departments to put this on record.

We will let you have a more detailed report early in the New Year, in which I hope we shall be able to include some more figuring about the relative positions of different creditors.

(J. G. LITTLER)

CONFIDENTIAL

SUBJECT

cc FCO
Sol Gen
CDL
B of E
CO

10 DOWNING STREET

From the Private Secretary

23 December 1983

cc master
+ Argentina, Relations, Pt 35

Dear John

Argentina: Arms Sales and Bank Lending

The Prime Minister held a meeting yesterday with the Chancellor, the Foreign Secretary and the Solicitor General. They considered the paper attached to the Chancellor's minute of 5 December.

The Prime Minister was concerned that the Government could be accused of permitting British banks to lend to Argentina who could use the money to finance weapons for use against Britain. She found this a very difficult argument to counter.

The discussion turned to the current loan agreement for $1.5 billion, of which $0.5 billion was drawn on 30 November. The Prime Minister said that the Government had reluctantly acquiesced in this when it was signed in August as, at the time, it was told that to oppose it would exacerbate the international debt crisis. The Chancellor said that the Government had not been shown a copy of the loan agreement but had been assured by Lloyds Bank International, who are the British bank represented on the Committee of International Banks dealing with Argentine debt, that the agreement constitutes a legally binding contract enforceable in the New York courts. Participation by British banks in further drawings could be stopped only by primary legislation which would open the Government to claims for damages. This interpretation was confirmed by the Solicitor General.

The Prime Minister asked about the conditions under which further drawings were made. The Treasury's latest report on the international debt scene had referred to the possibility of a drawing as early as mid January. This was puzzling as the new Argentine Government could not by then have established a new agreement with the IMF. Would the next drawing be a further arrears-clearing exercise like the first?

The discussion then turned to future loans to Argentina. The Solicitor General said the power of the Bank of England to issue instructions had to be general; it could not be directed at specific customer transactions. It was therefore unlikely that

/ instructions

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instructions could be used to prevent further loans. The Chancellor said the only other course was primary legislation which was extremely unattractive. Furthermore, it was not possible, in the IMF, to impose political conditions on its lending.

His preferred approach, therefore, was to work within the IMF to ensure that the new Argentine programme had tight limits for public expenditure, and that public expenditure should be directed towards strengthening the base of the economy, and in particular exports. This would limit the scope for arms purchases. In addition, he would ensure that the Government was given advance warning via the Bank of England of any further drawings or any new loans. He recognised the political problems though he thought the reality was that the absence of British banks, who provided only about 10% of current lending to Argentina, would not seriously limit Argentina's ability to buy arms. The Prime Minister said it might also be necessary to make clear to British banks that the UK Government would deplore their participation.

Summing up, the Prime Minister said the political prospect was very unattractive. If it were the case that the present agreement was legally binding, all she could say, if questioned, was that this was a matter for the banks and not the UK Government. The latter had not approved the agreement, nor even seen the detailed terms. On future loans, the Chancellor should establish an advance warning system. The Government should work to make IMF programmes, on which bank lending was based, as tight as possible. Nevertheless it might be necessary for the Government to make it clear that the participation of UK banks would not have its endorsement. She asked the Chancellor to prepare a further note clarifying, as far as possible, the conditions under which further drawings of the existing loan could be made and whether they were in any way dependent upon the establishment of a new IMF programme. She asked the Solicitor General to consider whether a general instruction could be issued by the Bank forbidding lending by UK banks to a country in a state of hostilities with the UK.

1)

B/F

2)

I am copying this letter to Brian Fall (Foreign and Commonwealth Office), Henry Steel (Solicitor General's Office), Alex Galloway (Office of the Chancellor of the Duchy of Lancaster), John Bartlett (Governor of the Bank of England's Office) and Richard Hatfield (Cabinet Office).

Yours sincerely

Andrew Turnbull

Andrew Turnbull

John Kerr, Esq.,
H.M. Treasury.

SUBJECT

CONFIDENTIAL

JD

T a FCO HMT

10 DOWNING STREET

THE PRIME MINISTER

22 December 1983

PRIME MINISTER'S PERSONAL MESSAGE SERIAL No. T229A/83

Dear Julius,

It was good of you to write as you did on 3 December. I greatly enjoyed our talk in New Delhi.

I am sure you are right to think in terms of a Fund programme, and the amount and pace of devaluation of the shilling will be crucial to its success. Clearly the right policies are those which make sense in the market place: if one's goods and commodities find ready export markets, that in turn makes it possible to raise domestic returns and thus enhance incentives for private producers.

Details such as these clearly need to be settled bilaterally with the Fund. But I have no doubt that the successful conclusion of your discussions would greatly benefit Tanzania, both in terms of direct balance of payments support and indirectly as a signal of confidence to potential investors and creditors. I shall ensure that the UK Executive Director at the IMF considers your programme with the utmost care and sympathy when it comes before the Board.

My warm good wishes for 1984.

Yours sincerely

Margaret Thatcher

His Excellency Mwalimu Dr. Julius K. Nyerere

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PRIME MINISTER

Argentina

The paper for this meeting is that prepared by the Treasury in consultation with the FCO and the Bank. In addition, there is the Treasury's latest survey of the international and financial scene and the exchange of correspondence between the Chancellor of the Duchy and the Chancellor of the Exchequer. The latter confirms that the $1.5 billion loan is a legally binding contract. What is not clear and could be established at the meeting is whether there are any conditions in it which, if not observed by Argentina, would mean that the banks would be released from their obligations.

My note of 7 December indicates that this issue can be approached at several levels, ranging from legislation to prevent further tranches of the $1.5 billion loan being drawn through to trying to ensure that future loans are subject to conditions which make the buying of weapons difficult.

AT

ANDREW TURNBULL

21 December, 1983

CONFIDENTIAL

Prime Minister
Things look slightly brighter.
The only news is that at X

AT 21/12

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

20 December 1983

Andrew Turnbull Esq
No 10 Downing Street
LONDON SW1

Dear Andrew,

INTERNATIONAL FINANCIAL SCENE

... I enclose the latest of our regular reports on developments on the international financial scene. As usual it has been prepared by the Bank of England and discussed in the Treasury's inder-departmental group on debt problems.

The general picture is more encouraging than in the last report. In particular, the IMF's resources should be strengthened following US Congressional approval of the Quota increase and by the agreements reached on the $3½ billion loan from the BIS and the parallel $3½ billion loan from the Saudis.

On Brazil the IMF has been able to satisfy the banks that the $2.5 billion new money from governments will be forthcoming, and this has unlocked the $6.5 billion new money from the banks, which should now be in place by the end of the year (although some temporary bridging finance may still be necessary).

Argentina will be discussed at the Prime Minister's meeting on Thursday. It is just possible, though at present it seems unlikely, that the second tranche of the August commercial loan X could be drawn as early as 15 January.

A high-level official delegation from Nigeria is now in London discussing possible relief on short-term debt from official and private creditors. They are being encouraged to seek a multilateral solution, and we are in touch with our main partners about this. Nigeria represents our single largest ECGD exposure (some $3.2 billion at end-June 1983).

Copies of this letter go to Brian Fall (FCO), John Rhodes (DTI) and John Bartlett (Bank of England).

Yours ever,
John Kerr.
J O KERR

INTERNATIONAL FINANCIAL SCENE

Some major hurdles have been successfully crossed since the last Report, and this has somewhat improved sentiment about prospects for the immediate future. On the other hand, the longer-term risks remain, with banks' new lending likely to remain lower than in the past, a bunching of debt repayments in about two years' time, and uncertainties whether continued severe adjustment by debtor countries will be politically or socially sustainable.

For the ldcs, developments on the economic front are mixed, but on the whole encouraging. The recovery, albeit patchy, in the large economies has continued; and their current account deficits widened in the third quarter, particularly in the USA, where the deficit was a record $12 bn. At the same time, the current accounts of Latin American countries have improved markedly, though much of this reflects a sharp cut in imports, which may not prove to be sustainable in the longer term; and commodity producers' terms of trade are no longer benefitting from the surge in commodity prices, which now seems to have been checked. On the other hand, oil prices have also tended to be weak. The future course of the dollar remains particularly uncertain, but US interest rates remain relatively high, thus limiting the scope for reductions elsewhere.

The most important developments since the previous Report have been the degree of success achieved in assembling the $11 bn package for Brazil, which has given a boost to confidence, and the ratification of larger Fund quotas. Banks' net lending to ldcs this year should fall within the IMF's latest forecast range of $15 - 20 bn, with a similar range in prospect for next year.

But major short-term problems persist. A particular cause for concern is the Philippines, although there is as yet no firm evidence of knock-on effects elsewhere in the region. The rescue packages for some of the smaller Latin American countries, such as Peru, Ecuador and Chile, are running into difficulties, and second round support operations could well be delayed. In Eastern Europe, no progress was made when discussions were resumed between Poland and its official creditors, and Romania's IMF standby arrangement remains inoperative (although a compromise may now be in sight). On the other hand, only some $250 mn remains to be committed to complete the $6.5 bn banking loan to Brazil; and the IMF have assured the banks that the $2.5 bn new export credit facilities will be forthcoming. Meanwhile, Brazil has suspended the issue of new import licences until 1 January, even though the $6.3 bn target for the trade surplus in 1983 seems certain to be surpassed.

An indication of banks' attitudes may emerge from the IIF's discussion of prospects for international lending, scheduled for next month. But in the medium term, a crucial test will be the performance of borrowers under IMF programmes. The picture here is mixed, with the main anxiety focused on Brazil, where trade targets might be achieved, but those for inflation and public sector borrowing seem much less likely to be met. Elsewhere, such policy statements as have emanated from the newly-elected Radical party in the Argentine seem somewhat contradictory; and in Venezuela, where bankers have no doubt welcomed the change of leadership, it remains to be seen whether the new government, which was elected with a large majority, is prepared to accept the measures recommended by the IMF.

Other major factors which will influence banking attitudes are the impact of international lending on end-year accounts; recent signs of a more active interest on the part of some supervisory authorities towards provisioning against problem loans; and a general tightening of supervisory approaches to capital adequacy, which is taking place world-wide, notably in the USA. There also seems to be a perception among some bankers (as well as debtor governments) that the interest burden faced by a number of borrowers could prove to be too great, and that the net reflows from ldcs to the banks, implied in the structure of the relief programmes, are unsustainable.

A rather more detailed assessment of the current position in major debtor countries is given below.

(i) Latin America

Encouragingly, the various elements of Brazil's Phase II financing package are falling into place. On 22 November, the IMF Board approved Brazil's revised EFF programe, thereby enabling drawings to resume. This paved the way for agreement on a Paris Club rescheduling, and has triggered release of the three remaining tranches of the banks' original Project I loan. Commitments to the $6.5 bn Phase II loan at present amount to about $6.25 bn, and the loan is now due to be signed by 29 December. But an initial drawing cannot be made before the end of the year, and the possibility of further bridging finance by the banks is under consideration. The existing BIS bridging facility was fully repaid on 30 November out of IMF funds, and an earlier bridging loan, provided by the commercial banks, will be repaid out of original Project I money.

As regards the $2.5 bn of new official export credits, the IMF have reiterated that the funds will be forthcoming, although the full list of contributors is not yet known, nor is the way in which facilities will be utilised. Even so, the overall picture is much more encouraging than at the time of the last Report, though it remains to be seen whether Brazil is able to adhere to the revised IMF performance criteria for next year.

Disbursement of the long-delayed first tranche of $500 mn of the $1.5 bn medium-term credit for Argentina finally took place on 30 November, after creditor banks waived requirements in respect of updating interest arrears and implementation of public sector refinancing agreements. The disbursement - used to make a partial repayment under the earlier $1.1 bn bridging loan and to help clear arrears - represented a gesture of good faith by the banks towards the new civilian Administration, which had promised to give the debt issue priority after taking office on 10 December. However, the Radicals are now seeking to delay completion of the 1982/83 public sector rescheduling agreements for six months, and meanwhile to negotiate a broader rescheduling package which would include 1984 maturities: this proposal is firmly opposed by the banks. The authorities have indicated their willingness to pay interest "to the best of their ability" while rescheduling talks are under way. (Surprisingly, arrears of interest on all debt are officially estimated to be as large as $2 bn.)

It is not yet known how far the Radicals will co-operate with the IMF, which hopes to negotiate a new programme to replace the ~~existing~~ standby (now clearly broken down). But their broad economic strategy appears to lack coherence: the authorities have declared their intention to raise real wages and stimulate economic growth, but at the same time to reduce drastically the rate of inflation and the Budget deficit.

Mexico is the only large debtor whose rescue package, as originally conceived, is still intact. The EFF programme remains well on course, with the stage now set for negotiations to begin with banks on next year's new money requirement, put at some $3 1/2 bn. The one outstanding problem relates to delays in implementing the Paris Club agreement, reached in June.

Elsewhere, existing rescue packages for some of the smaller countries are running into difficulties, and second round support operations could well be delayed. Following the suspension of drawings under Peru's EFF, the authorities have now reached agreement in principle with the IMF on a revised programme: a Letter of Intent is expected to be finalised shortly. The attitude of banks towards the country is also hardening, and further disbursements of new money are unlikely in the near future. While Ecuador has so far satisfied all IMF quantitative performance criteria, continued adherence to the standby programme is in doubt. Moreover, some large banks are unwilling to negotiate on 1984 requirements until the results of next January's Presidential elections are known. The Chileans are seeking a relaxation of the IMF standby programme next year, in order to alleviate the effects of domestic recession. Meanwhile, a package of measures has recently been announced, which includes a slower depreciation of the official exchange rate and an undertaking by the central bank to purchase the bad debts of commercial banks.

Little progress on rescheduling Venezuela's public sector debt owed to banks is expected before next February at the earliest, when the Opposition (Social Democrat) party, which won the Presidential elections this month, takes power. The President-elect appears to have ruled out negotiations on an IMF programme.

(ii) Far East

In the Philippines, negotiations are continuing on a financing package which is now expected to comprise an SBA of SDR 615 mn from the IMF, backed by new loan facilities of $3.3 bn (of which half from banks), rescheduling of $2.9 bn of short-term bank debt, and an additional rescheduling (through the Paris Club) of an unspecified amount of longer-term debt to official creditors. The Philippine authorities hope that all arrangements will be finalised and in operation by January; but this seems unrealistic and an extension of the moratorium may be necessary.

Although banks are taking a generally more cautious attitude to Asian borrowers in the wake of the problems in the Philippines, there is as yet no firm evidence that borrowing prospects for other major debtors in the region have been significantly impaired.

(iii) Eastern Europe

Congressional legislation requiring the US Executive Director in the IMF to oppose loans to "communist dictatorships", unless certain conditions are met, seems unlikely to have serious implications for East European members of the Fund.

The IMF standby for Romania remains in abeyance, but discussions in London on 7 December between Finance Minister Gigea and de Larosiere - to be continued in Washington - made substantive progress towards a compromise solution. The Fund Board is expected to meet in mid-January to discuss the Romanian standby. No progress was made in the resumed discussions between official creditors and Poland on 16 to 17 November: a further meeting is expected in January. The commercial bank agreement for 1983 was signed in early November, and discussions on 1984 and (possibly) 1985 maturities may start in mid-December. Official creditors met on 18 November to discuss Yugoslavia, and agreed on procedures for examining financing needs in 1984. Initial discussions with the commercial banks took place in early December, at which the banking representatives indicated their conditional readiness to restructure 100% of medium and long-term maturities in 1984. Meanwhile, discussions with the IMF on a further programme to succeed the present standby are expected to be completed early next month. Yugoslavia's interest in emulating Hungary's success with an IBRD cofinancing has met with little enthusiasm from the banks.

(iv) Southern Europe

Market reception of issues by Portugal, Spain and Greece continues to be favourable. But there are signs that banks may be starting to take a more critical view of Greece's overall economic position.

In Portugal, the adjustment programme associated with the standby facility and CFF is underway and, according to the IMF, it may be succeeded by a medium-term EFF to finance structural reforms in industry and agriculture. Thanks to the strong impact of measures taken earlier this year to constrain domestic demand, the Finance Minister has indicated that the current account deficit in 1983 should be perhaps \$300 mn lower than the government's target of \$2 bn (compared with \$3.2 bn in 1982). Meanwhile, in September Portugal repaid the remaining \$400 mn of the \$700 mn BIS facility arranged in two tranches earlier this year.

In Spain, a rundown of reserves and a smaller current account deficit prevented an increase in outstanding medium- and long-term debt during the first half of the year. Since June, there has been a modest recovery in reserves.

Despite an encouraging initial response in the markets to the \$250 mn package for the Greek Public Power Corporation, private contacts indicate that banks are reappraising the Greek risk, and future borrowing may meet with greater resistance. The 1984 Budget provides for a 9 1/2% reduction in real terms in the government deficit, but the revenue proposals may not go far enough to achieve this target.

Recent measures appear to have stabilised the position in Israel, although the large current account deficit continues to give cause for concern.

Nigeria's external payments position remains fairly tight, in spite of a drastic cut in imports and, more recently, agreements to refinance $2 bn of trade arrears. The Nigerians are also seeking multilateral refinancing of most of the remaining arrears, including officially guaranteed debt; and, being unwilling to use the Paris Club, seem certain to ask the UK - as major creditor and trading partner - to take the lead.

19 December 1983

INDEBTEDNESS AND BRITISH EXPOSURE (end December 1982)

$ billion

	Total external debt	British banks unguaranteed claims	ECGD amounts at risk
Latin America			
Argentina	39	2.3	0.4
Brazil	81	4.4	1.9
Chile	18	1.1	0.06
Ecuador	6	0.5	0.1
Mexico	83	5.2	1.8
Peru	12	0.4	0.1
Uruguay	4	0.3	0.01
Venezuela	33	2.4	0.09
Eastern Europe (convertible currency)			
East Germany	15	0.8	0.2
Hungary	7	0.5	0.07
Poland	25	0.5	1.4
Romania	10	0.4	0.6
Yugoslavia	20	0.9	1.3
Far East			
Indonesia	20⁄	0.6	0.9≠
Philippines	19	1.2	0.3≠
South Korea	37	2.0	0.9≠
[Hong Kong	-*	-*	5.2]

Because of differences in definition the ECGD exposure figures in the final column are not directly comparable with the figures in the other two columns.

⁄ At end March 1983; excludes short-term debt

≠ At end February 1983

* Because of Hong Kong's position as an offshore centre the available figures for external indebtedness and banking exposure to Hong Kong are not comparable to those for other countries shown above and do not provide a meaningful indication of the territory's debt exposure.

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

20 December 1983

John Coles Esq
10 Downing Street
LONDON
SW1

Type letter pl.

A.J.C. 22/12.

Dear John,

TANZANIA: IMF

attached

Thank you for your letters of 9 and 15 December.

The Prime Minister enquired whether Tanzania's willingness to devalue was likely to meet the IMF's requirements. Our understanding when I wrote to you on 8 December was that it would probably not do so. In the last round of negotiations in the summer, the IMF wanted a further 60 per cent devaluation, while Tanzania was reluctant to go much beyond the 20 per cent devaluation of the shilling which took place in June. At the IMF Board meeting in July, the Tanzanian Executive Director mentioned a figure of no more than a further 10 per cent. This would certainly not satisfy the Fund.

However, the latest news from Dar-es-Salaam is rather more hopeful. Negotiations are about to be re-opened; and there are signs that the President may now be willing to entertain more realistic discussions about devaluation; and that the Fund's tactics in not pushing Tanzania too hard may have paid off.

President Nyerere's letter of 3 December does not perhaps require a reply. But an acknowledgement would be courteous, and the Prime Minister might wish to reassure him that we remain ready to give their programme sympathetic consideration on the IMF Board. I attach a revised version of the draft letter which was enclosed with mine of 8 December.

The Prime Minister might be interested to glance at the attached background note, prepared by the ODA, which underlines the crucial importance of exchange rate policy.

A copy of this letter goes to Peter Ricketts.

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

CONFIDENTIAL

DRAFT LETTER TO PRESIDENT NYERERE OF TANZANIA

It was good of you to write as you did on 3 December. I greatly enjoyed our talk in New Delhi.

I am sure you are right to think in terms of a Fund programme, and the amount and pace of devaluation of the shilling will be crucial to its success. Clearly the right policies are those which make sense in the market place: if one's goods and commodities find ready export markets, that in turn makes it possible to raise domestic returns and thus enhance incentives for private producers.

Details such as these clearly need to be settled bilaterally with the Fund. But I ~~am sure~~ have no doubt that the successful conclusion of your discussions would greatly benefit Tanzania, both in terms of direct balance of payments support and indirectly as a signal of confidence to potential investors and creditors. I shall ensure that the UK Executive Director at the IMF ~~will~~ considers your programme with the utmost care and sympathy when it comes before the Board.

My warm good wishes for 1984.

A. J. C. 21/12.

Econ Pol: Indebtedness A3

CONFIDENTIAL

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

19 December 1983

A K Galloway Esq
Private Secretary to the
Chancellor of the Duchy of Lancaster

cc Mr Littler
Mr Unwin
Mr Lavelle
Mrs Case
Mr Denison
Mr Mountfield

Dear Alex,

ARGENTINA: ARMS SALES AND BANK LENDING

In his minute of 7 December Lord Cockfield asked about the legal status of the loan agreement signed in August between the commercial banks and Argentina. Lloyds Bank International, who are the British Bank represented on the Committee of International Banks dealing with Argentina debt, have confirmed to the Bank of England that the agreement constitutes a legally binding contract enforceable in the New York Courts.

Copies of this letter go to the recipients of Lord Cockfield's minute.

Yours ever,

J O Kerr

J O KERR
Principal Private Secretary

FILE

RW

10 DOWNING STREET

From the Private Secretary

15 December, 1983

TANZANIA: IMF

I wrote to you on 9 December about this subject.

I now enclose a copy of a letter which the Prime Minister has received from the President of Tanzania. You will note that in his second paragraph President Nyerere states that he was encouraged by the Prime Minister's offer to help Tanzania with the IMF.

I am sending a copy of this letter and its enclosure to Roger Bone (Foreign and Commonwealth Office).

A. J. COLES

J. Kerr, Esq.,
HM Treasury

CONFIDENTIAL

JH 338

Prime Minister

I have minuted your position as no change, with the IMF's interpretation of $10-20 million unchallenged.

AT 13/12

PRIME MINISTER

BRAZIL

I have seen the Foreign Secretary's minute to you of 7 December attached on export credit for Brazil.

2 I see nothing to lose and quite a lot to gain by adopting a position that puts us on a par with other European governments. In reality it is hard to see the Brazilians being able to take up any credit in the current financial year on the conditions being set, and we could get the best of both worlds.

3 I am copying this to the Foreign Secretary and the Chancellor of the Exchequer.

NT

N T

12 December 1983

Department of Trade and Industry

File

089

10 DOWNING STREET

From the Private Secretary 12 December 1983

BRAZIL

The Prime Minister has seen the Foreign Secretary's minute of 7 December and that from the Chancellor of 9 December. She does not believe that at present it is necessary to modify the Government's position or to adopt the case by case approach suggested. The representations made in Brazil seem to have been successful in achieving a better understanding of our position. Nor is the Government coming under serious pressure from other industrial countries.

The Prime Minister believes, however, that we should leave the matter as reported in the Chancellor's minute of 25 November, i.e. with no firm public commitment to additional medium term export credit (though with access to existing credits remaining open) but leaving the IMF's interpretation of our position, a token $10-20 million, unchallenged.

I am sending copies of this letter to John Kerr (HM Treasury), and to Callum McCarthy (Department of Trade and Industry).

Andrew Turnbull

Brian Fall, Esq.,
Foreign and Commonwealth Office.

NR

cc ECON POL: Indebtedness: Pt 3

Original on: COMMONWEALTH: CHOGM: Pt 7

10 DOWNING STREET

From the Private Secretary

9 December 1983

TANZANIA: IMF

Thank you for your letter of 8 December.

The Prime Minister has commented that her impression from her talk with President Nyerere in the margins of CHOGM was that he was prepared to devalue the shilling again if this would secure the loan from the IMF. Mrs. Thatcher has asked whether we could enquire whether this would meet the IMF's requirements. Perhaps you could let me have a further comment in due course.

BF

I am copying this letter to Peter Ricketts (Foreign and Commonwealth Office).

John Kerr, Esq.,
HM Treasury.

CONFIDENTIAL

LT.

CONFIDENTIAL

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

PRIME MINISTER

BRAZIL

I have seen the Foreign Secretary's minute of 7 December proposing a change in our policy on export credit for Brazil.

2. In my view such a move now would be unnecessary and undesirable. We are not isolated in not offering new medium term credit. And we are certainly not being badgered by either the Americans or the Brazilians.

3. If we were to offer credit and then give none, we could well be accused of bad faith. But to give credit would inevitably add to our commercial exposure on Brazil and, given the continuing uncertainty about Brazil's future economic performance, might in due course involve a claim on public funds. I continue to think that the right course is to hold to the policy on which we agreed, and not extend new medium term export credit for the present. We can always review the position if things improve.

4. Copies of this minute go to Geoffrey Howe and Norman Tebbit.

NL.

N.L.
9 December 1983

Indebtedness

10 DOWNING STREET

Prime Minister (i)

Brazil

Agree we should hold firm on medium term export credit and not adopt Foreign Secretary's case by case approach?

AT
9/12

We are already in to the tune of \$10-20 m - that is enough.

MT

3.29

CONFIDENTIAL

cc ECON POL: Indebtedness: Pt 3
Original on: COMMONWEALTH: CHOGM: Pt 7.

Prime Minister.
I think you only said to President Nyerere that you would look into the matter on your return. Do you wish to write to him?
A.J.C. 9/12.

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

8 December 1983

John Coles Esq.
10 Downing Street
LONDON
SW1

He has devalued twice and is prepared to do so again if it will gain the loan from the I.M.F. Can we enquire? MT

Dear John,

TANZANIA: IMF

Thank you for your letter of 29 November about the Prime Minister's discussions with President Nyerere of Tanzania in the margins of CHOGM.

Tanzania has been courting the IMF, on and off, for four or five years. The last Fund mission was in the summer, but negotiations now seem to be stalled. The main difficulty is indeed exchange rate policy. The Fund do firmly believe that further substantial devaluation is necessary in order to enable local producer prices to rise to levels giving realistic incentives to farmers. We have no reason to believe that the Fund are intransigent on the details of their prescription: as with Ghana and Uganda, they should be prepared to consider phased devaluation, fiscal proxies, or a temporary multi-tier exchange rate arrangement, so long as Tanzania is committed to credible medium term objectives offering some prospect of international viability. As with most Fund programmes, however, they are insisting on substantial initial adjustment measures both as a gesture of good faith and to get the programme off to a good start.

Tanzania suffers from the familiar African problems of an extensive parallel market, leading to corruption, coupled with sensitivity about surrendering a degree of autonomy to the IMF. The Fund may be losing patience with the protracted negotiation process, and have certainly encountered difficulty in obtaining the necessary statistical information, with recent letters to the President and Economic Minister going unanswered. And I imagine that the Tanzanians are reluctant to lose face by compromising.

In the meantime, Tanzania has accumulated substantial payments arrears, approaching $½ billion. As a significant proportion of these are owed to UK companies, it would be in our interest to persuade Tanzania to reach an understanding with the Fund. But it would set a bad precedent for us to argue that conditionality should be watered down in order to secure it. It would be obvious that the Fund had been forced to compromise because of Tanzanian intransigence, and other Fund clients - both developing countries and sovereign debtors - would not be slow to demand similarly lax terms. Moreover a poorly based programme would mean that Tanzania's need for supplementary Aid - to which we would be expected to contribute - would be that much higher. In any case, the Fund prescription for Tanzania seems broadly right.

Partly for this reason, the Chancellor is reluctant to lobby the IMF on behalf of President Nyerere. He is also conscious that such advocacy could undermine our credibility as objective and responsible members of the Fund. In any case, he is doubtful whether we would succeed.

If the Prime Minister agrees with this assessment, the Chancellor believes that it would be better for her not to write to President Nyerere just at the moment. But in case she would prefer to write, I attach a draft.

I am copying this letter to Peter Ricketts at the FCO.

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

DRAFT LETTER TO PRESIDENT NYERERE OF TANZANIA

You told me in New Delhi of your difficulties in negotiating a standby arrangement with the IMF

I am sure you are right to think in terms of a Fund programme, and the amount and pace of devaluation of the shilling will be crucial to its success. Clearly the right policies are those which make sense in the market place: if one's goods and commodities find ready export markets, that in turn makes it possible to raise domestic returns and thus enhance incentives for private producers.

Details such as these clearly need to be settled bilaterally with the Fund. But I am sure that the successful conclusion of your dicussions would greatly benefit Tanzania, both in terms of direct balance of payments support and indirectly as a signal of confidence to potential investors and creditors. I shall ensure that the UK Executive Director at the IMF will consider your programme with the utmost care and sympathy when it comes before the Board.

subject cc Master OPS

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T207/83

cc FCO JR

10 DOWNING STREET

THE PRIME MINISTER

8 December 1983

Excellency,

Thank you for your letter of 2 November requesting cancellation or conversion of debts which I have just received. I have asked that the points you raised should be looked at urgently, and I will send you a substantive reply as soon as possible.

Yours sincerely

Margaret Thatcher

His Excellency Commander-in-Chief Samuel K. Doe

JR

CONFIDENTIAL

PRIME MINISTER

Argentina

Attached is the note you asked for at Cabinet on 3 November examining ways in which British banks could be stopped from lending money to Argentina if it were feared that this might finance purchase of arms from the US.

This issue can be approached at several levels:

(i) Action could be taken to prevent British banks from disbursing their share of the further tranches of the $1.5 billion loan. As this loan has the status of a contract, this action would probably require legislation and could open the Government to claims for damages.

(ii) Action could be taken to persuade the banks and the IMF that no further disbursement of the present loan should be made until a new IMF programme is established.

(iii) We could exert pressure within the IMF to ensure that this programme keeps public expenditure as low as possible and that expenditure is devoted to strengthening the productive potential of the Argentine economy and in particular the balance of payments. This would minimise but not eliminate the scope for increased weapons' purchases.

(iv) We could work to ensure that any future loans, and such loans are almost certain to be sought by Argentina, are subject to the conditions in (iii) above.

Though (ii) - (iv) make more sense in terms of general financial diplomacy, only (i) provides convincing proof against the charge that the UK is helping to finance purchase of weapons which may be used

/ against

CONFIDENTIAL

against itself. Even (i) however cannot be guaranteed to ensure that Argentina is denied finance for weapons' purchases since it may be able to find alternative finance.

You will want to have a meeting on this, but presumably not in Cabinet. It would be better to have a smaller group of the Chancellor, Foreign Secretary, and possibly the Attorney General if he is available.

7 December 1983

CONFIDENTIAL

Prime Minister

A very relevant question. We also need to know whether there are any conditions which, if not fulfilled, would cause the agreement to lapse. To await Treasury reply.

AT 8/12

BF

Chancellor of the Duchy of Lancaster

CHANCELLOR OF THE EXCHEQUER

ARGENTINA

Note:- Treasury will circulate a note before meeting on 22/12

with AT?

I have seen your minute of 5 December to the Prime Minister.

An important issue is whether the "agreement" of August is legally binding or whether it is little more than a memorandum of understanding. Banks in this country - as distinct from the United States - rarely enter into legally binding agreements to lend money.

I am copying this minute to the other recipients of yours.

A.C.

A C

7 December 1983

CONFIDENTIAL

Econ Pol: Intellectual Pt 3

File and BF with Treasury response

AT 8/12

PRIME MINISTER

AT 8/12

BRAZIL

The FCO have returned to the charge on Brazilian credit, proposing a case by case approach. It is difficult to see why we should change our reluctance to grant extra credit.

(i) The conditions in paragraph 4 look feeble. When were credits not in support of British exports? What assurance can there be that the remaining conditions will be fulfilled?

(ii) The original proposition was that extra export credit might be needed to complete the internal debt package. In fact all the components seem to have fallen into place. Later it was argued that extra export credit was needed to keep in with the Brazilians. After the visit of our Ambassador, we seemed to have restored our position quite successfully. Thus the justification keeps changing all the time.

Treasury have not yet responded but are unlikely to be enthusiastic.

AT

7 December 1983

PM/83/99

PRIME MINISTER

Brazil

1. Our Ambassador in Brasilia has carried out your instructions to put across energetically our case on the substantial contribution which we have made to the Brazilian financial package. I attach a copy of his report (Brasilia telegram No CULL 5). I believe the Chancellor's helpful message to the Brazilian Finance Minister was instrumental in enabling us to turn an awkward corner in our relations with Brazil.

2. Meanwhile we have now had more details from Brasilia about the position which the German, French, Canadian and American Governments have taken with the Brazilians about new medium term export credits. In essence the French and Germans have refused to make any commitments to new lines or credit or global credit ceilings. Instead they have indicated willingness to guarantee new credits on a case by case basis and subject to some stringent conditions.

3. This is a useful move from our standpoint. It gets away from the American approach of trying to fill a global "financing gap" by allocating shares among creditors. In adopting this approach the other European governments are able to retain control over the amount of potential exposure by building in some restrictive conditions. In short the policy combines the advantages of looking generous while safeguarding their interests in practical terms.

/4. I suggest

4. I suggest that, if you agree, we could take a leaf out of their book by moving fully into line with them at little risk to ourselves. I think that we should confirm to the Brazilians that, like other European governments, we are not prepared to name a global figure for new medium term export credits. But we should go on to say that we are prepared, as they are, to look at requests for new medium term export credits on a case by case basis and subject to four conditions. These conditions are:

(i) that the credits are in support of British exports;

(ii) that the proejcts will be given priority in terms of import certificates and foreign exchange disbursements to UK exporters;

(iii) that the projects offer a reasonable prospect of timely repayment; and ?

(iv) that the projects are consistent with the IMF's structural adjustment programme and the long-term strengthening of the Brazilian economy.

5. The main advantage of this approach is that it would enable us to make a judgement ourselves on whether to grant new export credits in individual cases. The conditions are admittedly restrictive but are only prudent in present circumstances. They provide ample opportunity to turn down requests which we consider unreasonable. This approach would also place the onus firmly on the Brazilians to come up with specific, economically worthwhile proposals. It should stop the Americans and the Brazilians from badgering us about a global credit figure. We would also be demonstrating our support of the IMF programme for Brazil and the long-term strengthening of the Brazilian economy. ?

are we still being pressed?

/6. I believe

6. I believe that such an approach would consolidate the success we have achieved in preserving our political relations with Brazil without exposing us to extra commercial and public expenditure risks. As I said in my minute of 30 November, I do not envisage that we should commit ourselves to a specific amount of new credits. In practice I would doubt very much whether under the conditions stated there would be a rush of requests for new credits. Lastly I think that an approach on these lines would be seen by our exporters and by Parliament as a reasonable and pragmatic attitude in present circumstances.

7. I am copying this minute to Nigel Lawson and Norman Tebbit.

GEOFFREY HOWE

Foreign and Commonwealth Office
7 December 1983

Econ Pol I's AT 8/12

OID

1

Foreign and Commonwealth Office

London SW1A 2AH

Prime Minister:

6 December, 1983

agree to send acknowledgement as proposed?

AT 6/12

Yes MT

Dear John,

Liberia: Debts

The Embassy in Monrovia have forwarded the enclosed letter dated 2 November from the Head of State, Chairman Doe, to the Prime Minister requesting cancellation or conversion of loans to grants. (Because the bag service is infrequent, the letter took some time to arrive).

The issues it raises will require some interdepartmental consultation. We therefore recommend that the Prime Minister should at this stage send a brief acknowledgement, and I enclose a draft, which we propose to telegraph to Monrovia once approved. Since it is unlikely that we will be able to offer Liberia any concessions the draft is entirely non-committal.

Yours ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

A J Coles Esq
10 Downing Street

DSR 11 (Revised)

DRAFT: minute/letter/teleletter/despatch/note

TYPE: Draft/Final 1+

FROM: The Prime Minister

Reference

DEPARTMENT: TEL. NO:

SECURITY CLASSIFICATION

Top Secret

Secret

Confidential

Restricted

Unclassified

PRIVACY MARKING

..................In Confidence

CAVEAT......................

TO: C I C Samuel K Doe
Head of State and Chairman
People's Redemption Council
The Executive Mansion
Monrovia
Liberia

Your Reference

Copies to:

SUBJECT:

Thank you for your letter of 2 November requesting cancellation or conversion of debts which I have just received. I have asked that the points you raised should be looked at urgently, and I will send you a substantive reply as soon as possible.

Enclosures—flag(s)...........

GRS 440 CONFIDENTIAL

CONFIDENTIAL
CULL
FM BRASILIA 05:1740Z DEC 83
TO IMMEDIATE FCO
TELEGRAM NUMBER CULL 5 OF 5 DECEMBER
INFO IMMEDIATE UKDEL IMF/IBRD WASHINGTON

YOUR TELS NOS 290 AND 291: BRAZIL FINANCING

SUMMARY

1. FINANCE MINISTER REACTED VERY POSITIVELY TO THE CHANCELLOR'S MESSAGE IN YTUR 290 AND TO THE NEWS THAT ECGD WOULD GRANT UNRESTRICTED SHORT-TERM COVER AND WOULD ALLOW CONTINUED DRAWINGS ON EXISTING MEDIUM-TERM CREDITS. GALVEAS MADE PARTICULARLY FLATTERING COMMENTS ABOUT THE SUPPORT BRAZIL HAD RECEIVED FROM THE BANK OF ENGLAND AND THE BRITISH BANKS AND HE AGREED TO MAKE A SUITABLE STATEMENT TO THE PRESS TO SET THE RECORD STRAIGHT.

DETAIL

2. I CALLED THIS MORNING TO HAND OVER THE TEXT OF THE CHANCELLOR'S REPLY TO THE FINANCE MINISTER, WHO WAS ACCOMPANIED BY SERRANO, DIRECTOR OF THE EXTERNAL AREA AT THE CENTRAL BANK. I SPELLED OUT FULLY THE POINTS IN PARAGRAPH 3 OF YTUR 291. GALVEAS SAID HE WAS WELL AWARE OF THIS CONSTRUCTIVE ROLE AND SAID THAT THE PRESS HAD BEEN UNHELPFUL IN SPECULATING ABOUT THE ATTITUDE OF HMG TOWARDS BRAZIL'S PROBLEMS. I MADE THE POINT THAT CERTAIN OTHER COUNTRIES MIGHT PROMISE MORE BUT DO LESS. GALVEAS SAID THAT THE FRENCH HAD ALREADY PROPOSED A LIST OF PROJECTS WHICH COULD ATTRACT NEW FINANCING BUT BRAZIL WAS NOT IN A POSITION TO UNDERTAKE PUBLIC SECTOR PROJECTS UNTIL THE DEBT BURDEN HAD BEEN REDUCED. HOWEVER, THE QUESTION COULD WELL ARISE AS TO WHETHER NEW FINANCING WOULD BE AVAILABLE FROM BRITAIN IN AREAS OF TRADITIONAL EXPORTS SUCH AS NAVAL AND TRANSPORT EQUIPMENT. AT THIS POINT I TOOK HIM CAREFULLY THROUGH THE WORDING IN PARAGRAPH 6 OF TELNO 291.

3. SERRANO POINTED TO THE ABSENCE IN THE CHANCELLOR'S MESSAGE OF A REFERENCE TO THE US DOLLARS 2.5 BILLION PACKAGE OF OFFICIALLY GUARANTEED CREDITS AND ASKED WHETHER THIS MEANT THAT ECGD WOULD NOT PARTICIPATE. I TOOK HIM AGAIN THROUGH THE WORDING IN PARAGRAPH 6 OF TELNO 211 AND LEFT THEM TO DRAW THEIR OWN CONCLUSIONS. GALVEAS SAID THAT HE UNDERSTOOD THAT IT WAS DIFFICULT FOR ANY COUNTRY TO BE PRECISE ON PARTICIPATION IN THIS PACKAGE. HE NOTED THE CONTINUING COMMITMENT OF ECGD ON EXISTING BUSINESS AND THE LARGE SUM OF MONEY WHICH THIS IMPLIED. I HAD THE IMPRESSION THAT THIS WAS NEWS TO THE BRAZILIANS AND CAST THE BRITISH OFFICIAL PERFORMANCE IN A MORE POSITIVE LIGHT THAN THEY HAD HITHERTO REALISED. AT ALL EVENTS, GALVEAS AGREED

CONFIDENTIAL /THAT

CONFIDENTIAL

THAT HIS MINISTRY WOULD PREPARE A LINE FOR THE PRESS SETTING THE RECORD STRAIGHT ON THE BRITISH OFFICIAL CREDIT PARTICIPATION IN THE BRAZILIAN ADJUSTMENT PROGRAMME TO MATCH THE EXTREMELY POSITIVE PERFORMANCE OF THE BANK OF ENGLAND AND THE BRITISH BANKS.

4. AS THE FOREIGN MINISTER IS PRESENTLY OUT OF BRAZIL, MY COUNSELLOR WILL DELIVER A COPY OF THE CHANCELLOR'S MESSAGE AT AN APPROPRIATELY HIGH LEVEL IN THE FOREIGN MINISTRY.

FCO ADVANCE TO:

BANK OF ENGLAND - LOEHNIS, BALFOUR, HALL
HM TREASURY - LAVELLE, MOUNTFIELD, CASE
ECGD - BREACH, HARDING
DTI - OWEN
CABINET OFFICE - COLVIN

HARDING

FINANCIAL D
ERD
SAMD
MR GIFFARD
MR URE

COPIES TO
ADVANCE ADDRESSEES

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Brazil file

4766 - 1

DD 051430Z BRASILIA
GRS 680
CONFIDENTIAL [CULL]
DESKBY 051430Z
FM FCO 21430Z DEC 83
IMMEDIATE BRASILIA
TELEGRAM NUMBER 292 OF 5 DECEMBER
MY TELNO 291: BRAZIL: FINANCING

AT

1. I HAVE WRITTEN AT HIS REQUEST TO SIR ROBIN MAXWELL-HYSLOP, MP WHOM I SAW WITH OTHER MEMBERS OF THE BRITISH/BRAZIL PARLIAMENTARY GROUP LAST WEEK TO REMIND HIM OF THE SUBSTANTIAL CONTRIBUTION WE ARE MAKING. FOLLOWING IS TEXT OF MY LETTER DATED 5 DECEMBER. YOU MAY ALSO DRAW ON THIS AS NECESSARY WHEN SPEAKING TO THE BRAZILIANS.

BEGINS:

AT OUR MEETING YESTERDAY I UNDERTOOK TO LET YOU HAVE A NOTE ABOUT OUR CONTRIBUTION TO THE SOLUTION OF BRAZIL'S DEBT PROBLEM.

I VERY MUCH WELCOMED THE OPPORTUNITY TO DISCUSS THIS QUESTION WITH YOU AND YOUR GROUP, AND TO SET THE RECORD STRAIGHT ON THE SUBSTANTIAL EXISTING CONTRIBUTION WHICH WE ARE MAKING TO THE BRAZILIAN RESCUE PACKAGE. YOU MAY FIND IT HELPFUL IF I SET DOWN THE BASIC FIGURES. YOU WILL RECALL THAT AT THE OUTSET THE BANK OF ENGLAND WITH A GUARANTEE FROM HM TREASURY TOOK A DOLLARS 110 MILLION SHARE IN THE CENTRAL BANK CONTRIBUTION TO THE BIS BRIDGING LOAN TO BRAZIL. AT THE PARIS CLUB MEETING ON 22-23 NOVEMBER TO RESTRUCTURE BRAZIL'S 1983/84 DEBTS, ECGD'S CONTRIBUTION TO THE DOLLARS 3.8 BILLION TOTAL WAS APPROXIMATELY DOLLARS 330 MILLION. THIS AMOUNT IS TWICE THE ORIGINAL AMOUNT AT WHICH THE BRAZILIAN GOVERNMENT AND IMF HAD ESTIMATED ECGD'S SHARE (DOLLARS 180 MILLION). IT IS A VERY GENEROUS CONTRIBUTION BEARING IN MIND THAT ECGD'S EXPOSURE SHARE IS APPROXIMATELY 13 PER CENT WHILE THE UNITED KINGDOM'S SHARE OF THE BRAZILIAN MARKET IS ONLY 1.3 PER CENT. AT THE IMF EXECUTIVE BOARD MEETING ON 22 NOVEMBER, WHEN A REVISED THREE-YEAR EXTENDED FUND FACILITY FOR BRAZIL WAS APPROVED, THE BRITISH EXECUTIVE DIRECTOR TOOK A HELPFUL AND CONSTRUCTIVE PART IN THE DISCUSSION. HE PAID

PARTICULAR TRIBUTE TO THE SUBSTANTIAL EFFORT MADE BY THE BRAZILIAN GOVERNMENT TO ENABLE THE PROGRAMME TO BE REINSTATED.

AT THE SAME TIME THE BRITISH BANKS HAVE PLAYED A PROMINENT ROLE IN THE NEGOTIATIONS FOR THE DOLLARS 6.5 BILLION COMMERCIAL LOAN FOR BRAZIL. NEGOTIATIONS ARE STILL CONTINUING BUT THE BRITISH BANKS' SHARE OF THE LOAN IS EXPECTED TO BE OF THE ORDER OF DOLLARS 700 - 780 MILLION. THE BRAZILIAN GOVERNMENT HAS EXPRESSED ITS GRATITUDE TO THE BRITISH BANKS FOR THEIR HELPFUL ROLE AND FOR THE SUPPORT WHICH THE BANK OF ENGLAND HAS GIVEN THEM.

THERE WAS ALSO DISCUSSION AT OUR MEETING OF FUTURE EXPORT CREDITS FOR BRAZIL. I EXPLAINED THAT ECGD IS STILL MAINTAINING SHORT TERM COVER FOR BRAZIL. ON PRESENT LEVELS THIS IS EXPECTED TO RUN AT ABOUT A TOTAL OF POUNDS STG 20-30 MILLION PER YEAR. ECGD IS ALSO MAINTAINING COVER FOR A SUBSTANTIAL NUMBER OF MEDIUM TERM CREDITS, WHICH IN TOTAL COULD AMOUNT TO APPROXIMATELY PDS STLG 500 MILLION, IN SUPPORT OF EXISTING CONTRACTS. BRAZIL WILL CONTINUE TO BE ABLE TO DRAW UPON THESE CREDITS IN THE NORMAL WAY. YOU ALSO RAISED THE QUESTION OF EEW MEDIUM TERM EXPORT CREDITS. I EXPLAINED THAT IT HAS NOT YET BEEN CLEARLY ESTABLISHED WHAT THE SIZE OF ANY FINANCING GAP IN TIIS AREA MIGHT BE. WE, LIKE HHE OTHER MAJOR CREDITOR GOVERNMENTS EXCEPT THE US, HAVE NOT MADE ANY FORMAL COMMITMENTS FOR THE PRESENT. WE SHALL CONTINUE TO KEEP THIS QUESTION UNDER REVIEW IN THE LIGHT OF THE ECONOMIC CIRCUMSTANCES. I SUGGESTED THAT IF YOU OR DAVID MONTGOMERY WISHED TO DISCUSS PARTICULAR CONTRACTS YOU MIGHT HAVE A WORD WITH NORMAN TEBBIT.

I SHOULD LIKE TO EMPHASISE, AS I SAID AT OUR MEETING, THAT AS FOREIGN SECRETARY I AM PARTICULARLY CONCERNED TO PRESERVE AND STRENGTHEN OUR GOOD POLITICAL AND COMMERCIAL RELATIONS WITH BRAZIL. I FULLY RECOGNISE THE IMPORTANCE OF BRAZIL TO BRITAIN AND THE HELPFUL ROLE WHICH BRAZIL HAS PLAYED IN RECENT TIMES. I SHARE YOUR CONCERN ABOUT THE PRESS REPORTS THAT BRITAIN IS NOT TAKING A POSITIVE ATTITUDE TOWARDS BRAZIL'S PROBLEMS. WE SHALL BE TAKING STEPS TO REASSURE THE BRAZILIAN GOVERNMENT ABOUT THE CONTRIBUTION WHICH WE ARE MAKING TO BRAZIL IN HER HOUR OF

DIFFICULTY AND I VERY MUCH HOPE THAT THIS ACTION WILL PUT AN END
TO UNHELPFUL PRESS SPECULATION ON THIS SUBJECT.
HOWE

NNNN
FINANCIAL
ERD
SAMD
MR GIFFARD
MR URE

3.28 CONFIDENTIAL

Z PP's

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

Prime Minister ②
~~This is the note you asked for at Cabinet on 3 November. You will want to discuss it but~~

PRIME MINISTER

ARGENTINA

Noting the possibility of resumed US arms sales to Argentina - the risk of which has since increased - Cabinet on 3 November invited the Foreign Secretary, in consultation with me, to review our policy on debt relief for Argentina.

2. The attached paper, prepared by the Treasury in consultation with the FCO and the Bank, has been seen and agreed by the Foreign Secretary. It raises no immediate issues, and you may wish to defer any Cabinet discussion until the Foreign Secretary's return.

3. Copies of this minute and enclosure go to the Foreign Secretary, our other Cabinet colleagues, the Attorney General, the Chief Whip, and Sir Robert Armstrong.

NL.

(N.L.)

5 December 1983

ARGENTINA: ARMS SALES AND BANK LENDING

Cabinet on 3 November commissioned an examination of ways in which British banks could be stopped from lending money to Argentina, which might help finance purchase of arms from the USA. That remit has been partly overtaken by events, relating to an initial round of disbursements under an existing loan agreement (see below). But the problem will be likely to arise in future, over further disbursements of the existing loan, or over new loan agreements or any new IMF programme.

2. After an account of disbursements under the existing loan, the remainder of this note examines the scope for future action, and concludes:

(i) Where there is an existing loan agreement and its conditions are fulfilled, the British banks could only be prevented from disbursing their shares by primary legislation which might entail breach of contract;

(ii) If British banks alone were prevented from participation, the major row which this would create could well hurt the United Kingdom more than Argentina, at least financially;

(iii) It would be possible to prevent British banks from participating in any future loan, but this would have little effect on Argentina and could damage UK interests.

Recent Developments

3. In August, after the IMF at our insistence had persuaded Argentina to take steps to end discrimination against the UK in certain financial payments, international commercial banks, including British banks, signed a long-planned agreement for a loan of $1.5 billion to Argentina. The share of UK-based banks is just over 10%, of which British-owned banks account for 7%. The first tranche of $500 million was intended to be drawn pari passu with the May 1983 drawing on the IMF, but was repeatedly postponed, largely because of failure by Argentina to satisfy certain criteria relating to arrears and rescheduling of public sector debt. That first tranche is destined to return immediately to the lending banks: $350 million retained in

settlement of the instalment due on an earlier bridging loan; and the remainder to be paid into a special escrow account from which other arrears outstanding to the banks would be settled.

4. During November, considerable pressure developed, primarily from United States banks, to implement the first disbursement, in order to settle earlier arrears and thus improve the appearance of bank balance-sheets by 30 November. To this end, all participating banks were being urged to agree to waive various unsatisfied conditions.

5. When it became clear on 22 November that a recommendation from the banks' Advisory Committee was imminent, Ministers decided:

- to ensure that the IMF approval still stood, despite Argentine failure to meet all the criteria of the Fund programme and the consequent de facto suspension of further drawings on the IMF;

- to make it clear to the British banks that HMG thought their action premature and ill-advised; but

- not to attempt to block the operation or participation by British banks in it.

Ministers also decided to say, in response to press or parliamentary criticism of the loan, that it was a matter for the commercial judgment of the banks, but that HMG considered the disbursements premature, before there had been opportunity for the new Argentine Government to establish new and satisfactory arrangements with the IMF.

6. In accordance with the first point, the IMF Managing Director was approached, and he reported to the Board late on 22 November that he had told the banks that the IMF welcomed their proposed disbursement: there was no dissent and the banks took this as a clear signal to go ahead. They did so on 2 December.

7. Ministers have not taken, nor are they at this moment called upon to take, any view on further disbursements under the loan signed in August. It appears to be the clear understanding among the banks

concerned that there will be no further disbursements until there is a satisfactory new programme agreed with the IMF. This condition was not held to apply to the first tranche, partly because of its link with settlement of arrears, and partly because it was regarded throughout as being an overdue transaction linked with the position last May.

8. No further loan agreement is currently being considered. But, given Argentine balance of payments prospects, fresh lending will almost certainly be sought during 1984, although probably not until the new government is firmly in office and has negotiated a fresh IMF programme.

The IMF Programme

9. The IMF agreed in January 1983 to a standby facility for Argentina totalling SDR 1.5 billion to be drawn in stages over 15 months. Drawings are conditional on economic performance criteria. So far only two drawings, totalling SDR 600 million, have been made. Since May, further drawings have been suspended, first because of continuing discriminatory payments restrictions against UK companies (now removed) then because of unsatisfactory performance on clearance of other payments arrears, and most recently because of the deterioration of Argentine economic performance and the need to establish a fresh programme with the new Argentine government. Indications have been that the new government does want to get into early negotiations with the IMF.

Options For Government Action: Loans by Banks

10. If the commercial banks are satisfied that the loan conditions have been met, participation in the August agreement would be legally enforceable. A distinction therefore has to be drawn between the remaining drawings under the August loan, and any future loans. There are four options:

(a) Instructions to the Banks

A direction by the Bank of England under the Bank of England Act might be sufficient to prevent British banks signing a new loan agreement. However, given that the August loan documentation has been signed, a direction under this Act to desist from actual disbursement would almost certainly be *ultra vires*. This is one reason why no action was taken in respect of the November drawing.

(b) Sanctions and Exchange Control

Reintroduction of the sanctions originally imposed at the start of the Falklands conflict under the Emergency Laws (Re-enactments and Repeals Act) 1964 would require the Treasury to be satisfied that Argentina is taking, or is likely to take action to the detriment of the economic position of the UK. This option was not pursued in the case of the November drawings. It remains open in respect of future drawings or of new loans. But it would be hard to establish that potential sales of US arms to Argentina had this effect, at a time when there is no active conflict. Other powers available to the Treasury under the Exchange Control Act 1947 are also constrained.

(c) Primary Legislation

Fresh primary legislation remains a possible option. It could in principle be made retrospective, so as to forbid disbursement under the August agreement. (There could be some embarrassment, but not insuperable, in doing so for subsequent tranches when the first had been allowed to proceed.) But, as with any action of this kind, legislation could well lead to action being taken in foreign courts against the banks for breaking their contract and to demands for compensation from H.M.G. No such objection would lie against legislation to forbid British banks participating in any new loan agreement.

(d) Pressure

A further option would be to secure the non-participation of British banks by a mixture of persuasion and the threat of public opinion. Once a loan agreement had been signed, the banks would be in a strong position to resist. They have not been deterred by the threat of publicly-expressed Government criticism of the November drawing. If they bowed to pressure on a future occasion, they would lay the blame on H.M.G., and might seek compensation for any losses incurred. They might be more susceptible to pressure in the case of new loans but experience earlier this year is not encouraging and the banks would want the Government's involvement made public.

11. For the future, the banks now understand that they must consult the Government again before making any new loan agreements with Argentina. If we wanted to stop them where their judgment was to participate, the choice would lie between a direction and fresh legislation. The Bank of England has already told Lloyds Bank International (as coordinator for the British banks) that the Government should be kept informed about proposals for future disbursements under the August agreement and for future loans.

Possible UK Action on IMF Programme

12. As an alternative to action targetted on the banks, H.M.G. could take action at the IMF to try to block the Argentine programme and thus seek indirectly to frustrate the bank agreement. The question will arise some time in 1984, when a new Argentine programme is likely to be presented to the IMF. To attempt to stop the new programme would introduce a direct political element into Fund judgments. We doubt if this would be successful, and it would be an awkward precedent for the future.

Official Rescheduling

13. One further possible instrument, mentioned in the Cabinet discussion, but not involving the banks, is to withhold UK participation in rescheduling of official debt should the new Government seek that. The UK could not veto a Paris Club rescheduling but it could refuse to join in. However, the effect would be that other creditors would take precedence over the UK in obtaining a share of any money available for debt service. Assuming Argentina continued to withhold payment on non-rescheduled debt, it would still secure the benefits of debt relief to its balance of payments, which would release resources for arms purchase.

Implications of Financial Measures

14. For H.M.G. to take overt action to frustrate an existing agreement would run counter to our policy of seeking to restore more normal relations with Argentina especially in financial and commercial matters. Similar arguments apply to future agreements or new IMF programmes.

15. There are also banking considerations. Technically, the full support of the British banks is needed for any further drawings under the August agreement. If this were withheld, Argentina could well be entitled to claim damages for breach of contract and might be tempted to take economic reprisals. In the case of future loans,

the political convenience of not having British banks involved has to be weighed against the reality that Argentina would not in fact be put under any severe financial pressure by their absence. In the view of the Bank of England, British non-participation as a result of explicit government action and in the absence of any new moves by Argentina generally seen to be inimical to HMG's interests, would also damage the UK's ability to influence the handling of debt problems in the wider context, as well as hurting London's position as an international financial centre.

HM Treasury
5 December 1983

1688

Prime Minister (2)
Getting our case through to the Brazilians.
AT 6/12

INTERNATIONAL/CURRENCY SITUATION: ADVANCE COPIES

PS
[illegible]
PS/PUS
MR BULLARD
SIR C TICKELL
MR HAYES
GEOG DUS.........
GEOG AUS.........
HD/FRD (2)
HD/GEOG
HD/EID (2)
....
....
NEWS DEPT
RESIDENT CLERK

MR BREACH
MR HARDING } ECGD

PS NO 10 DOWNING ST
CABINET OFFICE
SIR R ARMSTRONG
MR P MOUNTFIELD
MR R L WADE GERY

50

TREASURY
PS TO CHANCELLOR OF THE EXCHEQUER
SECOND PERM. SEC. O.F.
MR J G LITTLER
MR P E MIDDLETON
MR J B UNWIN
MR R G LAVELLE
MR G E FITCHEW
MR M A HALL
~~MR D L C PERETZ~~
MR MOUNTFIELD
MR CASÉ
(7) OVERSEAS SECTION

BANK OF ENGLAND
MR EWBANK
MR LOEHNIS
MR BALFOUR
MR HALL

DEPT OF TRADE 1 VICTORIA ST
PS/S OF S TRADE
MR W M KNIGHTON
MR S ABRAMSON
MR OWEN

GRS 440
CONFIDENTIAL
FM BRASILIA 051740Z DEC 83
TO IMMEDIATE FCO
TELEGRAM NUMBER CULL 5 OF 5 DECEMBER
INFO IMMEDIATE UKDEL IMF/IBRD WASHINGTON

IMMEDIATE
ADVANCE COPY
SENT 1983

YOUR TELS NOS 290 AND 291: BRAZIL FINANCING

SUMMARY

1. FINANCE MINISTER REACTED VERY POSITIVELY TO THE CHANCELLOR'S MESSAGE IN YTUR 290 AND TO THE NEWS THAT ECGD WOULD GRANT UNRESTRICTED SHORT-TERM COVER AND WOULD ALLOW CONTINUED DRAWINGS ON EXISTING MEDIUM-TERM CREDITS. GALVEAS MADE PARTICULARLY FLATTERING COMMENTS ABOUT THE SUPPORT BRAZIL HAD RECEIVED FROM THE BANK OF ENGLAND AND THE BRITISH BANKS AND HE AGREED TO MAKE A SUITABLE STATEMENT TO THE PRESS TO SET THE RECORD STRAIGHT.

DETAIL

2. I CALLED THIS MORNING TO HAND OVER THE TEXT OF THE CHANCELLOR'S REPLY TO THE FINANCE MINISTER, WHO WAS ACCOMPANIED BY SERRANO, DIRECTOR OF THE EXTERNAL AREA AT THE CENTRAL BANK. I SPELLED OUT FULLY THE POINTS IN PARAGRAPH 3 OF YTUR 291. GALVEAS SAID HE WAS WELL AWARE OF THIS CONSTRUCTIVE ROLE AND SAID THAT THE PRESS HAD BEEN UNHELPFUL IN SPECULATING ABOUT THE ATTITUDE OF HMG TOWARDS BRAZIL'S PROBLEMS. I MADE THE POINT THAT CERTAIN OTHER COUNTRIES MIGHT PROMISE MORE BUT DO LESS. GALVEAS SAID THAT THE FRENCH HAD ALREADY PROPOSED A LIST OF PROJECTS WHICH COULD ATTRACT NEW FINANCING BUT BRAZIL WAS NOT IN A POSITION TO UNDERTAKE PUBLIC SECTOR PROJECTS UNTIL THE DEBT BURDEN HAD

COULD ATTRACT NEW FINANCING BUT BRAZIL WAS NOT IN A POSITION TO UNDERTAKE PUBLIC SECTOR PROJECTS UNTIL THE DEBT BURDEN HAD BEEN REDUCED. HOWEVER, THE QUESTION COULD WELL ARISE AS TO WHETHER NEW FINANCING WOULD BE AVAILABLE FROM BRITAIN IN AREAS OF TRADITIONAL EXPORTS SUCH AS NAVAL AND TRANSPORT EQUIPMENT. AT THIS POINT I TOOK HIM CAREFULLY THROUGH THE WORDING IN PARAGRAPH 6 OF TELNO 291.

3. SERRANO POINTED TO THE ABSENCE IN THE CHANCELLOR'S MESSAGE OF A REFERENCE TO THE US DOLLARS 2.5 BILLION PACKAGE OF OFFICIALLY GUARANTEED CREDITS AND ASKED WHETHER THIS MEANT THAT ECGD WOULD NOT PARTICIPATE. I TOOK HIM AGAIN THROUGH THE WORDING IN PARAGRAPH 6 OF TELNO 211 AND LEFT THEM TO DRAW THEIR OWN CONCLUSIONS . GALVEAS SAID THAT HE UNDERSTOOD THAT IT WAS DIFFICULT FOR ANY COUNTRY TO BE PRECISE ON PARTICIPATION IN THIS PACKAGE. HE NOTED THE CONTINUING COMMITMENT OF ECGD ON EXISTING BUSINESS AND THE LARGE SUM OF MONEY WHICH THIS IMPLIED. I HAD THE IMPRESSION THAT THIS WAS NEWS TO THE BRAZILIANS AND CAST THE BRITISH OFFICIAL PERFORMANCE IN A MORE POSITIVE LIGHT THAN THEY HAD HITHERTO REALISED. AT ALL EVENTS, GALVEAS AGREED THAT HIS MINISTRY WOULD PREPARE A LINE FOR THE PRESS SETTING THE RECORD STRAIGHT ON THE BRITISH OFFICIAL CREDIT PARTICIPATION IN THE BRAZILIAN ADJUSTMENT PROGRAMME TO MATCH THE EXTREMELY POSITIVE PERFORMANCE OF THE BANK OF ENGLAND AND THE BRITISH BANKS.

4. AS THE FOREIGN MINISTER IS PRESENTLY OUT OF BRAZIL, MY COUNSELLOR WILL DELIVER A COPY OF THE CHANCELLOR'S MESSAGE AT AN APPROPRIATELY HIGH LEVEL IN THE FOREIGN MINISTRY.

FCO ADVANCE TO:

BANK OF ENGLAND - LOEHNIS, BALFOUR, HALL
HM TREASURY - LAVELLE, MOUNTFIELD, CASE
ECGD - BREACH, HARDING
DTI - OWEN
CABINET OFFICE - COLVIN

HARDING

NNNN

SENT/RECD AT 05:1845Z DT

PRIME MINISTER'S PERSONAL MESSAGE SERIAL No. T203AAA/83

Subject

(2).

THE STATE HOUSE,
DAR ES SALAAM,
TANZANIA.

cc. Master ops.

3rd December 1983

Mrs Margaret Thatcher,
The Prime Minister,
10 Downing Street,
London, S.W.1

Prime Minister.

I shall let you have a reply on the IMF point.

A.J.C. 15/12.

Dear Margaret,

It was very good to see you again in New Delhi, and I particularly enjoyed the lunch on Tuesday last to which you kindly invited me. The Conference itself is, I believe, of great value to us all - as well as to the Commonwealth as an organisation - but at least equally valuable is the opportunity it provides for more informal discussion.

Now we have all returned to take up again the problems of our own countries, and particularly of the economy. I am afraid no miracle happened in Tanzania while I was away, and our foreign exchange problems become increasingly difficult despite our efforts. However, I was encouraged by your offer to help us with the I.M.F., for our discussions with them continue.

Let us hope that we meet again before the next Commonwealth Conference. For the present I send you my very good wishes, both for your own health and that of the economy of Britain. As we agreed in New Delhi, all countries are linked together!

Yours sincerely,

Julius K. Nyerere

Brazil file

OUT TELEGRAM

Classification and Caveats	Precedence/Deskby
CONFIDENTIAL	IMMEDIATE/DESKBY 021700Z

Prime Minister 4
This sets out our record and in para 6 sets out the caveats you requested.
AT 2/12

MT

ZCZC ZCZC

GRS GRS

CLASS CONFIDENTIAL

CAVEATS

DESKBY DESKBY 021730Z

FM FCO FM FCO DECEMBER 83

PRE/ADD IMMEDIATE BRASILIA

TEL NO TELEGRAM NUMBER

INFO TO IMMEDIATE UKDEL IMF/IBRD WASHINGTON

MY TELNOS 289 AND 290: BRAZIL FINANCING

1. Please now deliver the text of the message in my 2nd TUR. Ministers consider it is most important that you should use the opportunity of handing over the message to set the record straight with the Brazilians about our contribution to the international effort to help them meet their obligations. Please also take an early opportunity to call upon the Minister of Foreign Affairs to speak in similar terms.

2. You should begin by emphasising the importance which we attach to good political and trade relations with Brazil. You should go on to remind the Brazilians of the substantial contribution which the United Kingdom has made to the Brazilian debt operation by going through in full the figures in paras 3-5 below.

3. At the outset of the Brazilian problem the Bank of England backed by a guarantee from the Treasury took a dollars 110

NNNN ends telegram	BLANK	Catchword: million

File number	Dept: ERD	Distribution: Financial, ERD, SAmD, Mr Giffard, Mr Ure
Drafted by (Block capitals): T P HOLLAWAY		
Telephone number: 233 5753		
Authorised for despatch: AT 2/12		
Comcen reference	Time of despatch	

XY 48

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million share in the central bank contributions to the BIS bridging loan to Brazil. At the Paris Club meeting on 22-23 November to restructure Brazil's 1983/84 debts, ECGD's contribution to the dollars 3.8 billion total was approximately dollars 330 million. This amount is twice the original amount at which the Brazilian Government and IMF had estimated ECGD's share (dollars 180 million). It is a very generous contribution bearing in mind that ECGD's exposure share is approximately 13% while the United Kingdom's share of the Brazilian market is only 1.3%: that this, our share of the rescheduling burden is about ten times the size of our current share of the Brazilian market. At the IMF Executive Board meeting on 22 November, the British Executive Director took a helpful and constructive part in the discussion. He paid particular tribute to the substantial effort made by the Brazilian Government to enable the programme to be reinstated.

4. At the same time the British banks have played a prominent role in the negotiations for the dollars 6.5 billion commercial loan for Brazil. Negotiations are still continuing but the British banks' share of the loan is expected to be of the order of dollars 700-780 million. The Brazilian Government has expressed its gratitude to the British banks for their helpful role and for the support which the Bank of England has given them.

5. On the question of future export credits for Brazil, you should stress that ECGD is still maintaining unrestricted (new) short-term cover for Brazil. On present levels this is expected to run at about a total of £20-30 million per year. As we understand it a substantial part of the possible Eximbank credit of dollars 1.25 billion will consist of similar short-term cover. ECGD is also maintaining cover for a substantial number of medium-term credits, which in total could amount to approximately £500 million, in support of existing contracts. Brazil will

OUT TELEGRAM (CONT)

Classification and Caveats		Page
CONFIDENTIAL		3

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continue to be able to draw upon these credits in the normal way.

6. If asked about new medium-term export credits, you should point out that the IMF Managing Director and his staff assured the IMF Executive Board and the Paris Club that the dollars 2.5 billion would be forthcoming. As the Brazilians will be aware, the IMF's assurances were given after consultations with a large number of governments, including the United Kingdom. You should not (not) be drawn into detail on a specific UK contribution but should leave the Brazilians to draw their own conclusions. In this context Ministers attach great importance to avoiding any risk that the Brazilians will be able to claim subsequently that they were misled about the size of any UK contribution.

HOWE

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MT

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NNNN ends telegram	BLANK	Catchword

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I.P. Ltd Dmd 8200051 56-00 8/80

10 DOWNING STREET

Prime Minister (4)

Mr Tebbit keeping his foot in the door! Though Treasury acknowledged that things might improve in Brazil to point where we could offer cover again, they in fact were stressing the opposite ie that the programme might fail and that any extra credit would then have added to ECGD's exposure.

AT

2/12

MT

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215)
(Switchboard) 215 7877

JU121

Secretary of State for Trade and Industry

2 December 1983

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

MS

Dear Andrew,

BRAZIL

My Secretary of State has seen the correspondence on new credit for Brazil between John Kerr, Peter Ricketts and you.

2 He has asked me to say that he has noted in particular the implication in the penultimate paragraph of John Kerr's letter of 25 November that we may well be in a position to offer credit for exports to Brazil in the reasonably near future. It would be a great pity, he believes, if our policy were, in the meantime, to prejudice the chances of our exporters, particularly in the light of the bad feeling which has apparently been engendered in Brazil

3 I am copying this letter to John Kerr (Treasury), Peter Ricketts (FCO) and John Bartlett (Bank of England).

Yours sincerely,

Ruth Thompson

RUTH THOMPSON
Private Secretary

2 DEC 1985

FALKLAND ISLANDS GENERAL (ADVANCES) ~~39~~ 39 (x45) Telegram shown to PM 10am 3/12/83

PS
PS/LADY YOUNG
PS/MR WHITNEY
PS/MR RIFKIND
PS/PUS
~~SIR J BULLARD~~ MR JENKINS
SIR I SINCLAIR
MR GIFFARD
MR WRIGHT
MR ADAMS
LORD N G LENNOX
MR EVANS
MR URE
MR CARTLEDGE
HD/PUSD (2)
HD/SAMD
HD/FID
~~HD/DEFENCE DEPT~~
HD/NEWS DEPT
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HD/UND
HD/PLANNING STAFF

PS/NO 10 DOWNING ST (3)
PS/S OF S FOR DEFENCE
MR J STEWART AUSD STAFF MOD
PS/CHANCELLOR)
MISS M E CUND) TREASURY
MR LITTLER)
SIR R ARMSTRONG)
MR A D S GOODALL) CABINET OF
DIO)
MR M A PATTISON, FID, ODA
~~MR A TITCHENER DTI (Victoria S~~
Mr A FORTNAM IAT/ D. TRANSPORT
RESIDENT CLERK

IMMEDIATE

GRS 250
CONFIDENTIAL
FM WASHINGTON 021919Z DEC 83
TO IMMEDIATE FCO
TELEGRAM NUMBER 3632 OF 2 DECEMBER
INFO PRIORITY UKDEL NATO PORT STANLEY CIVIL COMMISSIONER
INFO SAVING PARIS BONN

ADVANCE COPY

MY TELEGRAMS NOS 3509 TO 3511:
ARGENTINA: CERTIFICATION

1. EAGLEBURGER TOLD MINISTER THIS MORNING THAT A RECOMMENDATION HAD NOW GONE TO THE PRESIDENT ON CERTIFICATION FOR ARGENTINA. EAGLEBURGER EXPECTED THAT THE PRESIDENT WOULD REACH A CONCLUSION ON THIS QUESTION OVER THE WEEKEND AND WOULD SEND A MESSAGE TO THE PRIME MINISTER WHEN HE HAD DONE SO. HE SAID HE BELIEVED THAT WE UNDERSTOOD THAT ONCE THE ELECTIONS IN ARGENTINA HAD TAKEN PLACE, CERTIFICATION WOULD BE INEVITABLE. OUR FRIENDS IN THE ADMINISTRATION HAD BEEN ABLE TO DELAY THIS BUT NEVER EXPECTED TO BE ABLE TO PREVENT IT. WE FOR OUR PART HAD MADE OUR CONCERNS VERY CLEAR AND

HAD BEEN ABLE TO DELAY THIS BUT NEVER EXPECTED TO BE ABLE TO PREVENT IT. WE FOR OUR PART HAD MADE OUR CONCERNS VERY CLEAR AND EAGLEBURGER GAVE AN ASSURANCE THAT THE CLOSEST ATTENTION WOULD BE PAID TO THESE IF AND WHEN IT CAME TO ACTUAL ARMS SALES. HE HIMSELF DOUBTED WHETHER THE ARGENTINIANS WOULD BE LOOKING TO THE UNITED STATES SO MUCH AS TO ISRAEL, WHICH WAS CONTINUING TO TAKE A CLOSE INTEREST IN THE POTENTIAL ARGENTINIAN ARMS MARKET. (WE HAVE REMINDED THE AMERICANS OF OUR CONCERN ABOUT ARGENTINIAN ATTEMPTS TO BUY SKYHAWKS FROM ISRAEL.)

2. THOMAS THANKED EAGLEBURGER FOR THIS WARNING. HE ACCEPTED THAT WE HAD HAD MANY INDICATIONS FROM THE SECRETARY DOWNWARDS THAT THE ADMINISTRATION WAS MOVING TOWARDS A DECISION. THIS DID NOT LESSEN THE IMPORTANCE OF CONSULTATION BEFORE A FINAL DECISION WAS PROMULGATED AND ABOUT SPECIFIC ARMS CONTRACTS, IF IT CAME TO THAT.

3. WITH THE VICE PRESIDENT ATTENDING ALFONSIN'S INAUGURATION (MY TEL NO 3570) A U.S. ANNOUNCEMENT MUST BE EXPECTED NEXT WEEK.

FCO PASS SAVING PARIS BONN.

WRIGHT

NNNN

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

2 December, 1983.

Dear Peter

The Prime Minister has seen your letter of 30 November which crossed with my letter to John Kerr of the same date. She has also seen John Kerr's letter to me of 1 December.

She takes the view that the UK has a very good case on its role in the Brazilian debt package, and it should be made energetically. She therefore welcomes the message which the Chancellor is proposing to send to the Brazilian Finance Minister. She agrees with the Chancellor that, when delivering the message, the Ambassador should take the line proposed by the Foreign Secretary, provided this can be done without being drawn into any specific commitments about new export credits.

She has commented, however, that the line which the Ambassador is being asked to take is a difficult one, and she hopes that there will be no danger that the Brazilians will subsequently claim they were misled about the size of any UK contribution.

She has also commented that there would be no advantage in publicising the figure of $20 m of additional export credit which the IMF is pencilling in against the UK. One effect of this could be to bring out into the open the German and French offers, against which our contribution would look ungenerous.

I am sending copies of this letter to John Kerr (HM Treasury), Callum McCarthy (Department of Trade and Industry), and John Bartlett (Office of the Governor of the Bank of England).

Yours sincerely

Andrew Turnbull

P. F. Ricketts, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

All FCO copies destroyed.
HM Forrester 1/12

CONFIDENTIAL

(R)

PS
PS/Lady Young
PS/Mr Whitney
PS/PUS
Sir C Tickell
Mr Thomas
SAMD
Ricketts 1/12

10 DOWNING STREET

From the Private Secretary

1 December 1983

Superceded

Dear Peter

Brazil

The Prime Minister has seen your letter of 30 November which crossed with my letter to John Kerr of the same date. She does not think any advantage would be gained from publishing the figure of $20 million of additional export credit which the IMF is pencilling in against the UK. One effect of this would be to bring out into the open the German and French offers, against which our offer would look ungenerous. The original justification for making a further offer was to prevent the package on Brazilian debt from falling apart at the last moment. Since it appears that all the parts have fallen into place, this justification no longer seems to hold.

The argument now is a different one, that we need to reveal this offer in order to improve our standing with Brazil. The Prime Minister feels that, even without an offer, we have a very good case, provided it is presented energetically. She therefore welcomes the message which the Chancellor is proposing to send to the Brazilian Finance Minister. She also hopes that this will be followed up in other ways.

I am copying this letter to John Kerr (H.M. Treasury), Callum McCarthy (Department of Trade and Industry) and John Bartlett (Office of the Governor of the Bank of England).

Yours sincerely
Andrew Turnbull

Andrew Turnbull

Peter Ricketts, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

10 DOWNING STREET

Prime Minister (1)

I have looked more carefully at the instructions FCO propose to give our Ambassador in Brazil. He would not mention $20 million, but would indicate that the $2.5 billion had been found after consultation with Governments including our own.

The aim is to keep in with the Brazilians without committing ourselves to a figure. This is fine so long as it can be pulled off, though it does run risk that Brazilians will later claim they were misled.

Nevertheless, agree FCO proposal on strict understanding that Ambassador does not get drawn into figures? The Chancellor is content - see attached letter.

AT 1/12

CONFIDENTIAL

✓CNO

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

1 December 1983

Andrew Turnbull Esq
10 Downing Street
LONDON
SW1

Dear Andrew,

BRAZIL

The Chancellor has seen the two FCO letters, and yours, of 30 November on Brazil. WHAT?

He is content that our Ambassador in Brazilia should, when delivering the message to the Brazilian Finance Minister, make not only the points mentioned in my letter, but also those suggested by the Foreign Secretary. But this is on the assumption that the Ambassador could, while taking the line proposed by the FCO, still avoid being drawn into speculation about a specific UK commitment to new medium term credit. For the Chancellor strongly endorses the Foreign Secretary's view that the Ambassador must not be so drawn.

I should perhaps report that our representative at a meeting of G5 officials in New York on 29 and 30 November came under no pressure for a UK commitment on medium term credit. Indeed the US representative argued that the maintenance of short term cover could be scored as counting against the $2.5 billion package. It is perhaps relevant that the bulk of the US Eximbank $1.25 billion facility is likely to be short term.

Copies of this letter go to Peter Ricketts (FCO), and Callum McCarthy (DTI).

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

Econ Pol: Indebtedness Pt 3

CONFIDENTIAL

f-le Xo

10 DOWNING STREET

From the Private Secretary

30 November 1983

BRAZIL

The Prime Minister has seen your letter of 25 November reporting the most recent developments on Brazil. She has noted this report and agrees that no further offer of export credit is desirable at this stage. She commented that, as she had expected, the Germans and French had conceded additional offers of export credits. She is concerned that what is a very creditable story on the UK's contribution to Brazilian debt is not being adequately reported in Brazil. She would be grateful if steps could be taken to correct this.

I am copying this letter to Brian Fall (Foreign and Commonwealth Office), Callum McCarthy (Department of Trade and Industry) and to John Bartlett (Bank of England).

ANDREW TURNBULL

John Kerr Esq
HM Treasury

CONFIDENTIAL

CONFIDENTIAL

CF NO

(2)

Foreign and Commonwealth Office

London SW1A 2AH

30 November 1983

Dear John,

Brazil

Thank you for your letter of 30 November, with which you enclosed a draft message from the Chancellor to his Brazilian counterpart. This arrived after I had sent my letter of the same date to Andrew Turnbull at No 10.

The Foreign Secretary would be happy to despatch the Chancellor's message as it stands. At the same time he suggests that the Ambassador should be authorised to make the points set out in my letter when he hands the Chancellor's message to the Brazilian Finance Minister. He would like therefore to await the Prime Minister's reaction to the line which we have proposed before we deliver the Chancellor's message.

I am copying this letter to Andrew Turnbull (No 10) and Calum McCarthy (DTI).

Yours ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

J O Kerr Esq
Principal Private Secretary
H M Treasury

CONFIDENTIAL

Econ Pol: Indebtedness Pt3

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

30 November 1983

B J P Fall Esq.
Principal Private Secretary
Foreign and Commonwealth Office

Dear Brian,

BRAZIL

Now that the dust has settled on the Brazilian financial package, the Chancellor would like to reply to the message which the Brazilian Finance Minister sent last month - Brasilia telegram No. 385. I enclose a copy of the Chancellor's message, and would be grateful if you could arrange for our Ambassador to deliver it.

The Chancellor hopes that the Ambassador will take this - and every - opportunity to emphasise to the Brazilian Government the constructive and generous attitude which the British Government has adopted throughout the Brazilian operation, and the full extent of UK support. It is clearly desirable that he should counter the critical reports in the Brazilian press which have been so fully reported in the telegrams from Brasilia.

I am copying this letter to Andrew Turnbull at No.10 and Callum McCarthy at the DTI.

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

MESSAGE FROM THE CHANCELLOR OF THE EXCHEQUER TO BRAZILIAN FINANCE MINISTER GALVEAS

You sent me a message last month, following our discussion in Washington in September, and I have kept your points very much in mind throughout the autumn. I should now like to let you know how much I welcome the successful outcome last week of the negotiations on support for Brazil by Governments, international organisations and the commercial banks.

You referred to prospects for future co-operation between our two countries. We have been happy to play a positive role during the international negotiations. In addition to the overall contribution of $1.4 billion made by British commercial banks to both last year's and this year's financial package - a contribution which exceeds that of any of our European partners' banks - the Government played a constructive role in the IMF discussions and is, as you know, taking on a very significant share - some $331 million - of the total burden of the restructuring of officially-guaranteed debt agreed in the Paris Club. All this amounts to a very substantial contribution.

As for continuing support for trade, I was pleased to hear from the representatives of the IMF that the remaining financing gap had been filled. I am happy to reassure you that the UK continues to make available for Brazil cover for short term credits, and will allow further drawings on existing medium term credits for existing contracts.

I appreciate the difficult decisions which the Brazilian Government, and you personally, have had to take in drawing up a satisfactory adjustment programme. I wish you every success in implementing it.

NIGEL LAWSON

H.M. Treasury
London
30 November 1983

(1) CE AT

Foreign and Commonwealth Office

London SW1A 2AH

30 November, 1983

Dear Andrew,

Brazil

with AT?

The Foreign Secretary has seen John Kerr's useful letter of 25 November, which arrived here yesterday.

The Foreign Secretary agrees that the Brazilians should be reminded of the substantial existing contribution which the UK is making to the Brazilian rescue package. The Ambassador in Brasilia has already been asked to put this across to the Brazilian government. Sir Geoffrey would like to reaffirm these instructions to the Ambassador. In particular he should be asked to point out that, in addition to the major role played by UK banks, HMG has made a substantial contribution through the BIS bridging loan earlier this year, the recently agreed Paris Club restructuring operation and, more generally, the UK contribution to financing the IMF.

At the Prime Minister's meeting on 16 November she said that our objective should still be to hold our contribution on official debt to the current offer. The UK should continue to encourage France and Germany to hold the line in order to secure the maximum contribution from the US. The meeting recognised the political disadvantage of being isolated vis-a-vis Brazil and the other industrial countries. If, at the end of the day, the package was in difficulty and other industrial countries were proposing to increase their contribution, the UK could consider making an additional contribution on a very limitied scale, eg one comensurate with the importance of trade with Brazil.

It is clear we are becoming isolated in our relations with Brazil. The Brazilians regard eventual willingness to participate in providing new export credits as the touchstone of relations with Western governments. The Ambassador has reported mounting criticism of our position both by Government Ministers and in the press. We are also coming under pressure at home from MPs and senior businessmen over the apparent rift in our relations with Brazil. The Foreign Secretary will be receiving members of the British/Brazil Parliamentary Group later today. The European press, especially the French, has not been slow to report this rift. Unless we take action to check the drift, considerable damage could be caused to our political relations with Brazil.

/As

As Mr Kerr's letter points out, the IMF has pencilled in a contribution of $20 million from the UK to the package of new export credits. This sum contrasts with the very substantial indicative figures for France and Germany. Since we have not discouraged the IMF from using this figure, the IMF must regard this as a fairly clear hint of our eventual readiness to participate with a modest share. At the same time it is not clear that the Brazilians are yet aware of this. Our Ambassador in Brasilia is likely to be tackled on this issue. If the Prime Minister agrees, Sir Geoffrey would propose to instruct him to take the line, if asked, that the Managing Director of the IMF reassured both the recent Executive Board meeting and the Paris Club that the $2.5 billion of new export credits would be forthcoming. The Brazilians will know that he did this after consultation with a number of governments including our own. The Ambassador should say that we are not privy to the details of all these consultations. He should not be drawn into speculation about a specific UK commitment, and would leave it to the Brazilians to draw their own conclusions.

We do not think there is any question, at this stage, of our committing a specific amount of new export credits. As John Kerr's letter points out, there is a good deal of uncertainty about the size of any financing gap, and the extent to which other European governments would be prepared formally to commit themselves to the indicative figures which they gave the IMF. Our concern is that in the meantime, we should not allow ourselves to be politically isolated in our relations with Brazil.

I am copying this letter to John Kerr (HM Treasury), Callum McCarthy (DTI) and John Bartlett (Bank of England).

Yours ever,

Peter Ricketts

(P F Ricketts)
Private Secretary

Andrew Turnbull Esq
10 Downing Street

Econ Pol: Indebtedness
Pt 3

30 NOV 1983

PRIME MINISTER

See overpage

BRAZIL

The FCO's first letter arrived after I had minuted out that you thought that no further offer of export credit should be made for the time being.

The FCO are proposing that we should now go public on the $20 million which the IMF has pencilled in against the UK. This is not, as was originally argued, because such an offer is necessary to stop the debt package falling apart, since that seems to have been successfully put together, but is in order to placate criticism in Brazil. The arguments against this course are:

(i) We do not appear to be under pressure from other industrial countries to make a further offer;

(ii) In the process of rescheduling the total of debts concerned turned out to be larger than expected, and the additional export credit required seems to have been found. It is possible, therefore, that the IMF may never come round to ask us to deliver the additional credit. In which case, it would be foolish to offer it now;

(iii) We have a good case on Brazil, provided that it is properly deployed.

You asked specifically for efforts to be made to present our case better. The Chancellor has responded by preparing the attached message to the Brazilian Finance Minister. The FCO are content for it to be sent except that they want to add a reference to the $20 million. It seems unlikely that this would significantly improve the impact of the message since it is a tiny sum in relation to the UK's total contribution and looks small in relation to the offers made by Germany and France.

/ Agree,

Agree, therefore, that your original decision stands?

You wanted to see the telegrams from Brazil reporting criticism of the UK. These are attached.

AT

Original decision stands. To mention the $20m would only draw forth the German & French sums and we should look ungenerous by contrast

MT

30 November 1983

CONFIDENTIAL

vcc CHGM Pt 7

Indebtedness

BF

10 DOWNING STREET

From the Private Secretary

29 November 1983

Dear John,

Tanzania: IMF

The Prime Minister today had a brief conversation with the President of Tanzania in the margins of CHOGM. Mr. Nyerere said that the IMF were now seeking another devaluation of the Tanzanian currency on top of the two which he had had to carry out already. He urged the Prime Minister to consider this matter and use her influence with the IMF.

BF The Prime Minister said that she would look into this question on her return. I should be grateful for advice.

I am copying this letter to Peter Ricketts (Foreign and Commonwealth Office).

Yours ever

John Coles.

John Kerr, Esq.,
H.M. Treasury.

CONFIDENTIAL

10 DOWNING STREET

1

Prime Minister

To note the Chancellor's report and agree no offer at this stage of further export credit?

AT 28/11

Yes

MT.

But we need to take seriously his comment that the facts must be got across in Brazil. I see that as usual the Germans & the French gave in. MT

Andrew
N.B. the PM's question on the note attached to the minute below. We need a reply to this for Questions on Thursday.
FERB 30.11

10 DOWNING STREET

(2)

Prime Minister

News of an Argentine drawing on the $1.5 billion bank loan did not, as feared, break before Treasury questions on Thursday.

It appears that telexes have been sent out to the banks seeking agreement to a drawing on 30 November – see Guardian cutting.

The line being taken by Treasury is as attached.

AT
28/11

PS. A note on the $300 million drawing you remembered is also attached.

M

File

Government attitude to bank loans to Argentina

This is a matter for the banks themselves. International banks, including British banks, are committed to shares in a $1.5 billion international loan to Argentina.

2. The loan was signed last August after Argentina had removed their discriminatory financial measures against the UK in response to IMF requirements.

3. It might have been better for the banks to wait until the newly-elected government had taken office and come to grips with their economic and financial policies.

Will the loans be used to buy arms?

4. No. We understand $500 million is to be disbursed and this will all come straight back to the banks. $350 million will be used immediately to pay an instalment of an earlier bridging loan. The other $150 million will be used to pay off other arrears.

DAILY TELEGRAPH (PAGE 21): TUESDAY 29 NOVEMBER 1983.

Argentine loan going ahead

By ANNE SEGALL

THE first $500 million instalment of the controversial $1·1 billion international bank loan for Argentina will be paid over tomorrow in spite of Argentina's failure to settle the question of its outstanding debts to banks.

Confirmation that the payout will go ahead was provided yesterday by Lloyds Bank, acting as agent for the British banks in the loan. Between them the British banks are providing roughly 10 p.c. of Argentina's new money demands.

Banks had originally insisted that Argentina should first reach agreement with its international bank creditors on rescheduling roughly $6 billion of public sector debts before new funds were made available.

But they have since agreed to waive this demand under pressure from Argentina's incoming economy minister, Sr Bernardo Grinspun, who wants the question left open until the newly-elected government takes office on December 10.

Banks were relieved when Argentina's first elections for eight years produced a victory for the Radical party early in November. But Sr Grinspun's recent comments have raised some concern among the country's bank creditors because of the emphasis he has placed on seeking better terms on rescheduled debts.

The $1·1 billion medium-term loan for Argentina unleashed a storm of protest in Britain when it was first announced last December.

Concern has continued to be expressed over the inability of Argentina's creditors to prevent the country using outside finance to support a programme of heavy arms purchases.

By making the new money available now banks are hoping to help Argentina clear existing interest arrears.

From: P Mountfield
Date: 25 November 1983

MR TOWERS IDT

cc -

PS/Chancellor
Mr Littler
Mr Unwin
Mr Lavelle
Mrs Case
Mr Denison

Mr Balfour Bank of England
Mr Appleyard, FCO

ARGENTINA

I attach some defensive briefing (agreed with Mr Littler and cleared with Bank and FCO) on the points raised in the Guardian story this morning.

PM

P Mountfield

ARGENTINA: NEW BANK LOAN AND ARMS SALES

PRESS LINE (DEFENSIVE ONLY)

1. Is the Guardian report correct?

We have no direct knowledge of these negotiations, which are nothing to do with HMG. But we have no reason to doubt the report.

2. Was HMG aware of the new loan?

Yes, although we are not familiar with the details; but HMG's approval is not needed, and we did not need to be consulted.

3. Does HMG approve?

The banks appear to be acting under an existing contractual commitment (signed in August). So far as we know, the conditions of the contract have been met in general terms. Our understanding is that the conditions allow for waiver in certain respects and this is the point which the banks are now considering.

The IMF standly remains technically in existence but no further disbursements are being made or contemplated at present. We beleive that the IMF expect to resume discussions when the new government is in office in the hope of establishing a satisfactory revised programme. For this purpose it might have been better to wait ~~it is questionable whether it would have been better to wait~~ until the new government was in office and had begun the programme of economic recovery which has been promised. This would have provided a basis for a revised IMF programme, and that in turn would have given the banks greater assurance.

4. Will the loans be used to buy arms?

No. Of the $500m which we understand is to be disbursed at the end of November, $350m is to be used immediately to repay an earlier bridging loan, while the remaining $150m will go into an escrow account to be used to pay off other arrears.

5. US resuming arms sales?

/Ask the FCO./

including loans to pay for armaments?

6. Will HMG join in a rescheduling of offical /public sector/ debt?

No request has been recived for any debt restructuring.

7. Past Government statements?

/See attached Hansard extracts./

25/xi

Argentina to get $500m aid

By Peter Rodgers, Financial Correspondent

Argentina is expected to get a $500 million cash injection by next Wednesday from British and other banks, in a rushed deal which it is hoped will pre-empt any attempt by the new civilian government to fundamentally renegotiate terms with foreign creditors.

The arrangement, put together late on Wednesday night at the headquarters of Citibank in New York, is also designed to allow the Argentines to catch up with some of the overdue interest payments. Otherwise American banks will be forced by their auditors to make huge and damaging loan write-offs at the year end.

Some banks have had reservations about handing over the $500 million by the end of this month, because the new civilian government does not take over from the military until December 10. The money will also have to be paid over before a series of rescheduling deals with Argentine public sector bodies is signed, which until now has been a condition of payment.

The $500 million is part of a $1.5 billion medium-term loan first mooted over a year ago but continually delayed. Argentina has indicated that it wants better terms from the banks next year but has been ambiguous about whether it will try and change the terms of the present loan. Argentine central banks officials at the Citibank meeting in New York were suggesting however that they have agreed the proposal to go ahead next week.

So far 90 per cent of the several hundred banks involved have agreed to payment by next Wednesday, and the leading banks are now trying to whip the rest into line.

Yesterday telexes went out from Citibank and from the steering group of banks organising the loan.

The Citibank telex said that Argentina will be drawing $500 million by or on November 30. It said banks were asked to waive two loan conditions — that interest on bank debt should be up to date and that public-sector reschedulings should be "in place" by December 15. The new economy minister, Mr Bernardo Grinspun, has indicated that he wants to revise some of the terms of the rescheduling and it now looks as if signature could be delayed past the year end.

A second telex from the steering group confirmed that with the new government coming in on December 10, it would be impossible to finish the rescheduling deals by December 15, which had been the original target date.

The $500 million will be instantly recycled to the banks to repay a bridging loan and interest arrears to the end of September, and possibly into October. The British banks, led by Lloyds, appear to be in favour of this scheme.

extract Hansard 24 3 83 OA 1008 - 1010 Vol 39

Argentina (Bank Loan)

7. Mr. Newens asked the Chancellor of the Exchequer whether he has given any advice to British banks about their involvement in a consortium of foreign banks which is seeking to negotiate the new medium term loan to Argentina following the Argentine decision to suspend repayment on nearly £1,000 million of its foreign debt.

Mr. Bruce-Gardyne: No, Sir. This must be a matter for the individual banks concerned. The swap facilities, to which I assume the hon. Gentleman refers in the latter part of his question, form part of the foreign debt obligations of Argentina which are the subject of negotiations currently in progress between that country and international banks.

Mr. Newens: Will the hon. Gentleman confirm that there are no conditions attached to the loan to prevent the Argentine Government from using it to purchase arms, and that recently the Almirante Brown has been delivered, replete with British components, along with 70 Mirage III or Dagger jet fighters? Numerous other items are on order. Is it not a disgrace that the Government are prepared to finance the rearming of Fascist Argentina?

Mr. Bruce-Gardyne: The part of the hon. Gentleman's question relating to Argentina's recent acquisition of frigates is not a matter for the Treasury— [HON. MEMBERS: "Oh".] There is no shortage of arms sellers around the world. We would not deny the Argentines the opportunity of purchasing arms by driving Argentina into default.

Mr. Newens: Really. What a disgrace.

Mr. Bruce-Gardyne: It is clear that this loan is an integral part of the IMF programme for Argentina which puts tight controls on Argentina's public finances. If Argentina diverted money to buy more arms that could jeopardise the IMF programme and hence Argentina's ability for future drawings.

Mr. James Lamond: Disgraceful.

Mr. McCrindle: On the more general point, is it the Government's view that no one economy can be allowed to disintegrate without a substantial knock-on effect on its neighbours and, ultimately, on the whole international economic scene? In those circumstances, does my hon. Friend agree that the Government have no alternative but to pursue their policies irrespective of their views of the regime in Buenos Aires?

Mr. Bruce-Gardyne: My hon. Friend is entirely right. We are a major trading nation and we depend upon exports for a larger proportion of our total output than do most other major trading nations and upon a steady expansion of international trade. A default that was triggered in Argentina by a failure to resolve the immediate problems of Argentina's indebtedness could have repercussions in other countries and serious implications for international trade that would be seriously to our disadvantage.

Mr. Dalyell: To borrow the Minister's graphic phrase of last year, is not this a mug's game?

Mr. Bruce-Gardyne: No, Sir. It would be a mug's game to perform otherwise.

Mr. Eggar: If Argentina were to default, would that not mean that British banks would have to write off considerable loans. *[Interruption.]* Before the Opposition jump for joy will my hon. Friend confirm that the effect would be a reduction in their capital base which would mean that they would find difficulty in lending to domestic companies? Would not that mean a reduction in jobs?

Mr. Cryer: I think that the hon. Gentleman is a merchant banker.

Mr. Bruce-Gardyne: My hon. Friend is entirely right. The propositions advanced by the Opposition would be damaging to international trade and to the structure of international banking and would ultimately have repercussions on employment.

Mr. Robert Sheldon: Is the hon. Gentleman aware of Tuesday's report in the *Financial Times*, that despite Argentina's reduction in interest arrears, the conditions for the \$1·5 billion loan have not yet been settled? As the Prime Minister has stated categorically that the money is not being lent to purchase armaments, why is that not to be a condition of the loan?

Mr. Bruce-Gardyne: As the right hon. Gentleman knows well, international arms trading is conducted on credit which is not necessarily pervious to the consequences of such banking negotiations. All the arrangements that are being conducted by the IMF are designed to ensure that Argentina, like other countries with debt problems, pursues correction policies that will enable it to settle its debts and not involve itself in additional outgoings that it could not meet.

Mr. Newens: On a point of order, Mr. Speaker. In view of that disgraceful Pontius Pilate-like reply, I shall seek to raise the matter on the Adjournment.

Mr. Dalyell: Further to that point of order, Mr. Speaker.

Mr. Speaker: Order. There can be no further point of order on that point of order except to the extent that it was not expressed in the usual language.

Mr. Dalyell: Further to that point of order, Mr. Speaker. I give notice that I intend to raise this matter tonight on the Consolidated Fund (No. 2) Bill.

Pratts Bottom

Q2. Mr. Stanbrook asked the Prime Minister if she will pay an official visit to Pratts Bottom.

The Prime Minister: I have at present no plans to do so, although I know Pratts Bottom well because I used to live within walking distance. Will my hon. Friend please give my warm regards to the people there?

Mr. Stanbrook: Is my right hon. Friend aware that her reply, notwithstanding her good wishes, will be deeply disappointing to the villagers of Pratts Bottom? Is she aware that they seek an early opportunity to express to her their appreciation of the benefits of the Budget—*[Interruption.]*—in which they are keenly interested, especially the raising of the tax threshold and the further relief given to mortgagors?

The Prime Minister: I am grateful for my hon. Friend's warm and fully justified praise for my right hon. and learned Friend's Budget. I am especially grateful for his praise of the extra relief on mortgages. In the Greater London area, about 23 per cent. of first-time house purchasers, and about 30 per cent. of those not buying for the first time, have mortgage loans above the former tax relief limit. The extra relief is well deserved.

Mr. Christopher Price: Is the Prime Minister aware that, were she to visit Pratts Bottom, she would be in P district of the Metropolitan police area and that, to get there, she would have to drive through my constituency down the Bromley road? Is she aware that if she happened to stop on Bromley road, get out of her car and talk to my constituents about the Police and Criminal Evidence Bill, she would find them enormously encouraged by the remarks of her right hon. Friend the Home Secretary from the Dispatch Box on Tuesday—when she was unhappily away—to the effect that the Government intend to withdraw two clauses from the Bill because they know that it will be rubbished by the bishops and the judges in the House of Lords? Will she tell us about the Government's exact intentions in respect of that Bill now that it has fallen into such contempt on both sides of the House?

The Prime Minister: My right hon. Friend the Home Secretary has audibly dissented from the hon. Gentleman's interpretation of his remarks when I was away on Tuesday. The hon. Gentleman will accept that the Bill was based on the findings of a Royal Commission. He will also accept that we wish to fight crime with every possible legitimate weapon, and it is important that we should be denied neither the means of identification nor the means of proof for fighting those crimes.

Engagements

Q3. Mr. Heddle asked the Prime Minister if she will list her official engagements for Thursday 24 March.

The Prime Minister: This morning I presided at a meeting of the Cabinet and had meetings with ministerial colleagues and others. In addition to my duties in the House I shall be having further meetings later today. This evening I shall be attending a dinner given by President Kaunda.

Mr. Heddle: Does my right hon. Friend agree that for far too long teacher training courses have contained too many irrelevant and spurious subjects such as sociology and psychology? Does she agree that the timely announcement earlier this week by my right hon. Friend the Secretary of State for Education and Science will better equip teachers to teach children real subjects that will be of practical benefit to them in the real world? Will she undertake to bring forward the White Paper proposals as early as possible?

The Prime Minister: I welcome my right hon. Friend's White Paper on the training of teachers. There is an opportunity to improve teaching in our schools, to secure a match of teachers' qualifications with the shortage subjects, which is most important, and to assess what really matters, which is their competence in the classroom. Those things will be done and will be warmly welcomed in the country.

Mr. Foot: Perhaps the Prime Minister can help us by clearing up the confusion created by some answers we heard earlier this afternoon from Treasury spokesmen about loans to Argentina. Can she confirm that talks on the legal conditions of the loan have proved difficult, as was reported in a newspaper a few days ago? Have those difficulties been created by the British Government because they are trying, at last, to lay down conditions about the expenditure of that money on arms?

The Prime Minister: I remember the right hon. Gentleman saying from that Dispatch Box that it was no earthly good trying to lay down such conditions, but his question now is completely different. We supported the loans from the IMF to Argentina on certain stringent conditions. There are two commercial loans to which different conditions apply. We supported the loans for two reasons. First, in the absence of either an IMF loan or commercial loans there was a possibility that Argentina would default. If it did so, it would have far more money to spend on arms than if it met the debt. *[Interruption.]* I am afraid that is a fact of life. Furthermore, unless Argentina receives some help, it could default to third countries and, therefore, trigger off the collapse of the difficult and delicate packages that were agreed between the IMF and those countries. Therefore, it was in our interests to do what we did, both through the IMF and through the agreement of two commercial loans under different circumstances.

Mr. Foot: Does the right hon. Lady stand by her statement of 27 January that the money has not been lent for arms? Is it not the case that, under the plans that she is now apparently allowing to go ahead, the money may be spent on arms? Does she take account of the fact that, according to recent reports, up to £6 million of Argentina's £38 million foreign debt is believed to have been spent on defence? Is she aware that Argentina has greatly increased its arms supplies, some of which may have been paid for with British money?

The Prime Minister: The right hon. Gentleman has still not taken note of my first point. The alternative was that Argentina may default. *[Interruption.]* The right hon. Gentleman may not like it, but if a country defaults on all its debts, much more money is released that could pay for arms than would have been the case if that country was held to repaying its debts. That is obvious.

Mr. David Steel: Has the Prime Minister had time to see the study by the Association for the Conservation of Energy, which suggested that 150,000 new jobs could be

EXTRACT FROM HANSARD 20.7.83
VOL 46 . Nº 25 WA 142/3

Argentina (Arms Purchases)

Mr. Dalyell asked the Prime Minister what evidence Her Majesty's Government have for the statement by the Economic Secretary to the Treasury, *Official Report*, 11 July, c. 617, that International Monetary Fund loans will make Argentina less likely to purchase arms.

The Prime Minister: The International Monetary Fund cannot lay down the detailed public expenditure programmes. It requires a disciplined financial policy which limits the level of public expenditure and which sets other performance targets. To the extent, therefore, that Argentina is forced to give priority to paying debt, controlling public expenditure and limiting borrowing, its ability to purchase arms should be constrained.

4 AD

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

25 November 1983

Andrew Turnbull Esq
10 Downing Street
LONDON
SW1

Dear Andrew,

BRAZIL

The Prime Minister might like to see a summary of developments on Brazil since her meeting on 16 November.

The two main developments were reported by telegram:-

- on 22 November the IMF Board agreed to a revised economic and financial programme and hence to further drawings by Brazil. This was on the basis that additional financial support from rescheduling of official debt, new commercial bank loans, and additional official export credit, would all be forthcoming;

- rescheduling of official and officially-guaranteed debt was agreed at a meeting of the Paris Club on 22/23 November. The original estimate by the IMF based on Brazilian sources was that the amount involved could be around \$2 billion. In the event, some \$3.8 billion proved to be under discussion. I understand that a discrepancy of this kind is not surprising or unusual, when knowledge available to creditors is added to knowledge available to the government of the debtor country, although the size of the discrepancy this time is unusually large. You may recall that the UK component, which we had previously reported as being about £200 million, and which is currently identified by us as \$331 million, was originally reported from the IMF as only about \$200 million. A very large difference emerged for Japan, and substantial ones for many other countries. Within the framework of the Paris Club agreement, details will now be negotiated bilaterally. In our case the technique will, as the Prime Minister knows, mainly be that of refinancing, which minimises the costs falling on the PSBR and ECGD trading accounts this year and next (and, if the refinanced debts are repaid on the new schedule, avoids costs to the PSBR completely). The benefit to the Brazilians is, as noted in your letter, identical with that of rescheduling.

You saw a report by Geoffrey Littler of talks in Paris last week about the question of additional export credit from governments. The result of the soundings carried out by the Deputy Managing Director of the IMF (Dale) was that the IMF asserted confidently that they would raise the target of \$2.5 billion of new export credit. We do not know the details by country - it was a key feature of the deal that the IMF took soundings bilaterally and in confidence. But we have some picture of how the total may have been built up.

The United States will certainly have offered $1.25 billion, and may have been pushed a little higher. In private conversation, we learned that Germany may be thinking in terms of $250 million (apparently they have a good deal of continuing business in the pipeline). From French reactions when their officials and ours together heard of this, we infer that the French contribution might be of the order of $100 million. Our impression is that the Japanese will have wanted to keep close to Germany, and offer about the same. The IMF were hoping for something from Saudi Arabia, Brazil's main oil supplier, and there would be bits and pieces from other countries. At the end of the day, the indicated total would probably fall a little short of the target, and need to be rounded up. Indeed, this thought is supported by the fact that, without seeking a commitment from us, the Deputy Managing Director told Nigel Wicks that he had included a token $10-20 million for the UK - a somewhat generous interpretation of what he was told by Littler. * But the Chancellor does not propose to instruct Wicks to challenge it: it is the IMF's figure, and in no way commits us.

We are not under any pressure from the IMF, or from other creditor countries - or indeed from British banks - to change our public position. The only complaint seems to be from Brazil, and particularly some critical articles in the Brazilian press. But the facts are that we have treated Brazil generously; we are significant contributors through the IMF; British banks are taking a substantial share in commercial support; we are contributing fully in the rescheduling operation; and we have, of course, at no stage attempted to frustrate the package as a whole. In the Chancellor's view, these facts need to be got across in Brazil.

I agree

Finally, there is the question of whether we should in practice now take on new export credit. The Chancellor considers it prudent for the present not to do so. It would be very unusual to extend new credit while the details of our Paris Club refinancing are still under discussion. And, inevitably, there is a good deal of uncertainty about whether Brazil will actually implement the programme agreed with the IMF. If they fail to do so, any new export credit we would have given in the interval would simply have increased our exposure, and ECGD's potential loss. If, in a few months' time, it seems that matters are progressing more satisfactorily, we can review the matter.

Copies of this letter go to Brian Fall (FCO), Callum McCarthy (DTI), and John Bartlett (Bank of England).

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

* What Littler told Dale was "You would be lucky to get into double figures in millions of dollars".

Econ Pol: Indebtedness

PTJ

28 NOV 1983

File

From: P Mountfield
Date: 25 November 1983

MR TOWERS IDT

cc -

PS/Chancellor
Mr Littler
Mr Unwin
Mr Lavelle
Mrs Case
Mr Denison

Mr Balfour Bank of England
Mr Appleyard, FCO

ARGENTINA

I attach some defensive briefing (agreed with Mr Littler and cleared with Bank and FCO) on the points raised in the Guardian story this morning.

PM

P Mountfield

ARGENTINA: NEW BANK LOAN AND ARMS SALES

PRESS LINE (DEFENSIVE ONLY)

1. Is the Guardian report correct?

We have no direct knowledge of these negotiations, which are nothing to do with HMG. But we have no reason to doubt the report.

2. Was HMG aware of the new loan?

Yes, although we are not familiar with the details; but HMG's approval is not needed, and we did not need to be consulted.

3. Does HMG approve?

The banks appear to be acting under an existing contractual commitment (signed in August). So far as we know, the conditions of the contract have been met in general terms. Our understanding is that the conditions allow for waiver in certain respects and this is the point which the banks are now considering.

The IMF standly remains technically in existence but no further disbursements are being made or contemplated at present. We beleive that the IMF expect to resume discussions when the new government is in office in the hope of establishing a satisfactory revised programme. For this purpose it might have been better to wait ~~it is questionable whether it would have been better to wait~~ until the new government was in office and had begun the programme of economic recovery which has been promised. This would have provided a basis for a revised IMF programme, and that in turn would have given the banks greater assurance.

4. Will the loans be used to buy arms?

No. Of the \$500m which we understand is to be disbursed at the end of November, \$350m is to be used immediately to repay an earlier bridging loan, while the remaining \$150m will go into an escrow account to be used to pay off other arrears.

5. US resuming arms sales?

/Ask the FCO./

Will HMG join in a rescheduling of offical [public sector] debt?

No request has been recived for any debt restructuring.

7. Past Government statements?

[See attached Hansard extracts.]

25/xi

Argentina to get $500m aid

By Peter Rodgers,
Financial Correspondent

Argentina is expected to get a $500 million cash injection by next Wednesday from British and other banks, in a rushed deal which it is hoped will pre-empt any attempt by the new civilian government to fundamentally renegotiate terms with foreign creditors.

The arrangement, put together late on Wednesday night at the headquarters of Citibank in New York, is also designed to allow the Argentines to catch up with some of the overdue interest payments. otherwise American banks will be forced by their auditors to make huge and damaging loan write-offs at the year end.

Some banks have had reservations about handing over the $500 million by the end of this month, because the new civilian government does not take over from the military until December 10. The money will also have to be paid over before a series of rescheduling deals with Argentine public sector bodies is signed, which until now has been a condition of payment.

The $500 million is part of a $1.5 billion medium-term loan first mooted over a year ago but continually delayed. Argentina has indicated that it wants better terms from the banks next year but has been ambiguous about whether it will try and change the terms of the present loan. Argentine central banks officials at the Citibank meeting in New York were suggesting however that they have agreed the proposal to go ahead next week.

So far 90 per cent of the several hundred banks involved have agreed to payment by next Wednesday, and the leading banks are now trying to whip the rest into line.

Yesterday telexes went out from Citibank and from the steering group of banks organising the loan.

The Citibank telex said that Argentina will be drawing $500 million by or on November 30. It said banks were asked to waive two loan conditions — that interest on bank debt should be up to date and that public-sector reschedulings should be "in place" by December 15. The new economy minister, Mr Bernardo Grinspun, has indicated that he wants to revise some of the terms of the rescheduling and it now looks as if signature could be delayed past the year end.

A second telex from the steering group confirmed that with the new government coming in on December 10, it would be impossible to finish the rescheduling deals by December 15, which had been the original target date.

The $500 million will be instantly recycled to the banks to repay a bridging loan and interest arrears to the end of September, and possibly into October. The British banks, led by Lloyds, appear to be in favour of this scheme.

extract Hansard 24 3 83 VOL 39
OA 1008 - 1010

Argentina (Bank Loan)

7. Mr. Newens asked the Chancellor of the Exchequer whether [illegible] has given any advice to British banks about their involvement in a consortium of foreign banks which is seeking to negotiate the new medium term loan to Argentina following the Argentine decision to suspend repayment on nearly £1,000 million of its foreign debt.

Mr. Bruce-Gardyne: No, Sir. This must be a matter for the individual banks concerned. The swap facilities, to which I assume the hon. Gentleman refers in the latter part of his question, form part of the foreign debt obligations of Argentina which are the subject of negotiations currently in progress between that country and international banks.

Mr. Newens: Will the hon. Gentleman confirm that there are no conditions attached to the loan to prevent the Argentine Government from using it to purchase arms, and that recently the Almirante Brown has been delivered, replete with British components, along with 70 Mirage III or Dagger jet fighters? Numerous other items are on order. Is it not a disgrace that the Government are prepared to finance the rearming of Fascist Argentina?

Mr. Bruce-Gardyne: The part of the hon. Gentleman's question relating to Argentina's recent acquisition of frigates is not a matter for the Treasury—[HON. MEMBERS: "Oh".] There is no shortage of arms sellers around the world. We would not deny the Argentines the opportunity of purchasing arms by driving Argentina into default.

Mr. Newens: Really. What a disgrace.

Mr. Bruce-Gardyne: It is clear that this loan is an integral part of the IMF programme for Argentina which puts tight controls on Argentina's public finances. If Argentina diverted money to buy more arms that could jeopardise the IMF programme and hence Argentina's ability for future drawings.

Mr. James Lamond: Disgraceful.

Mr. McCrindle: On the more general point, is it the Government's view that no one economy can be allowed to disintegrate without a substantial knock-on effect on its neighbours and, ultimately, on the whole international economic scene? In those circumstances, does my hon. Friend agree that the Government have no alternative but to pursue their policies irrespective of their views of the regime in Buenos Aires?

Mr. Bruce-Gardyne: My hon. Friend is entirely right. We are a major trading nation and we depend upon exports for a larger proportion of our total output than do most other major trading nations and upon a steady expansion of international trade. A default that was triggered in Argentina by a failure to resolve the immediate problems of Argentina's indebtedness could have repercussions in other countries and serious implications for international trade that would be seriously to our disadvantage.

Mr. Dalyell: To borrow the Minister's graphic phrase of last year, is not this a mug's game?

Mr. Bruce-Gardyne: No, Sir. It would be a mug's game to perform otherwise.

Mr. Eggar: If Argentina were to default, would that not mean that British banks would have to write off considerable loans. *[Interruption.]* Before the Opposition jump for joy will my hon. Friend confirm that the effect would be a reduction in their capital base which would mean that they would find difficulty in lending to domestic companies? Would not that mean a reduction in jobs?

Mr. Cryer: I think that the hon. Gentleman is a merchant banker.

Mr. Bruce-Gardyne: My hon. Friend is entirely right. The propositions advanced by the Opposition would be damaging to international trade and to the structure of international banking and would ultimately have repercussions on employment.

Mr. Robert Sheldon: Is the hon. Gentleman aware of Tuesday's report in the *Financial Times*, that despite Argentina's reduction in interest arrears, the conditions for the $1·5 billion loan have not yet been settled? As the Prime Minister has stated categorically that the money is not being lent to purchase armaments, why is that not to be a condition of the loan?

Mr. Bruce-Gardyne: As the right hon. Gentleman knows well, international arms trading is conducted on credit which is not necessarily pervious to the consequences of such banking negotiations. All the arrangements that are being conducted by the IMF are designed to ensure that Argentina, like other countries with debt problems, pursues correction policies that will enable it to settle its debts and not involve itself in additional outgoings that it could not meet.

Mr. Newens: On a point of order, Mr. Speaker. In view of that disgraceful Pontius Pilate-like reply, I shall seek to raise the matter on the Adjournment.

Mr. Dalyell: Further to that point of order, Mr. Speaker.

Mr. Speaker: Order. There can be no further point of order on that point of order except to the extent that it was not expressed in the usual language.

Mr. Dalyell: Further to that point of order, Mr. Speaker. I give notice that I intend to raise this matter tonight on the Consolidated Fund (No. 2) Bill.

Pratts Bottom

Q2. Mr. Stanbrook asked the Prime Minister if she will pay an official visit to Pratts Bottom.

The Prime Minister: I have at present no plans to do so, although I know Pratts Bottom well because I used to live within walking distance. Will my hon. Friend please give my warm regards to the people there?

Mr. Stanbrook: Is my right hon. Friend aware that her reply, notwithstanding her good wishes, will be deeply disappointing to the villagers of Pratts Bottom? Is she aware that they seek an early opportunity to express to her their appreciation of the benefits of the Budget—*[Interruption.]*—in which they are keenly interested, especially the raising of the tax threshold and the further relief given to mortgagors?

The Prime Minister: I am grateful for my hon. Friend's warm and fully justified praise for my right hon. and learned Friend's Budget. I am especially grateful for his praise of the extra relief on mortgages. In the Greater London area, about 23 per cent. of first-time house purchasers, and about 30 per cent. of those not buying for the first time, have mortgage loans above the former tax relief limit. The extra relief is well deserved.

Mr. Christopher Price: Is the Prime Minister aware that, were she to visit Pratts Bottom, she would be in P district of the Metropolitan police area and that, to get there, she would have to drive through my constituency down the Bromley road? Is she aware that if she happened to stop on Bromley road, get out of her car and talk to my constituents about the Police and Criminal Evidence Bill, she would find them enormously encouraged by the remarks of her right hon. Friend the Home Secretary from the Dispatch Box on Tuesday—when she was unhappily away—to the effect that the Government intend to withdraw two clauses from the Bill because they know that it will be rubbished by the bishops and the judges in the House of Lords? Will she tell us about the Government's exact intentions in respect of that Bill now that it has fallen into such contempt on both sides of the House?

The Prime Minister: My right hon. Friend the Home Secretary has audibly dissented from the hon. Gentleman's interpretation of his remarks when I was away on Tuesday. The hon. Gentleman will accept that the Bill was based on the findings of a Royal Commission. He will also accept that we wish to fight crime with every possible legitimate weapon, and it is important that we should be denied neither the means of identification nor the means of proof for fighting those crimes.

Engagements

Q3. Mr. Heddle asked the Prime Minister if she will list her official engagements for Thursday 24 March.

The Prime Minister: This morning I presided at a meeting of the Cabinet and had meetings with ministerial colleagues and others. In addition to my duties in the House I shall be having further meetings later today. This evening I shall be attending a dinner given by President Kaunda.

Mr. Heddle: Does my right hon. Friend agree that for far too long teacher training courses have contained too many irrelevant and spurious subjects such as sociology and psychology? Does she agree that the [illegible] announcement earlier this week by my right hon. Friend the Secretary of State for Education and Science will better equip teachers to teach children real subjects that will be of practical benefit to them in the real world? Will she undertake to bring forward the White Paper proposals as early as possible?

The Prime Minister: I welcome my right hon. Friend's White Paper on the training of teachers. There is an opportunity to improve teaching in our schools, to secure a match of teachers' qualifications with the shortage subjects, which is most important, and to assess what really matters, which is their competence in the classroom. Those things will be done and will be warmly welcomed in the country.

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The Prime Minister: I remember the right hon. Gentleman saying from that Dispatch Box that it was no earthly good trying to lay down such conditions, but his question now is completely different. We supported the loans from the IMF to Argentina on certain stringent conditions. There are two commercial loans to which different conditions apply. We supported the loans for two reasons. First, in the absence of either an IMF loan or commercial loans there was a possibility that Argentina would default. If it did so, it would have far more money to spend on arms than if it met the debt. *[Interruption.]* I am afraid that is a fact of life. Furthermore, unless Argentina receives some help, it could default to third countries and, therefore, trigger off the collapse of the difficult and delicate packages that were agreed between the IMF and those countries. Therefore, it was in our interests to do what we did, both through the IMF and through the agreement of two commercial loans under different circumstances.

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The Prime Minister: The right hon. Gentleman has still not taken note of my first point. The alternative was that Argentina may default. *[Interruption.]* The right hon. Gentleman may not like it, but if a country defaults on all its debts, much more money is released that could pay for arms than would have been the case if that country was held to repaying its debts. That is obvious.

Mr. David Steel: Has the Prime Minister had time to see the study by the Association for the Conservation of Energy, which suggested that 150,000 new jobs could be

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Argentina (Arms Purchases)

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PRIME MINISTER

LOANS TO ARGENTINA

When the Treasury wrote on 17 November to say that no drawings had by then been made on the $1.5 billion loan, you referred to an earlier drawing of $300 million which you said was associated with the first IMF programme.

The position is as follows. There is only one IMF programme - a 15-month standby facility of SDR 1.5 billion, which started in January 1983. The intention was that this should be drawn upon in quarterly instalments. Two drawings of SDR 300 million were made, the last in May 1983. Subsequent drawings were suspended as, by August it became apparent that the Argentine economic programme was off course and the performance criteria were not being met.

In December 1982 a bridging loan of $1.1 billion (share of UK banks $111 million) was arranged with commercial banks. The $300 million which you correctly recalled, was the last instalment of the bridging loan, drawn I believe in June. It is to repay part of this bridging loan that the $500 million instalment of the new $1.5 billion loan is being sought.

AT

24 November 1983

10 DOWNING STREET

Andrew.

On Argentina, the plot thickens, and it's clear to me that we shall have to send the PM, by Knight Delhi time, an account of what's going on, and what we're doing about it.

I hope to let you have a draft by 4.

John K.

[illegible]

[illegible] FCO DESKBY 240830Z

IMMEDIATE

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PP UKDEL IMF/IBRD, WASHINGTON

ADVANCE COPY

4

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TO IMMEDIATE FCO
TELEGRAM NUMBER 927 OF 24 NOVEMBER.
AND TO PRIORITY UKDEL IMF/IBRD, WASHINGTON.

RC
HD/ERD
PS/CHANCELLOR, TS
~~PS~~

FOLLOWING FOR CHANCELLOR FROM FOREIGN SECRETARY

MY TELNO 924: LOAN TO ARGENTINA

1. I HAVE DISCUSSED WITH THE PRIME MINISTER IN THE LIGHT OF WICK'S REPORT (UKDEL IMF/IBRD TELNO 383). AS WE UNDERSTAND IT, HE WAS NOT BRIEFED TO ARGUE IN WASHINGTON THAT WE HAD DOUBTS ABOUT THE DECISION ON NORMAL IMF/CONDITIONALITY GROUNDS. THIS MAY PUT US IN A SOMEWHAT WEAKER POSITION IN STATING PUBLICLY THAT WE REGARD THE BANKS DECISION AS PREMATURE AND REGRETTABLE. IF YOU NEVERTHELESS FEEL THAT SOME SUCH STATEMENT IS NECESSARY, IT IS IMPORTANT THAT IT SHOULD BE PRESENTED AND EXPLAINED STRICTLY IN TERMS OF OUR NORMAL APPROACH TO IMF CONDITIONALITY. WE WISH TO AVOID ANY SUGGESTION THAT OUR REACTION IS ON THIS OCCASION PROMPTED BY POLITICAL RATHER THAN TECHNICAL CONSIDERATIONS.

WADE-GERY

NNNN

Econ Pol -
Indebtedness Pt 7
with AT 24/11

CONFIDENTIAL

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cc FCO
BofE

10 DOWNING STREET

From the Private Secretary

24 November 1983

Argentina: Commercial Bank Lending

I have spoken to Robin Butler on the telephone in Delhi and have taken the opportunity to clarify the Prime Minister's view on how the Chancellor should respond if he is questioned about drawings onthe commercial bank loan. I asked specifically whether the Prime Minister thought that "premature and regrettable" was going too far. Robin said that the Prime Minister did not necessarily object to this wording but did feel that if such a statement were made it would be important to make very clear the grounds for our reservations. These would be that we were not satisfied that the Fund's normal approach to conditionality was being followed. As indicated in the Foreign Secretary's telegram No. 927, it was important to avoid any suggestion that our reaction was prompted by political considerations.

I am copying this letter to Roger Bone (Foreign and Commonwealth Office) and John Bartlett (Governor of the Bank of England's Office).

Andrew Turnbull

John Kerr, Esq.,
H.M. Treasury.

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TO IMMEDIATE FCO DESKBY 250900Z
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AND TO IMMEDIATE PARIS DESKBY 250900Z
AND TO IMMEDIATE UKDEL IMF/IBRD WASHINGTON DESKBY 251400Z
INFO SAVING RIO DE JANEIRO, SAO PAULO (ACTIONED)

Mr Turnbull

MY TELNO CULL 2: BRAZIL'S DEBT AND ANGLO-BRAZILIAN RELATIONS

1. IN MY TELNO 405 OF 19 OCTOBER I DREW ATTENTION TO THE RISK THAT OUR APPARENTLY SOLITARY OPPOSITION TO PARTICIPATING IN NEW GOVERNMENT-BACKED CREDITS TO BRAZIL MIGHT PREJUDICE OUR LONGER TERM INTERESTS IN THIS COUNTRY.

2. SINCE THEN THE BRAZILIANS HAVE REPEATEDLY VOICED THEIR CONCERN AT OUR UNYIELDING STANCE, WHICH THEY SEE AS INFLUENCING UNHELPFULLY THE ATTITUDE OF OTHER GOVERNMENTS AND THEREBY PUTTING AT RISK THE REFINANCING PACKAGE AS A WHOLE. MOST RECENTLY THIS WAS DONE BY THE BRAZILIAN AMBASSADOR TO MR CHANNON, BY KAFKA (THE BRAZILIAN IMF DIRECTOR) TO WICKS , AND BY ITAMARATY AND SEPLAN OFFICIALS TO THIS EMBASSY.

3. AS I SEE IT, ALL THAT IS REQUIRED TO DISPEL THE BRAZILIANS' SUSPICIONS AND AVERT THE RISK OF SOME DAMAGING DISCRIMINATION BY THEM AGAINST OUR TRADING INTERESTS IN FAVOUR OF OUR COMPETITORS IS A PROMPT AND AUTHORITATIVE STATEMENT THAT, IF OTHER IMPORTANT CREDITOR GOVERNMENTS PLEDGE AN APPROPRIATE CONTRIBUTION, WE SHALL DO LIKEWISE. THIS WOULD HAVE THE ADDED ADVANTAGE OF SMOKING OUT OTHERS, SUCH AS THE FRENCH, AND PERHAPS ALSO THE GERMANS AND JAPANESE, WHO I SUSPECT ARE CONVENIENTLY HIDING BEHIND OUR SKIRTS AND AVOIDING THE ODIUM WHICH IS AT PRESENT BEING FOCUSSED ENTIRELY ON US.

HARDING

FINANCIAL
S AM D
MR THOMAS

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DESKBY 231445Z
FM PARIS 231310Z NOV 83
TO IMMEDIATE FCO
TELEGRAM NUMBER 1075 OF 23 NOVEMBER
INFO PRIORITY BRASILIA, UKDEL IMF/IBRD WASHINGTON.

Mr Turnbull
To see.
[illegible] 23/11

PARIS CLUB: BRAZIL DEBT.

1. AGREEMENT WAS SIGNED TODAY BETWEEN BRAZIL AND PARIS CLUB REPRESENTATIVES ON A RESCHEDULING/REFINANCING OF OFFICIALLY GUARANTEED COMMERCIAL DEBT. THE AGREED TERMS ARE:

(A) DEBT WITH MATURITIES OF ONE YEAR OR OVER ENTERED INTO BEFORE 31 MARCH 1983 ARE INCLUDED.

(B) 85 PERCENT OF PRINCIPAL AND INTEREST FALLING DUE IN THE PERIOD 1 AUGUST 1983 TO 31 DECEMBER 1984 TO BE PAID IN 8 EQUAL INSTALMENTS COMMENCING 1 JANUARY 1989 FINISHING 1 JULY 1992.

(C) THE REMAINING 15 PERCENT TO BE PAID AS FOLLOWS:

(I) 5 PERCENT ACCORDING TO THE ORIGINAL SCHEDULE OR IF IN ARREARS ALREADY NOT LATER THAN 31 MARCH 1984.

(II) 4 PERCENT, 3 PERCENT AND 3 PERCENT ON 30 JUNE IN 1985-1987.

(D) ACCUMULATED ARREARS OF PRINCIPAL AND INTEREST DUE ON 31 JULY 1983 TO BE PAID IN 3 EQUAL INSTALMENTS ON 31 MARCH AND 30 SEPTEMBER 1984 AND 31 MARCH 1985.

2. CAMDESSUS OPENED THE DISCUSSION BY URGING GENEROSITY. THERE WAS NO DISPOSITION BY CREDITOR DELEGATIONS TO HOLD OUT FOR TOUGHER TERMS EXCEPT FROM THE DUTCH, WHO COMPLAINED THAT OFFICIAL AGENCIES WERE BEING FORCED TO ACCEPT TERMS CONSIDERABLY LESS FAVOURABLE THAN THOSE AGREED BY THE BANKS. THE ARITHMETIC ON WHICH THIS OBJECTION WAS BASED SEEMED OPEN TO QUESTION AND THEY EVENTUALLY ACCEPTED THE ABOVE TERMS.

3. THERE WAS NO DISCUSSION OF NEW PLEDGES OF EXPORT CREDIT. THE IMF (WIESNER) SAID THEY WERE CONFIDENT THAT DOLLARS 2.5 BILLION WOULD BE AVAILABLE.

4. THE CREDITORS FIGURES FOR DEBTS COVERED IN THIS SETTLEMENT ARE DOLLARS 3.8 BILLION OF THE BRAZILIAN FIGURE OF DOLLARS 2.4 BILLION: BUT IT REMAINS OBSCURE HOW MUCH OF THE EXTRA SUM IS OFFICIALLY GUARANTEED BANK CREDIT, AND THUS ORIGINALLY COUNTED UNDER A DIFFERENT HEAD IN THE OVERALL EXTERNAL DEBT STATISTICS, OR IS ADDITIONAL. THIS WILL NOT BE CLARIFIED UNTIL AFTER THE BILATERAL NEGOTIATIONS. IN THE CASE OF THE UK THE DISCREPANCY IS DOLLARS 331 MILLION (UK FIGURES) AGAINST DOLLARS 198 MILLION (BRAZILIAN FIGURES).

5. TO MINIMISE SUCH DISCREPANCIES IN FUTURE IT WAS AGREED THAT THE PARIS CLUB SECRETARIAT WOULD COLLECT CREDITORS DATA MORE QUICKLY AFTER AN APPLICATION TO THE CLUB AND TRANSMIT IT TO THE IMF ON REQUEST. THE FIRST SUCH CALL WILL BE FOR DATA ON THE PHILIPPINES.

6. FCO PLEASE ADVANCE TO: BALFOUR(BANK OF ENGLAND) MOUNTFIELD (TREASURY) TWYFORD(ECGD) APPLEYARD(FCO).

FRETWELL

(ADVANCED AS REQUESTED)

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ADVANCE ADDRESSEES

FINANCIAL
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S AMD

CONFIDENTIAL

GRS 450

UNCLASSIFIED [CULL]

FM BRASILIA 231700Z NOV 83

TO IMMEDIATE FCO DESKBY 240900Z NOV 83

TELEGRAM NUMBER CULL 2 OF 23 NOV 83

AND TO IMMEDIATE PARIS DESKBY 240900Z

AND TO IMMEDIATE UKDEL IMF/IBRD WASHINGTON DESKBY 241400Z

AND TO IMMEDIATE NEW DELHI (FOR SECRETARY OF STATE'S PARTY) DESKBY 240500Z

INFO SAVING RIO DE JANEIRO, SAO PAULO (PASSED LOCALLY)

~~Brazil file~~

Mr ~~Turnbull~~

24/11

BRAZIL'S DEBT: PRESS REACTIONS TO BRITISH POSITION

1. THE BRITISH GOVERNMENT'S NEGATIVE ATTITUDE TO BRAZILIAN REQUESTS FOR EXPORT CREDIT FINANCE IS INCREASINGLY SINGLED OUT FOR CRITICISM IN THE BRAZILIAN PRESS.

2. GENERAL COMMENT HERE ON THE OUTCOME OF THE IMF BOARD MEETING ON 22 NOVEMBER IS OF RELIEF AND SATISFACTION. BUT THREE BRAZILIAN NEWSPAPERS - FOLHA DE SAO PAULO, JORNAL DE BRASILIA AND CORREIO BRASILIENSE - CARRY IN VARYING FORMS A STORY DATELINED LONDON TO THE EFFECT THAT THE CHANCELLOR, WITH FIRM SUPPORT FROM THE PRIME MINISTER AND IN DEFIANCE OF PRESSURE NOT ONLY FROM THE IMF AND BRAZIL BUT ALSO FROM BRITISH BANKS AND OTHERS, HAD REFUSED TO TAKE A 200 MILLION US DOLLAR SHARE OF THE 2.5 BILLION US DOLLARS SOUGHT BY BRAZIL IN NEW OFFICIAL EXPORT CREDITS. THE FOLHA'S HEADLINE IS 'BRITISH GOVERNMENT WILL NOT GIVE CREDIT', WHILE THE JORNAL DE BRASILIA HAS 'THATCHER DOES NOT WANT TO LEND TO BRAZIL'.

3. MR LAWSON IS QUOTED AS SETTING OUT THE REASONS FOR OUR REFUSAL TO PARTICIPATE AS (I) BRITAIN'S CONTRIBUTION VIA THE IMF TO THE BRAZILIAN ADJUSTMENT PROGRAMME, (II) THE SERIOUS RISK BRITAIN ALREADY RUNS WITH BRAZIL, GIVEN THAT THE BRITISH GOVERNMENT HAS GUARANTEED APPROXIMATELY 2.5 BILLION US DOLLARS LENT BY BRITISH COMMERCIAL BANKS, AND (III) THE PRIME MINISTER'S VIEW THAT THE BRAZILIANS SHOULD MAKE FURTHER SACRIFICES (AS HAVE THE BRITISH OVER THE LAST FEW YEARS) TO PUT THEIR HOUSE IN ORDER.

4. THE BRITISH DECISION IS SAID TO HAVE BEEN CONVEYED TO THE FINANCE MINISTER IN THE COURSE OF YESTERDAY'S MEETING IN PARIS. GALVEAS IS REPORTED AS HAVING TOLD JOURNALISTS BEFORE THE MEETING BEGAN THAT HE WAS SURE THAT THE BRITISH DELEGATION 'WOULD NOT CREATE PROBLEMS'.

5. THE JORNAL DE BRASILIA REPORTS THAT 'SOME SECTORS' FEAR THAT THE BRITISH ATTITUDE MAY AFFECT COMMERCIAL AND POLITICAL RELATIONS BETWEEN LONDON AND BRASILIA. BE THAT AS IT MAY, WE ARE CERTAINLY SEEN HERE AS AN UNHELPFUL - EVEN SPITEFUL - MINORITY OF ONE ON THIS ISSUE.

HARDING

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BRAZIL

Econ Pol: Indebtedness Pt 7 with At

cc: CYPRUS: Int Sit Cyprus files
LEBANON: Int Sit Lebanon files

OUT TELEGRAM

Classification and Caveats	Precedence/Deskby
CONFIDENTIAL	IMMEDIATE DESKBY ~~2330Z~~ 240300Z

ZCZC	ZCZC
GRS	GRS
CLASS	CONFIDENTIAL
CAVEATS	
DESKBY	DESKBY ~~2330Z~~ 240300Z
FM FCO	FM FCO 231630Z NOV 1983
PRE/ADD	TO IMMEDIATE DESKBY NEW DELHI
TEL NO	TELEGRAM NUMBER

FOLLOWING FOR PS TO PRIME MINISTER; FOR PRIVATE SECRETARY; AND FOR PUS

Situation Report 22/23 November

Cyprus

1. On 22 November 1983 PoCo Foreign Ministers asked the Commission to examine the possible consequences for EC trade with Northern Cyprus of Turkish Cypriot UDI. Any decisions by EC Ministers would be taken in the light of this. In practice it will probably mean withdrawal of preferential treatment for exports from northern Cyprus for the EC.

Brazil

2. Brazil's request for a revised IMF programme (an Extended Fund Facility of 4.6 bn dollars) and for a buffer stock drawing for 58 m dollars were approved by the IMF Executive Board on 22 November. This will release immediately 673 m dollars under the Extended Fund Facility. This will in turn permit repayment

NNNN ends telegram	BLANK	Catchword: of
File number	Dept: PLANNING	Distribution: LIMITED
Drafted by (Block capitals): A J COLQUHOUN		Private Secretary PS/Mr Luce PS/Mr Rifkind PS/Lady Young PS/Mr Whitney PS/PUS Planning Staff
Telephone number: 233 7888		
Authorised for despatch: 23/11		
Comcen reference	Time of despatch	

XY 48

Classification and Caveats		Page
CONFIDENTIAL		2

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of the BIS bridging loan. The Deputy MD said that the commercial banks had pledged sufficient new money for the programme to go ahead. Commitments of 5.865 billion dollars had been pledged out of the 6.5 billion dollars total. The MD expressed confidence that the 2.5 billion dollars sought from governments 'would be forthcoming' but did not go into details of individual country contributions. ~~The Paris Club is meeting today to consider Brazil's request for restructuring of her 1983/84 debt.~~ (The Paris Club reached agreement with Brazil today (23 November) on Brazil's request for restructuring of her 1983/4 debt)

Lebanon

3. In an exchange between the Lebanese Army and Shia in Southern Beirut on 22 November one rocket-propelled grenade missed its target and detonated on the rocket screen surrounding BRITFORLEB HQ. There were no casualties and no response from BRITFORLEB. HMS Glamorgan and HMS Brazen arrived off Beirut yesterday and have taken up positions 15 nautical miles off coast (outside Lebanese territorial waters).

4. There has been a lull in the fighting in Tripoli, but rebel forces are reported in Northern outskirts of the city within half a mile of Arafat's HQ. The rebel leader has threatened to enter the city in force unless Arafat leaves within three days. The loyalists have been moving artillery to new positions within Tripoli to counter expected an final attack. The dominant local militia (Islamic fundamentalist) is now apparently fully involved on the side of the loyalists and is building barricades. Diplomatic efforts to stop the fighting continue. The Saudi Foreign Minister met his Syrian opposite number in Damascus on 22 November. The NAM Delegation have also arrived in Damascus. The PLO "Foreign Minister" Farouk Qaddoumi (loyalist) has gone to Moscow for talks.

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Classification and Caveats
CONFIDENTIAL

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~~5. Defence Department will be reporting on the Bundestag debate separately.~~

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ZZ DELHI

MR WILLIAMS SEEN 231852Z. 3

RECEIVED BRITISH HIGH COMMISSION NEW DELHI CHANCERY REGISTRY 24 NOV 1983 DUPLICATES

SECRET

FLASH

GRS 460
SECRET
FM FCO 231715Z NOV 83
TO FLASH NEW DELHI
TELEGRAM NUMBER 875 OF 23 NOVEMBER
INFO FLASH UKDEL IMF/IBRD WASHINGTON
FROM CHANCELLOR FOR PRIME MINISTER AND FOREIGN SECRETARY

1. WE LEARNED LATE YESTERDAY MORNING (22 NOVEMBER) THAT THERE WAS A MEETING TAKING PLACE IN NEW YORK OF THE ADVISORY COMMITTEE OF THE COMMERCIAL BANKS, TO DECIDE WHETHER TO RECOMMEND THE NECESSARY UNANIMOUS AGREEMENT TO MAKE THE FIRST DISBURSEMENT (OF DOLLARS 500 MILLION) UNDER THE DOLLARS 1.5 BILLION MEDIUM-TERM LOAN AGREEMENT ON 30 NOVEMBER. A FINAL DECISION IS LIKELY TO BE TAKEN TODAY. (THE AWKWARD TIMING IS APPARENTLY DETERMINED BY AMERICAN THANKSGIVING AND THE URGENT DESIRE OF US BANKS TOO AVOID 'NON-PERFORMING' LOANS TO ARGENTINA BEFORE CLOSING THEIR BOOKS ON 30 NOVEMBER. OF THE DOLLARS 500 MILLION, DOLLARS 350 MILLION WOULD BE RETAINED BY THE BANKS TO EXTINGUISH PART OF A PREVIOUS BRIDGING LOAN, THE REMAINDER GOING INTO AN ESCROW ACCOUNT TO SETTLE OTHER ARREARS).

2. IT APPEARS THAT U.S. AND OTHER REPRESENTATIVES ARE SEEKING TO PERSUADE THE COMMITTEE THAT THE LOAN CONDITIONS HAVE BEEN MET. THE ONLY CONDITION IN WHICH WE MIGHT BE CONSIDERED TO HAVE SOME LOCUS IS THAT ARGENTINA SHOULD REMAIN IN GOOD STANDING WITH THE IMF, DESPITE RECENT FAILURE TO MEET ALL THE PERFORMANCE CRITERIA UNDER THE FUND PROGRAMME. THE FUND MANAGING DIRECTOR CONVEYED A MESSAGE TO THE COMMERCIAL BANKS AROUND EQD-OCTOBER, TO THE EFFECT THAT THE IMF PROGRAMME REMAINS IN BEING, ALTHOUGH FURTHER DRAWINGS ARE NOT BEING MADE AND WILL NOT BE MADE UNTIL, WHEN THE NEW ARGENTINE GOVERNMENT HAS TAKEN STOCK, A SATISFACTORY NEW PROGRAMME IS AGREED.

3. IT REMAINS POSSIBLE THAT THE ADVISORY COMMITTEE WILL NOT REACH A POSITIVE DECISION, OR THAT SOME BANKS WILL IGNORE ITS ADVICE. THE DISBURSEMENT COULD THEREFORE STILL BE POSTPONED, PARTICULARLY SINCE UNANIMITY IS REQUIRED.

4. I HAVE INSTRUCTED WICKS INZWASHINGTON TO RAISE THIS MATTER WITH THE MANAGING DIRECTOR DURING THE DAY, TO ASCERTAIN WHETHER HE IS FULLY SATISFIED WITH THE LOAN GOING AHEAD, AND TO ASK THAT HE SHOULD MAKE A STATEMENT IN THE IMF BOARD TODAY. IF THE BOARD WITHDRAWS SUPPORT, THE BANKS WILL PROBABLY NOT GO AHEAD. BUT IF THE FUND CONFIRMS SUPPORT, AND THE BANKS GO AHEAD, THEY WILL BE ABLE TO SAY THAT THIS WAS A PURELY COMMERCIAL DECISION UNDER AN EXISTING CONTRACTUAL ARRANGEMENT WHOSE CONDITIONS HAVE BEEN MET.

5. I HAVE HOWEVER, MADE IT CLEAR TO SIR JEREMY MORSE, AS CHAIRMAN OF THE LEADING BRITISH BANK IN THIS OPERATION, THAT IF IT GOES AHEAD I SHALL HAVE TO STATE PUBLICLY THAT THE DECISION IS PREMATURE AND REGRETTABLE. (THE NEED FOR ME TO DO SO MAY ARISE TOMORROW AT 2.30 WHEN SKINNER HAS A QUESTION DOWN.) I HAVE DISCUSSED THIS WITH THE GOVERNOR. HE WOULD HAVE PREFERRED NO ACTION IN WASHINGTON, BUT IS CONTENT WITH THE LINE TAKEN WITH MORSE.

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RECEIVED
BRITISH HIGH COMMISSION
NEW DELHI
CHANCERY REGISTRY
24 NOV 1983
DUPLICATES
OF LETTER............
OF ENCLOSURES............
LOCATION............

LUK 545

FDW FØ22/24
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SECRET

ZZ NEW DELHI

FLASH

GRS 26Ø
FM UKDEL IMF/IBRD WASHINGTON 24ØØ4ØZ NOV 83
TO FLASH FCO
TELEGRAM NUMBER 38Ø OF 23 NOVEMBER
AND TO FLASH NEW DELHI (FOR PRIVATE SECRETARIES TO THE PRIME MINISTER AND THE FOREIGN SECRETARY)

IMF AND ARGENTINA: YOUR TELNO 875

1. AS INSTRUCTED, I ASKED THE MD TO MAKE A STATEMENT IN THE IMF BOARD ABOUT THE DOLLARS 5ØØ MN FIRST TRANCHE OF THE BANKS' DOLLARS 1.5 BN MEDIUM-TERM LOAN TO ARGENTINA. THE MD AGREED AND MADE THE FOLLOWING STATEMENT THIS AFTERNOON IN THE FULL IMF BOARD. HE SAID RHODES (CHAIRMAN OF THE BANKS' ADVISORY COMMITTEE) HAD TOLD HIM THIS LUNCHTIME THAT, ALTHOUGH THERE WERE MATTERS STILL TO RESOLVE, THE BANKS WERE MOVING FORWARD ON THE RELEASE OF THE DOLLARS 5ØØ MM. THE MD SAID THAT HE HAD TOLD RHODES HE WELCOMED THIS. THE LOAN HAD BEEN A LONG TIME IN THE OFFING AND RELEASE OF THE FIRST TRANCHE WOULD HELP WHEN IT CAME TO A RESUMPTION OF MORE FUNDAMENTAL DISCUSSIONS ABOUT THE ARGENTINE ECONOMY BETWEEN THE IMF AND THE NEW ARGENTINIAN GOVERNMENT. NO DIRECTOR COMMENTED ON THE MD'S REPORT.

2. I HOPE THAT THE MANAGING DIRECTOR'S STATEMENT IS WHAT IS REQUIRED. IT COULD HELP MINISTERS TO MAINTAIN THE LINE TO ONE CONSTITUENCY THAT THE BANKS' DECISION TO MAKE THE LOANS IS, FROM OUR POINT OF VIEW, QUOTE PREMATURE AND REGRETTABLE UNQUOTE, WHILE ARGUING TO A DIFFERENT CONSTITUENCY THAT THE BANK LOANS ARE PART OF THE CONTINUING INTERNATIONAL EFFORT TO MAINTAIN THE INTERNATIONAL FINANCIAL SYSTEM AND THUS TO SUPPORT THE WORLD ECONOMY.

3. FCO PLEASE ADVANCE TO PS/CHANCELLOR AND LITTLER (HMT), PS/GOVERNOR AND LOEHNIS (BANK OF ENGLAND) AND APPLEYARD (ERD). NO FURTHER CIRCULATION.

WICKS

NNNN

ZZ UKDEL IMF/IBRD WASHINGTON

FLASH

GRS 160

SECRET

FM DELHI 232000Z NOV 83

TO FLASH FCO

TELEGRAM NUMBER 924 OF 23 NOVEMBER

INFO FLASH UKDEL IMF/IBRD WASHINGTON

ADVANCE COPY

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PS

PS/CHANCELLOR

EX.

FOLLOWING FOR CHANCELLOR FROM FOREIGN SECRETARY

YOUR TELNO 875: LOANS TO ARGENTINA

I ASSUME THAT WICKS WILL ALREADY HAVE ACTED IN WASHINGTON. THERE WILL BE TIME ON THURSDAY MORNING HERE TO CONSIDER IN THE LIGHT OF HIS REPORT THE LINE TO TAKE IN THE HOUSE, SO I HAVE NOT DISTURBED THE PRIME MINISTER (YOUR TELEGRAM REACHED US JUST BEFORE 0100 LOCAL). IT WOULD BE HELPFUL TO HAVE BY 240130Z SOME BACKGROUND ON WHY GOVERNOR WOULD HAVE PREFERRED NO ACTION IN WASHINGTON. I SHOULD ALSO LIKE TO THINK OVER THE LINE YOU PROPOSE TO TAKE IN THE HOUSE. IF WE ASK THE MANAGING DIRECTOR WHETHER HE IS FULLY SATISFIED WITH THE LOAN GOING AHEAD, AND IF HE GIVES US THIS ASSURANCE AND IS SUPPORTED BY THE BOARD, ON WHAT GROUNDS WOULD WE JUSTIFY A PUBLIC STATEMENT THAT THE ACTION OF THE BANKS WAS PREMATURE AND REGRETTABLE?

WADE-GERY

NNNN

SECRET

RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE GOVERNOR ON COMMERCIAL BANK LENDING TO ARGENTINA: 12.15PM, 23 NOVEMBER 1983 AT NO 11

Present:

Chancellor	Governor
Mr Middleton	Deputy Governor
Mr Littler	Mr Loehnis
Mr Mountfield	

The Chancellor said that he was grateful to the Governor for agreeing at short notice to discuss how the authorities should react to reports, which had first reached the Treasury shortly after noon on 22 November, that the advisory committee on the $1.5 billion commercial bank loan to Argentina was meeting in New York on 22 and 23 November, and might recommend that the first $500 million drawing should be permitted before 30 November.

2. Mr McMahon said that Sir J Morse had this morning reported that no decision had been taken in New York on 22 November, but that the resumed meeting on 23 November could agree on the issue of a telex to the 300 participating banks designed to secure agreement, particularly from the 30 who had not so far come into line, to the release of the $500 million tranche over the weekend of 26/27 November, or at least before 30 November. $350 million would be used to repay an instalment due on an earlier bridging loan: the remainder would be used to settle arrears of interest outstanding. The impetus for action by 30 November came from the US banks, who were concerned to be able to classify loans outstanding on that date as performing rather than non-performing. No green light from the IMF was thought necessary: a red light from the IMF

would probably block action, but Larosiere's last signal had been positive. Unanimity among all 300 banks was required before a drawing could take place; but most and perhaps all banks were concerned at the risk of an Argentine moratorium - which might in practice improve their cash flow position - if no drawing were allowed. The LBI representative in New York, acting for all the participating UK banks was now under instructions to take a neutral line: a move to casting a veto would be very high profile indeed. Mr McMahon added that LBI believed that the drawing could proceed only on the basis that the Argentine were in good standing with the IMF as of 30 November; and that the advisory committee would assume that this was the case unless they received contrary advice from the IMF.

3. The <u>Chancellor</u> suggested that the proper course would be for the IMF Board to meet. The fact was that the IMF's own agreement and programme with the Argentine had collapsed: to pretend otherwise would be a fiction, and the line that a collapse was not a collapse until so certified by the Fund to the commercial banks would not be sustainable in the House of Commons. If the advisory committee went ahead with the issue of telexes tonight from New York, the inevitable publicity would ensure that the matter was raised in the House on 24 November, and he would be obliged to say that HMG thought the decision premature and regrettable. If the Fund were to decide that the Argentine was not at present a member in good standing, the proposed $500 million commercial bank disbursement would presumably stop. If, on the other hand, the Fund were to decide that the disbursement was on balance desirable, given the change of government in Argentina, the participation of UK banks would seem less inexplicable to UK public opinion. The key point was that the Fund should not connive at a breach of its own rules: the maintenance of its authority was more important than the wishes of the US banks to be able to classify more of their loans as "performing" on 30 November.

4. The Governor and Mr McMahon thought it likely that news that the IMF's views were in doubt, and being reconsidered, would stop the loan. The British hand would be detected, and considerable publicity would ensue. It might be better for HMG to rest on, and if necessary act on, the warning given to Sir J Morse on 22 November that HMG would distance itself from any decision to allow new commercial bank lending to Argentina under present circumstances. And it was noted that a majority on the IMF Board would probably agree with the US view (and Larosiere's) that the $500 million disbursement should go ahead: to raise the matter in Washington might therefore combine the disadvantages of stopping the loan and losing the argument.

5. The Chancellor was however concerned that a damaging precedent would be set if the fiction that Argentina was in good standing with the Fund were taken as permitting new commercial bank lending. Apart from the difficulties of public presentation in this country, there would be a clear breach of the important rule that the international banking community was ready and willing to assist debtor countries, but only when they had, in agreement with the Fund, accepted sensible programmes of adjustment. If the rule were to be breached, that should be with the prior knowledge of the Board: Larosiere should be asked to explain his reasoning to it. He would however ensure that the Governor's advice against action in Washington was recorded in the report to the Prime Minister in New Delhi which would be required immediately.

J O KERR
23 November 1983

Distribution:

Economic Secretary	Mr Mountfield	PS/Governor) Bank of England
Mr Middleton	Mrs Case	Mr McMahon) Bank of England
Mr Littler	Mr Ridley	Mr Loehnis) Bank of England
Mr Unwin	Mr Hall	PS/Secretary of State, FCO
Mr Lavelle		Mr Turnbull, No 10

CONFIDENTIAL

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

23 November 1983

Andrew Turnbull Esq
No 10 Downing Street
LONDON SW1

Dear Andrew,

ARGENTINA: COMMERCIAL BANK LENDING

We spoke about developments on the Argentina commercial bank loan subsequent to my letter of 17 November.

... I now attach a draft telegram to New Delhi. The Chancellor would be grateful if you could ensure that it reaches the Prime Minister this evening, Indian time.

Copies of this letter and enclosure go to Roger Bone at the FCO and John Bartlett at the Bank.

Yours ever,

John Kerr.

J O KERR

(16939) Dd.897300 200m 9/72 G.W.B.Ltd. Gp.863
(17785) Dd.897533 400m 5/73 G.W.B.Ltd. Gp.863

XY 4.

File No.

Department HM TREASURY

Drafted by (Block Capitals) J. G. LITTLER

Tel. Extn. 233-4225

OUTWARD TELEGRAM

Security Classification: SECRET

Precedence: IMMEDIATE

DESKBY Z

FOR COMMS. DEPT. USE | Despatched (Date) (Time) Z | POSTBY Z

PREAMBLE

(Time of Origin) Z(G.M.T.)

(Security Class.) SECRET

(Codeword)

(Restrictive Prefix)

(Caveat/ Privacy Marking)

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TO Flash (precedence) DELHI (post) Tel. No. of

AND TO (precedence/post)

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REPEATED TO (for info) Flash UKDEL IMF/IBRD.

SAVING TO (for info)

Distribution:-

Copies to:-

[TEXT] FROM CHANCELLOR FOR PRIME MINISTER AND FOREIGN SECRETARY

We learnt late yesterday morning (22 November) that there was a meeting taking place in New York of the Advisory Committee of the commercial banks, to decide whether to recommend the necessary unanimous agreement to make the first disbursement (of \$500 million) under the \$1.5 billion medium-term loan agreement on 30 November. A final decision is likely to be taken today. (The awkward timing is apparently determined by American Thanksgiving and the urgent desire of US banks to avoid "non-performing" loans to Argentina before closing their books on 30 November. Of the \$500 million, \$350 million ~~is~~ would be retained by the banks to extinguish part of a previous bridging loan, the remainder going into an escrow account to settle other arrears.)

/It

2. It appears that US and other representatives are seeking to persuade the Committee that the loan conditions have been met. The only condition in which we might be considered to have some locus is that Argentina should remain in good standing with the IMF, despite recent failure to meet all the performance criteria under the Fund programme. The Fund Managing Director conveyed a message to the commercial banks around end-October, to the effect that the IMF programme remains in being, although further drawings are not being made, and will not be made, until, when the new Argentine Government has taken stock, a satisfactory new programme is agreed.

3. It remains possible that the Advisory Committee will not reach a positive decision, or that some banks will ignore its advice. The disbursement could therefore still be postponed, particularly since unanimity is required.

4. I have instructed Wicks in Washington to raise this matter with the Managing Director during the day, to ascertain whether he is fully satisfied with the loan going ahead, and to ask that he should make a statement in the IMF Board today. If the Board withdraws support, the banks will probably not go ahead. But if the Fund confirms support, and the banks go ahead, they will be able to say that this was a purely commercial decision under an existing contractual arrangement whose conditions have been met.

NOTHING TO BE WRITTEN IN THIS MARGIN

5. I have however, made it clear to Sir Jeremy Morse, as Chairman of the leading British bank in this operation, that if it goes ahead I shall have to state publicly that the decision is premature and regrettable. (The need for me to do so may arise tomorrow at 2.30 when Skinner has a question down.) I have discussed this with the Governor. He would have preferred no action in Washington, but is content with the line taken with Morse.

File

10 DOWNING STREET

(2)

Prime Minister

The US Senate voted yesterday for the IMF Bill. The House of Representatives is expected to vote in favour today. There could still be trouble from conditions tacked on, but this is unlikely to be serious.

AT
18/11

CONFIDENTIAL

Prime Minister 2
for information.
Duty Clerk
PP A.T.
18/11

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

18 November 1983 → File

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew,

BRAZIL

The Chancellor thought that the Prime Minister might be interested to see the attached note by Geoffrey Littler on the discussions on Brazil at the meetings which he attended in Paris this week. The Chancellor found his account encouraging. I found the last para puzzling.

Copies of this letter and enclosure go to Brian Fall (FCO) Callum MacCarthy (DTI) and John Bartlett (Bank of England).

Yours ever,

John Kerr

J O KERR

FROM : J G LITTLER

DATE : 18 November 1983

NOTE FOR THE RECORD

BRAZIL

In discussion among officials in Paris during the last few days, I did not find myself in difficulties over Brazil. In the light of Mr Unwin's report to me of the Chancellor's meeting with the Prime Minister, I was at pains to keep our position very closely in line with that of others (particularly France and Germany), and I think I succeeded.

2. At no time was there particular pressure on me, or any particular pointing at the United Kingdom as the awkward member. There were two main discussions.

3. First, on Tuesday night (before the Chancellor's meeting) we had the meeting of G5 deputies. Sprinkel reported at some length on discussions he had just had with the IMF Managing Director (no need to rehearse because Mr Wicks gave identical accounts in his telegrams). The conclusion we all reached was that we had to share the IMF judgement that the action proposed by the Brazilian authorities was sufficient to justify IMF lending. My French and German colleagues took the lead in saying that they were not prepared to commit specific sums of new export credit; I simply said that our position was unchanged. There was no argument. The only additional comment - made initially by Camdessus, and immediately endorsed by Tietmeyer and myself, was that we remained very worried over the risk that the Brazilian authorities would not live up to their promises.

4. The second meeting (or series of meetings) was with the IMF Deputy Managing Director, Dale, yesterday. The purpose of his visit to Paris was to round up sufficient support of new export credit. We had a general discussion over lunch, in which he gave assurances of IMF staff satisfaction with the programme

agreed with Brazil. He was challenged (by Camdessus) on the amount of increase of reserves assumed by the IMF, which he stated to be $1 billion this year and $2.6 billion next year (at which there was a good deal of shaking of heads - why should governments be asked for $2½ billion if reserves as a result were projected to rise by about that amount?) It was then agreed, at the suggestion of Dale himself, that the best way to proceed would be for him to talk privately with each of us, not revealing to any of us what the others had said.

5. When my turn came, I began by saying that we would give full support to the IMF and, on the account he had given of the prospective agreement with Brazil, I would expect our Executive Director to be able to give a positive vote. I also said (as agreed with Mr Loehnis) that I understood that all UK banks (with one possible exception on which the others were bringing pressure to bear) had committed themselves. I then said that I wanted to make three points:

- I must repeat that the UK had been from the outset, and remained, unhappy about the way in which the IMF had established a financing gap which could only be met by governments, and I earnestly hoped that the difficulties which had resulted would persuade them to try to avoid this in future; I said that I was confident of support of several G10 colleagues in this, and I mentioned the particular strength with which Delors had spoken on the subject. Dale accepted what I said, and confirmed that he was aware that this was not simply a view of the UK, but one shared by others;

- I said that we were also in the same position as several other countries, particularly France and Germany, in believing that the right procedure at this stage was for us to suspend new export credit; but that this did not rule out the re-opening of cautious lines of credit at some stage thereafter. But the uncertainties made it particularly difficult for any of us to commit ourselves to particular numbers in advance.

- Finally, however, I said that we had also been influenced because there was genuine difficulty for us in foreseeing export credit finance. Unlike Germany in particular, we did not have a very large pipeline of continuing export credit; moreover, as Dale was well aware, the scale of UK exports to Brazil had become very small. I put it to him that it would not serve the purposes he was seeking to meet if we were to commit ourselves to export credit finance which could then only be applied if Brazil undertook additional imports. I repeated the point that no figure could be given, but said that I thought he really must assume for his purposes that our contribution would be negligible. I said "You would be lucky to get into double figures in millions of dollars".

6. At the end of this discussion, in which Dale was throughout sympathetic and understanding, he said that he understood the position, and was inclined to agree with all that I had said about the practical possibilities, so that he would not press me.

7. Later in the day, I asked him how he had got on in general. ? He said that the outlook was rather better than he had feared it might be, and he thought we would get through.

J G LITTLER

OLO 3.19 ✓cc NO

CONFIDENTIAL

AT 18/11 (2)

1) Mr. Turnbull

2) Prime Minister.

A.J.C. 18/11

CHANCELLOR OF THE EXCHEQUER

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

17 November 1983

A J Coles Esq.
No.10 Downing Street
LONDON
SW1

Mr. Turnbull

Will you handle pl?

A.J.C. 24/11.

Dear John,

ARGENTINA

I understand that there was some discussion at Cabinet today about whether the first tranche of the $1.5 bn commercial bank loan to Argentina had been drawn down. I can confirm that no drawings have been made.

The loan agreement was signed in August, but the first drawing of $500m has been repeatedly postponed because of Argentina's failure to meet conditions attached to it. The proposed disbursement date is now 30 November. But since Argentina has introduced new (though non-discriminatory) payments restrictions, contrary to the terms of the Fund programme, and since no further Fund disbursements will be made until the Fund have at least been able to reassess the situation in consultation with the new Argentine Government, it follows that a further postponement must be on the cards. We are investigating the position urgently.

Copies of this letter go to Brian Fall at the FCO, John Bartlett at the Bank, and Richard Hatfield at the Cabinet Office.

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

The point is not the first tranche of the loan associated with the 2nd IMF drawing, but the ~~the~~ tranche (I believe of $300m) associated with the first IMF drawing. That is what I meant by the first tranche. My recollection is from the Cabinet briefing. No

Subject

cc Master

GLC

DA

10 DOWNING STREET

From the Private Secretary

16 November 1983

Dear John,

Brazil

The Prime Minister held a meeting today to discuss the UK's contribution to the financial package being assembled for Brazil. Present were the Chancellor of the Exchequer, the Foreign Secretary, the Secretary of State for Trade and Industry and the Governor of the Bank of England. Also present were Mr. Middleton and Mr. Unwin (HM Treasury), Mr. Appleyard (Foreign Office), Mr. Titchener (Trade and Industry) and Mr. Blunden (Bank of England).

The Foreign Secretary recognised that the UK was making a substantial contribution to the financial package for Brazil. He fully accepted the policy of trying to limit the contribution which the UK made to the refinancing of official debt. The aim should be to hold to the existing offer, in the hope that the US would make good any shortfall.

His concern was that when the commercial banks had made their pledges, and the contributions from governments had been identified, there could still be a shortfall. It would be regrettable if, after Brazil had offered to make substantial policy adjustments, the deal fell through for want of a small additional contribution from governments on export credit. He was worried that, if this arose, the UK Government could find itself isolated politically. He was therefore seeking contingent authority to offer a small addition to export credit.

The Secretary of State for Trade and Industry said that Brazil was a market with great potential in the longer term. The financial package was being assembled on the assumption that Brazil would eventually resume being a paying importer. It was therefore worth keeping a foothold in this market. This would justify some additional export credits, commensurate with the size of the UK's trade with Brazil. One or two projects had been identified which would strengthen Brazil's balance of payments and which could benefit UK exporters. In discussion it was suggested that the size of our trade would justify additional export credits in the range $35-50 million.

/ The Chancellor

The Chancellor took the view that the financial package was falling into place. The IMF would be consulting the G10 members individually to assess their potential contributions. He believed that the Fund would find that sufficient funds would be forthcoming. This would be reported to the IMF Board without identifying the contributions of individual governments. He believed the total UK contribution from commercial banks and from the Government, directly and through the Fund, was substantial - perhaps around £750 million - and could be defended. The UK was not coming under pressure to raise its official contribution. To offer anything further would weaken credibility in future negotiations and could also weaken the resolve of others in the G5 who were currently standing firm.

The Governor argued that a further gesture from the Government would help secure the final pledges from UK commercial banks which were still being sought. In the bank package $788 million had been allocated to UK banks and of this $628 million had so far been found. It was noted, however, that for this tactic to work the UK would be required to disclose its fall-back position.

In discussion it was noted that ECGD would not be rescheduling Brazilian debts as originally envisaged but would be refinancing them. The benefit to Brazil was identical but the cost to the PSBR would be deferred instead of being incurred over the next two years. The refinancing of official credits was due to be discussed by the Paris Club around 23 November.

Summing up, the Prime Minister said that our objective should still be to hold our contribution on official debt to the current offer. The UK should continue to encourage France and Germany to hold the line in order to secure the maximum contribution from the US. The meeting recognised the political disadvantage of being isolated vis-a-vis Brazil and the other industrial countries. If, at the end of the day, the package was in difficulty and other industrial countries were proposing to increase their contributions, the UK could consider making an additional contribution on a very limited scale e.g. one commensurate with the importance of trade with Brazil. But no indication of our willingness to do this should be given until the very last stage of the negotiations and then only after clearing the proposal with her. If necessary this could be done by phone during her visit to India.

I am copying this letter to Brian Fall (Foreign and Commonwealth Office), Callum McCarthy (Department of Trade and Industry) and John Bartlett (Bank of England).

Yours sincerely

Andrew

John Kerr, Esq.,
HM Treasury.

cc NO

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

15 November 1983

The Rt. Hon. Norman Tebbit MP
Secretary of State for Trade and Industry

Dear Norman

BRAZIL

Thank you for your letter of 11 November.

As I said in Bonn, I am of course well aware of the risks to ECGD (and still more, to British banks) which would flow from a Brazilian default. But, like the Prime Minister, I am also concerned about the risks to the world financial system and the impact on other borrowers if there were any softening of the position which has been successfully maintained so far on Brazil. There has indeed been a degree of weakening of the IMF's own de-indexation condition, although we still hope that the overall effect of this and other measures will be satisfactory. It is essential that the debtor countries themselves make the major contribution to the solution of their problems, by the adoption of appropriate adjustment policies. Brazil, like Mexico last year, is in a very good position to take the necessary steps. And there is now encouraging evidence that it intends to do so. It would be a great mistake to risk the success of this policy, just when (in the Brazilian case, which is the one which matters most) it shows every sign of succeeding.

Moreover, a UK contribution in the form of new export credit is not going to make the difference between success and failure of the package which Larosiere and Regan have put together. If there is any shortfall, I am sure that the Americans will make it up. It was originally suggested that we would have to join in because, if we did not do so, the UK banks would also stay out. They have in fact gone in. We were told in the summer that the Americans and the French would regard our participation as critical. Since the Prime Minister's visit, and mine, to Washington in late September it is clear that they understand our position: we are no longer under pressure.

This means I think that the only case for our going in is the trade argument you describe. I have to say that I do not find it convincing. There is at present very little UK trade with Brazil, and little potential for developing it in the short term. Brazil does not need large imports of raw materials or of capital equipment in order to strengthen its balance of payments, and its recovery programme will in fact require a considerable cut-back in imports. I see no point in stimulating sales which Brazil does not need and cannot afford to pay for, for several years ahead. A figure as high as £100 million looks particularly hard to justify in these circumstances. It seems to be based on the relative proportions of officially guaranteed debt, in which we happen to score particularly high (probably because past exports were concentrated in the capital sector). On the more usual trade-weighted basis, our contribution would be $30-50m, though I would be most reluctant to consider even that degree of commitment.

It may be helpful, and save time at the Prime Minister's meeting tomorrow, if I record the latest developments and the prospective next moves. As the Governor will tell us, Brazil was high on the agenda at the recent Basle meeting, and (although there is still some uncertainty about the outcome) the prospects for the IMF package and associated bank lending now look fairly good. There was a meeting of Executive Directors of the IMF on 14 November, at which the UK representative came under no pressure to make any offer.

The next step is a meeting of the full Executive Board. This may slip from 18 November to the following week. For that meeting, I suggest that our line should be to agree the IMF package (the conditions for which have now been met), to indicate that the UK banks will be prepared to play their part, but to maintain our position on new government credit. Thereafter, there is likely to be a Paris Club meeting (originally 21-22 November but this too may slip). We have agreed that we shall then play a full part in rescheduling operation, proportionate to our share of officially guaranteed debt, which is substantial. The cost to us is likely to be some £190 m. I see no need for us to go further, and become drawn into a discussion of further new credits.

I am sending copies of this minute to the Prime Minister, the Foreign Secretary, the Governor of the Bank of England, and Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

Econ Pol: Indebtedness Pt 3

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PRIME MINISTER

BRAZIL

You are holding a meeting tomorrow on Brazil. This arises out of the Foreign Secretary's letter, Flag A, which argued that the Brazil package was in danger of breaking down and that a further UK contribution might be needed.

Mr. Tebbit has written at Flag B, arguing for a small increase in export credit on trade grounds.

The Chancellor has written at Flag C, arguing that

1) FCO fears are overdone - both on IMF and commercial bank channels progress is being made;

2) pressure for further UK Government involvement is being successfully resisted;

3) the trade case for more export credits is weak.

Also relevant is the background note at Flag D.

Attendance will be:

Chancellor
Mr. Middleton
Mr. Unwin

Secretary of State for Trade and Industry
Mr. Titchener

Foreign Secretary
Mr. Appleyard

Governor
Mr. Blunden

AT

15 November 1983

International Debts file

WHY THE U.S. SHOULDN'T FILL THE IMF'S TILL

■ Legislation increasing the U.S. contribution to the International Monetary Fund has stalled in Congress. Even if the Reagan Administration starts pushing it enthusiastically, the measure's opponents may win, and get a chance to test their contention that subsidizing the Third World is not necessary to avoid global calamity.

The task the IMF is now offering to perform is completely different from the one for which it was created. The Fund was set up at the Bretton Woods conference in 1944 for a world of fixed exchange rates, and its purpose was to lend short-term funds to countries in temporary difficulty so that they could stabilize their currencies. When fixed rates were replaced by floating rates in the early 1970s, the IMF was deprived of its essential function.

But as Milton Friedman observed in a statement to Congress opposing the bill, "International bureaucratic organizations neither die nor fade away." The IMF went marching on, partly as a foreign aid agency offering three- to five-year loans, and partly as a sort of incipient world central bank, involving itself in international unpleasantnesses caused by countries unable or unwilling to pay off their debts. Its new role has been a source of comfort to commercial bankers on the hook for loans to those countries. In the process, the IMF has grown steadily. Its lending has increased 35% more than world exports have between 1970 and 1982. IMF officials have constantly pressed for more money. In the current round of requests for capital contributions from member states, the U.S. is to kick in about 20% of the total, some 6% of it in cash and the remainder as a letter of credit.

JEFF TAYLOR

CONGRESS HAS LONG been underwhelmed by the idea of giving what works out at around $8.4 billion to an international agency when the U.S. was running huge budget deficits. But it got downright balky when the grass roots came alive with last-minute protest activated by an unlikely but effective coalition of pressure groups, spanning the spectrum from goldbugs to environmentalists. In the end, authorization was approved by both Senate and House (narrowly). But the two versions of the bill differed radically, and no effort has yet been made to reconcile them. And new complications have appeared, including a proliferation of amendments mostly promoting political causes or harassing the banks. One unkindly directs that the salaries of the IMF's 1,500 Washington employees be limited to $67,200, which about a fifth of them currently exceed.

The Reagan Administration was initially cool to an IMF quota increase. But the threatened Mexican default last year and subsequent alarums about the "debt bomb" apparently changed its mind. The numbers looked impressive. In mid-1982 the total capital of U.S. banks was an estimated $66.2 billion. Their loans to non-OPEC developing countries, including the Eastern bloc, were $108 billion. The nine largest U.S. banks were disproportionately represented: their exposure amounted to 235% of their capital. Only a beefed-up IMF, its supporters argued, could extend cheap emergency credit, coordinate international action, and generally guard against a country's default blowing a hole in the banking system and precipitating a 1930s-type collapse of international trade.

"It's been labeled a bank bailout bill," American Express Chairman James D. Robinson III says. "The small town politician or bank in Maine says, 'It serves those bastards right.' I'd like to ask how many able-bodied men between the ages of 18 and 24 they have in their community and what size boots they wear. I'd tell them to get ready to go to Latin America, because you let some of those governments go populist and you're going to have national security problems."

It is hard to shrug off what might happen if debtors defaulted on loans that represented a substantial portion of the lending institutions' capital. But opponents of the IMF quota increase point out that not much attention has been paid to the many possible solutions that lie between unequivocal support for the IMF and world financial collapse.

For one thing, it's by no means clear that the IMF needs the U.S. contribution. Its unique role in dealing with troubled debtor nations is to serve as the "bad cop," imposing strict economic policy conditions that will reassure other lenders that the borrower will behave responsibly in the future. This imprimatur could be backed with a token loan or, conceivably, nothing at all. What the borrowers want is the IMF seal of approval that will reopen their lines of credit with the commercial banks. And that's where the major lending role belongs.

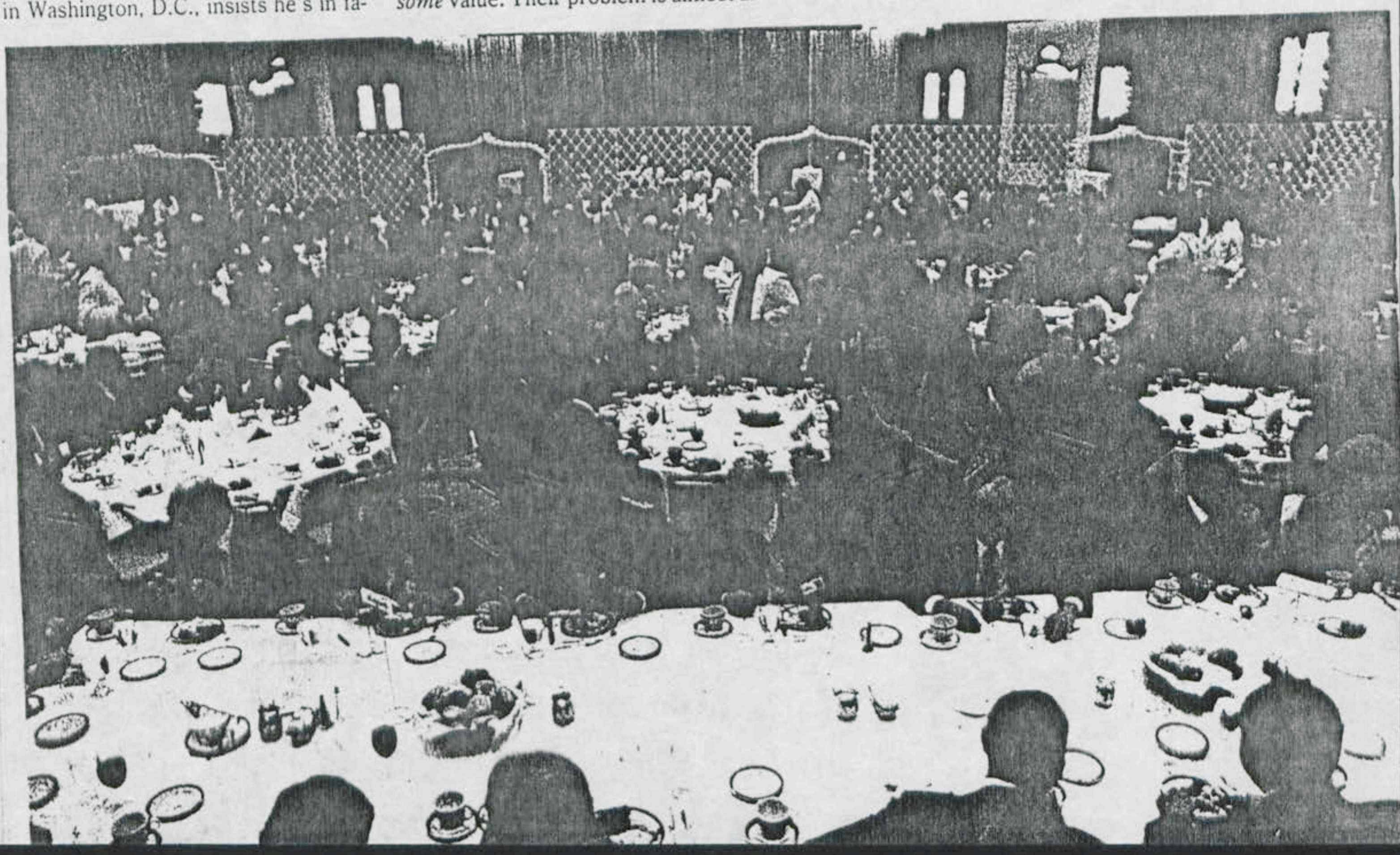
But the IMF may not be needed to stave off financial crisis at all. One articulate advocate of this thesis is Sir Alan Walters, an academic economist and adviser to British Prime Minister Margaret Thatcher (who like Reagan is officially committed to the quota increase). Walters, now Resident Scholar at the American Enterprise Institute in Washington, D.C., insists he's in favor of U.S. support for the current bill—as Thatcher's economic adviser, he could hardly do otherwise. Radical changes, he says, should come slowly so as not to unsettle financial markets.

Nonetheless, he believes that if the IMF doesn't get its funding, the commercial banks can handle the problem loans largely on their own—with some pain, to be sure, but without critical damage to the financial system. The banks can begin, as he puts it, by "telling the truth" and writing down their problem loans to their true economic value, as normal banking practice would dictate.

WHAT MAKES THIS possible, Walters says, is that the write-downs would not be anywhere near as large as IMF supporters think. Much of the Third World's debt, he points out, is quite solid. Countries like Malaysia are perfectly sound. Even loans to notorious basket cases have *some* value. Their problem is almost always illiquidity, a shortage of cash, rather than bankruptcy. Mexico, for example, could easily pay off its borrowings by selling or leasing its natural resources to foreigners, and would benefit from more efficient production into the bargain. While Mexican political leaders will doubtless resist submitting to this indignity, the financial markets' view of the country's situation appears surprisingly calm. Mexican government bonds with a 16½% coupon recently traded in London at 96½% of face value. The discount on them has narrowed appreciably, and even at the height of the crisis it was never more than 20%.

Other signs support Walters' nonexplosive view of the debt bomb. A secondary market in foreign bank loans has been quietly operating for some time in London—Walters calls it a "covert market." It has now grown to the point where the need for a Reuters screen displaying prices is being seriously debated, a sure sign of a market both maturing and coming out of

Debtor nations *wined and dined bankers and IMF officials at the agency's annual meeting in September. This lunch was sponsored by Brasilinvest, a large Brazilian bank.*



the closet. Latin American loans now trade at 75% to 87% of face value.

The secondary market would provide an outlet for written-down loans, says Walters, and it should be developed accordingly. By selling the loans off at whatever discount was necessary, the banks would recover at least some of their money. Those new owners, in turn, could take a lot lower payout from the borrowing countries and still make a profit.

Walters does not think the costs to the banks would be unbearable. For example, the nine largest U.S. banks have shareholders' equity of $24.5 billion and loans of $31.4 billion to Mexico, Brazil, and Argentina. They might have to write those loans down some 25%, which would be equivalent to a loss of $7.9 billion. That wouldn't do much for their shareholders, of course, but the resources are there to pay if the writeoffs are taken over time: their dividends last year came to more than $1 billion.

ONE PROBLEM IS THAT the Internal Revenue Service recently reduced the percentage of loan loss reserves that are tax deductible. In West Germany, by contrast, banks have been actively building up reserves against their bad loans to Eastern Europe, and the government has recently encouraged them by granting tax-deductible status to their reserves against loans to Poland, one of their biggest debtors. (Previously, such loans to sovereign states weren't deductible.)

If any bank was particularly hard hit, it could be merged with another. If a country abruptly defaulted, the whole panoply of provisions against panic would come into effect as with any domestic bank failure, including deposit insurance and the ability of the Federal Reserve to pump liquidity into the system. The existence of national central banks precludes the need for an international one.

Advocates of the increased IMF contribution have argued that its cost will only be $200 million a year, the estimated average annual cost to the Treasury of the difference between its cost of borrowing and the interest it will get from the IMF. Opponents counter that these interest costs are only the tip of the iceberg; the true economic impact is the appropriation of some $8.4 million worth of resources from the U.S. economy. Beyond this, the economic consequences of both plans depend on events and are hard to quantify.

On the whole, the world might be better off without the IMF. As of now, argues Carnegie-Mellon University economist Allan Meltzer, the agency is the perpetrator of an "international Ponzi scheme" whereby U.S. banks keep bad loans on their books at face value, lend more money so that their debtors can meet interest payments, rely on the IMF's injecting funds into debtors to assist the process, and paradoxically end up showing increased earnings despite the deteriorating quality of their loan portfolios. Indeed, the critics maintain that by encouraging the banks' belief in ultimate bailout, the IMF inspired reckless loan policies in the first place.

Even the bankers who so ardently support the IMF and the quota increase should be having second thoughts; their cozy relationship with it may be entering a less cozy phase. The IMF has begun to assume the power, for example in this year's Brazil bailout, to direct the creditor banks to lend yet more money as part of any settlement—"bailing the banks in deeper," as Administration defenders of the quota increase have been proclaiming. Says former Reagan Treasury official Paul Craig Roberts, now at Georgetown University's Center for Strategic and International Studies: "This amounts to the political allocation of credit." He argues that the IMF itself is going to lose control to politicians in the debtor nations, who will realize its decisions are political rather than economic and can be affected by the specter of default. "The banks' friends," says Roberts, "are putting them over a barrel." Brazil's refusal in late October to accept the IMF's wage-limiting proposal suggests the shift of power has already begun.

■ The fundamental assumption underlying the IMF is that free markets can be improved by enlightened intervention. At the time of Bretton Woods this assumption dominated virtually every aspect of economic policy. Now international economics is one of its few unchallenged refuges. Yet relatively more money was lent and invested across borders before 1914 than today. With no IMF to save it, the system absorbed defaults regularly. ■

C. Andrews

CONFIDENTIAL

GPS 1070

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DESKBY 150900Z
FM UKDEL IMF/IBRD WASHINGTON 150134Z
TO IMMEDIATE F C O
TELNO 366 OF 14 NOVEMBER 1983,
AND TO IMMEDIATE UKDEL OECD (FOR LITTLER),
INFO BRASILIA.

IMF: BRAZIL

1. THE MANAGING DIRECTOR TOLD G10 DIRECTORS THIS MORNING THAT HE WAS STILL TELLING THE BANKS THAT THE IMF EXECUTIVE BOARD WOULD CONSIDER THE BRAZILIAN PAPER ON FRIDAY, NOVEMBER 18. HE WOULD, HOWEVER, CONCEDE TO G10 DIRECTORS THAT THERE MIGHT BE A FEW DAYS SLIPPAGE, POSSIBLY UNTIL, SAY, WEDNESDAY, NOVEMBER 23, BUT HE WOULD NOT WANT THE BANKS TO KNOW THAT. HIS WEEKEND DISCUSSION WITH DELFIM NETTO AND PASTORE HAD GONE WELL WITH AGREEMENT ON THE MONETARY AND FISCAL CONTENT OF THE PROGRAM. THERE WOULD BE A FURTHER DISCUSSION THIS AFTERNOON ON THE DRAFT LETTER OF INTENT. HIS CONCLUSION NOW AS HE THOUGHT THAT QUOTE AN AGREEMENT WAS SHAPING UP UNQUOTE. (THE MANAGING DIRECTOR SAID THAT THE FUND PAPER WOULD BE TELEXED TO CAPITALS DIRECTLY IT WAS PREPARED).

2. TURNING TO THE OFFICIAL FINANCIAL PACKAGE, THE MD SAID THAT HE WAS MOST CONCERNED THAT NO COUNTRY, EXCEPT THE UNITED STATES, HAD QUANTIFIED ITS CONTRIBUTION TO THE DOLLARS 2.5 BILLION. HE WAS NOT ASKING FOR PRECISE COMMITMENTS, BUT FOR ORDERS OF MAGNITUDE, PERHAPS IN TERMS OF RANGES, OF THE EXPORT CREDIT WHICH THE EXPORT CREDIT AGENCIES WOULD CONTEMPLATE IF THE BRAZILIAN PROGRAM WAS ENDORSED BY THE IMF BOARD AND IF THE HOPED FOR IMPROVEMENT IN THAT COUNTRY'S ECONOMIC SITUATION MATERIALISED. IN SUCH CIRCUMSTANCES, EXPORT CREDIT FACILITIES WOULD BE RESUMED, AS HAD HAPPENED IN THE CASE OF MEXICO. HE HAD COMMITTED HIMSELF TO THE BANKS AND HE NOW NEEDED THE SUPPORT OF MEMBER GOVERNMENTS IF THE BRAZILIAN PACKAGE WAS TO BE SUSTAINED.

3. HE THEN ASKED G10 DIRECTORS TO CONVEY THAT MESSAGE TO THEIR AUTHORITIES. THE DEPUTY MANAGING DIRECTOR, WITH DINI'S AGREEMENT, WOULD BE ATTENDING THE G10 DEPUTIES MEETING IN PARIS ON THURSDAY, NOVEMBER 17. THE MD HOPED THAT THE G10 DEPUTIES COULD INFORM THE DMD OF THEIR CONTRIBUTION DURING THE PARIS DISCUSSION. THIS INFORMATION COULD BE GIVEN BILATERALLY AND NO OTHER PARTY NEED BE TOLD ABOUT EACH COUNTRY'S RESPONSE. THE FUND COULD AGGREGATE RESPONSES, BUT WOULD NOT CIRCULATE THEM IN TABLES. THE MD EMPHASISED THAT THIS PROCEDURE WAS DIFFERENT FROM THE ORIGINAL PLEDGING SESSION APPROACH.

CONFIDENTIAL

/4.

4. THE ONLY SUBSTANTIVE QUESTION CAME FROM LOVATO (ITALIAN EXECUTIVE DIRECTOR) WHO ASKED ABOUT THE CRITERIA FOR ALLOCATING THE DOLLARS 2 AND ONE HALF BILLION BETWEEN COUNTRIES. THE MD REFERRED TO THE TABLES, DESCRIBED IN MY TELNO 360 OF NOVEMBER 7, WHICH GAVE KEYS BASED ON LEVELS OF TRADE AND BANKS' EXPOSURE. LOVATO SAID THAT HE HAD HEARD THAT SOME COUNTRIES, THOUGH NOT HIS AUTHORITIES, HAD FAVOURED ALLOCATION ACCORDING TO IMF QUOTAS. THE MD, SUPPORTED BY ERB (UNITED STATES ED) DISMISSED THIS APPROACH AND SEEMED TO SUGGEST THAT THE BETTER KEY WAS ONE BASED ON TRADE SHARES ASSESSMENT.

5. I AM SORRY THAT I STILL CANNOT OFFER HARD INFORMATION ON THE FUND PROGRAM WHICH IS EMERGING FROM THE MD'S DISCUSSIONS WITH DELFIM NETTO AND PASTORE. THE SENIOR FUND STAFF ARE CLOSETED IN MEETINGS AND ARE RATHER UNWILLING TO DISCLOSE POSITION IN ADVANCE OF FINAL AGREEMENT. MY UNITED STATES COLLEAGUE (PLEASE PROTECT) TELLS ME THAT FOR THE PURPOSE OF BRIEFING SECRETARY REGAN FOR HIS MEETING WITH DELFIM NETTO THIS AFTERNOON, THE MD HAS TOLD HIM THAT THE FINAL PACKAGE WILL PROBABLY INCLUDE SOME SIDE AGREEMENTS FOR FURTHER FISCAL ACTION. THESE WILL BE KEPT SECRET AND MAY NOT EVEN BE MENTIONED TO THE BOARD.

6. THE ABSENCE OF HARD INFORMATION ON THE FUND PROGRAM MAKES IT DIFFICULT TO GIVE A WORTHWHILE ASSESSMENT. BUT IT IS EVIDENT THAT THE MD IS HAVING TO STEER A COURSE BETWEEN POLITICAL REALITIES IN BRAZIL AND THE REALITIES OF THE MARKET PLACE. HE KNOWS THAT WHATEVER ENDORSEMENT THE FUND GIVES THE BRAZILIAN PROGRAM, THE MARKET, AND IN PARTICULAR BRAZIL'S ABILITY TO COMMAND CONFIDENCE IN INTERNATIONAL FINANCIAL CIRCLES, WILL BE THE FINAL ARBITER OF THAT COUNTRY'S ECONOMIC RECOVERY. AN AGREEMENT ON PAPER BETWEEN THE FUND AND BRAZIL, MIGHT HELP THE BRAZILIAN GOVERNMENT'S IMMEDIATE POLITICAL DIFFICULTY AND MIGHT LET THE FUND OFF THE HOOK. BUT IF THE PROGRAM FELL TO PIECES NEXT YEAR, THIS WOULD BE VERY DAMAGING TO THE IMF'S EFFORTS TO MAINTAIN THE STABILITY OF THE INTERNATIONAL MONETARY SYSTEM AND TO BRAZIL'S OWN MEDIUM-TERM PROSPECTS.

7. ALL THIS WILL BE CLEAR TO THE MD AND I WOULD THEREFORE BE SURPRISED IF HE KNOWINGLY WOULD PUT A LAME-DUCK PROGRAM TO HIS BOARD. BUT MY CONCERN IS THAT THE FUND'S HIGHLY CAPABLE ECONOMISTS MAY STILL HAVE NOT GOT TO GRIPS WITH THE INTRICACIES OF BRAZIL'S HIGHLY COMPLEX ECONOMY SO THAT THE REVISED PROGRAM, LIKE THE EARLIER ONE, MAY NOT BE SOUNDLY BASED. MOREOVER, THE MD MAY BE ONCE AGAIN RATHER TOO READY TO ACCEPT ASSURANCES FROM MR DELFIM NETTO ABOUT FUTURE PROGRESS: THE SUGGESTION THAT THERE MIGHT BE AN UNPUBLISHED SIDE AGREEMENT BETWEEN THE FUND AND BRAZIL DOES NOT, ON THIS ACCOUNT, INSPIRE CONFIDENCE.

8. BUT DESPITE THESE RESERVATIONS, AND SUBJECT TO THE OUTCOME OF THE DOLLARS 2 AND ONE HALF BILLION FINANCING PACKAGE, I THINK THAT WE SHOULD ENDORSE THE RECOMMENDATION FROM THE MD TO SUPPORT A REVISED BRAZILIAN PROGRAM UNLESS THERE ARE FIRM GROUNDS FOR BELIEVING THAT IT WILL BE INEFFECTIVE.

/9.

9. WHATEVER THE SUCCESS OF THE MD'S DISCUSSIONS WITH DELFIM NETTO AND PASTORE, IT IS STILL MOST UNCLEAR WHETHER HE CAN ASSEMBLE THE DOLLARS 2 AND ONE HALF BILLION OFFICIAL FINANCING PACKAGE. MY GERMAN COLLEAGUE (LASKE) TOLD ME TODAY THAT IT IS VERY DIFFICULT, IF NOT IMPOSSIBLE, FOR HIS AUTHORITIES TO GIVE THE SORT OF QUANTIFIED ANSWER WHICH HE IS NOW SEEKING. THE JAPANESE ALTERNATE DIRECTOR (YAMASHITA) SAID THAT HIS GOVERNMENT'S POSITION ON A CONTRIBUTION TO THE DOLLARS 2 AND ONE HALF BILLION WAS STILL AS DESCRIBED IN MY TELNO 357 OF NOVEMBER 3, BUT THE MD'S RETREAT FROM A FORMAL PLEDGING SESSION MIGHT HELP MATTERS. IN SHORT, IT LOOKS AS IF THE MD MAY HAVE MANOEUVRED HIMSELF INTO A BOX ON THE DOLLARS 2 AND ONE HALF BILLION. IT IS, OF COURSE, POSSIBLE THAT G10 DEPUTIES WILL PROVIDE THE DMD WITH QUANTIFIED RANGES, IN HOWEVER VAGUE A FORM, WHICH PERMITS HIM TO GIVE THE BANKS AND THE EXECUTIVE BOARD ASSURANCES THAT THE DOLLARS 2 AND ONE HALF BILLION WILL BE MET. BUT STRAIGHTFORWARD AND HONEST DEALING CLEARLY LIMITS THE DEGREE OF VAGUENESS TOLERABLE HERE. NOTHING HAS EMERGED FROM THE DISCUSSIONS HERE WHICH SUGGESTS THAT A UK CONTRIBUTION IS ESSENTIAL TO THE SUCCESS OF THE OFFICIAL FINANCING PACKAGE.

10. SO FAR AS WE CAN TELL, THERE ARE NO CONTINGENCY PLANS HERE TO DEAL WITH THE EVENT THAT THE DOLLARS 2 AND ONE HALF BILLION IS NOT RAISED.

11. FCO PLEASE ADVANCE TO PS/CHANCELLOR, PS/SOS, LITTLER AND MOUNTFIELD (TREASURY) LOEHNIS AND GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

WICKS

MONETARY
SAMD

COPIES TO
MR LOEHNIS } B/ENGLAND
MR GILCHRIST }

CE NO

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DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
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JH 123

Secretary of State for Trade and Industry

11 November 1983

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Dear Chancellor,

BRAZIL

We had a quick word in Bonn about Brazil. I said that there are one or two trade considerations which ought to be taken into account. The purpose of this letter is to amplify what I said.

2 The situation seems to be constantly changing but if, contrary to latest expectations, the rescue package should collapse outright, default by Brazil would involve ECGD in meeting claims totalling some £500 million in the period up to the end of 1986. If it led to domino-like further defaults elsewhere in Latin America, a further £250 million of additional claims might arise. Claims on ECGD on this scale would have unwelcome PSBR implications, and would threaten the financial viability of the whole ECGD scheme, although as you said, even these sums would be small beside other costs which might arise.

3 A Brazilian default would also result in a significant loss of UK exports. Brazil would be forced to pay cash for imports, and place even greater reliance on counter trading, which in general would work against us. Similar defaults elsewhere in Latin America could put at risk much of our £600 million trade with the region. Longer term prospects in Latin America, a region of great potential to absorb more UK exports, but where at present our market share is minimal, would suffer a severe knock.

4 For good reasons we have hitherto been against putting up new export credits. But there is a case for doing so on the ground that without incurring any additional public expenditure, we could keep a continuing UK foothold in the Brazilian market, and avoid discrimination against UK exports in the longer term, when Brazil may again be able to take imports - as we hope she will if the IMF package is successful.

5 Our share of new export credits in proportion to current export credit exposure would be around £100 million, guaranteed by ECGD and <u>tied to UK exports</u> of industrial products essential

to the Brazilian stabilisation programme or for longer term projects in which there is already a British interest.

6 Other factors will rightly come into our decision, but we should not discount the trade and employment benefits which would accrue from guarantees for a modest amount of new export credits in line with our OECD partners. In contrast to what must be expected if the rescue operation were to fail, there would be no direct charge on public expenditure, but no more than a contingent liability against the possibility of future non-payment. This might most conveniently be assumed by making use of ECGD's dormant powers to render economic assistance to overseas countries.

7 However, if we believe that the IMF package will work, then clearly a new line of ECGD credit would not be at risk. On the other hand if we are unwilling to risk a new line of credit, the implication must be that we have little confidence in the package and must therefore be bracing ourselves for its failure.

8 I am copying this letter to the Prime Minister, the Foreign Secretary and the Governor.

Yours sincerely,

Ruth Thompson

NORMAN TEBBIT

(approved by the Secretary of State and signed in his absence)

020

Prime Minister (2)

We have arranged a meeting for Wednesday morning with ChlEx, FS and Governor, each with one supporter. Treasury are likely to oppose strongly.

AT 9/4

PM/83/88

PRIME MINISTER

Brazil

1. You indicated in September that it might be necessary to reconsider our decision not to provide new export credits for Brazil if Brazil's problems reached a critical stage.

2. The latest JIC assessment on Latin American debt and the most recent Bank of England survey of the international financial scene are both sombre about prospects in Latin America. I think we both had this in mind during our talk with Dam at Chequers on Monday. The JIC assessment argues that there is a substantial risk that the current ad hoc rescue package technique might break down in the case of one or two debtor countries. This could involve providing additional official support to minimise the resulting impact on the international banking system. The Bank of England paper argues that the success of the Brazilian exercise is vital to sustaining confidence. It concludes that if this confidence is lost the outlook for next year will be bleak.

3. Meanwhile the Brazilian package itself is at a crucial stage. On 18 November the IMF Executive Board is due to consider the Brazilian programme, and the following week the Paris Club will discuss rescheduling Brazil's officially guaranteed debt. The Brazilian Government has made strenuous efforts to pass a law which will de-index wages. The latest proposal provides for less de-indexation than the IMF originally envisaged. But the political pressures on the Brazilian Government are intense and it believes that this is the best that can be achieved in the prevailing situation.

/4. The IMF

4. The IMF calculates that there is a financing gap of some $2.5 billion. The IMF's Managing Director asked governments to indicate by 14 November whether they are willing to grant new credits or to participate in a managed package for Brazil. He is also seeking from the commercial banks by the same date firm commitments that they will be prepared to participate in the $6.5 billion commercial loan operation for Brazil.

5. The Americans have taken the line that they are prepared to put up $1.25 billion of Eximbank credits as part of a managed operation if other governments provide a similar amount in aggregate. The Japanese and Germans have not said definitely whether they will participate themselves but have not ruled out a contribution. Although we had an earlier indication that the French, like the Germans, would be prepared to make export credits available on an ad hoc basis in support of their own commercial contracts, the French have not revealed this to the IMF. Nor have other European countries. The UK's position of not being willing to provide new export credits is well known.

6. I fully understand the reasons why we have taken a firm line. I entirely agree that the Americans must be pressed to do more for the IMF. At the same time the Brazilians are now beginning to single out the United Kingdom as taking a particularly hard line on the provision of export credits. There have been suggestions in the press about a linkage with transit rights to the Falklands. Our Ambassador in Brasilia has taken corrective action but there is a risk of long-term damage to our bilateral trading and political relations with Brazil. There is also the question of the signal which is given by governments to the private banks in present circumstances, in view of the generally increased possibility of a breakdown described by the JIC and the Bank of England.

/7. I suggest

7. I suggest it would be useful to have a meeting soon to discuss Brazil, perhaps early next week. We would then be able to take a final decision on our policy in the light of the other replies to the Managing Director's request for commitments from creditor governments. If you agree, it might also be prudent to ask our Executive Director at the IMF in any discussions with M. de Larosiere to continue to emphasise our reluctance to participate in a managed package, but to indicate that we are still considering the matter.

8. I am copying this minute to Nigel Lawson and to Robin Leigh-Pemberton.

GEOFFREY HOWE

Foreign and Commonwealth Office
8 November 1983

Econ Pol
Indebtedness
Part 3.

Prime Minister (2)
To note. I am considering how to reflect this in Guildhall speech. No need to read beyond p. 4 of attachment.
AT 7/11

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

7 November 1983

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew,

INTERNATIONAL FINANCIAL SCENE

I enclose the latest assessment of the international financial scene by the Bank of England, which the Treasury have discussed with the Bank and other Departments. The Prime Minister may find it useful background reading before the Anglo-German Summit.

On Brazil, our approach remains as agreed between the Prime Minister and the Chancellor in September. Problems over the introduction of the wage de-indexation law have however caused fresh uncertainties about the IMF package, and the Fund are currently assessing the impact of the revised law. Our Executive Director and other G10 colleagues saw the Managing Director on 3 November. There is no sign so far that the Fund staff are taking a less stringent view of Brazil's adjustment requirements. The Executive Board discussion is still planned for 18 November. At the 3 November meeting the Managing Director's main concern was to try to firm up an official package in order to be able by 14 November to indicate its approximate size to the commercial banks, who have been asked to make their commitments by then. The Americans confirmed that they were prepared to fill up to half of the $2.5 billion "financing gap" but that they looked to other official creditors "in the aggregate to make a matching commitment". So far only the Canadians ("an appropriate share") and the Dutch ("if the US contribution were more than 50 per cent") have made any commitment. The Japanese and the Germans remain unforthcoming: both see problems in providing new export credit to a country rescheduling its debts, but neither has finally ruled out making a contribution. We propose (and this is understood by the Fund and our G10 colleagues) to stick on our participation in the Paris Club rescheduling. The Chancellor is confident that the American contribution will in the end be above $1.25 billion.

/As for Argentina,

As for Argentina, it is too early to say exactly how the election results will affect debt repayment. Sir Alfonsin has said that Argentina will honour its international debt obligations, and his policy line is more moderate than that of the Peronists. But the transitional period, before he and his government assume power, will inevitably be one of further risk to the implementation of the IMF programme. We shall be monitoring the situation closely, and work has of course started on the remit from last week's Cabinet on arms sales and the commercial bank loan.

Our next overall assessment will come forward in mid December.

As usual, I am sending copies of this letter to Brian Fall at the FCO, Callum McCarthy at DTI, and John Bartlett at the Bank of England.

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

INTERNATIONAL FINANCIAL SCENE

General situation

Two major developments since the last Report have created much uncertainty on the international debt front. First, Congress has not yet endorsed the USA's higher contribution to the Fund which, together with the related delay in the BIS' credit facility to the Fund, threatens to restrict the IMF's ability to lend at a critical stage. Second, prospects for the Brazilian package - on which much else hinges - now depend essentially on the Fund's reaction to the recent decree on wage indexation. With the Philippines having entered the emergency ward and the long anticipated Argentine elections imminent (30 October), the general atmosphere is highly tense, and confidence in current case-by-case techniques of debt management will be severely tested in the months ahead. The run-up to the IMF Board discussion of Brazil on 18 November will be a crucial period.

Economic background

Economic recovery is continuing in the major industrial countries. In particular, there have been encouraging signs during the third quarter of further non-inflationary growth in the United States. This industrial revival should benefit indebted countries in terms of export demand and has already given some impetus to commodity prices, thus improving the terms of trade for some ldcs - although a number of others continue to suffer from weak prices for their main exports. Recent declines in US short-term interest rates from their peak in August should also bring some relief, but they still remain well above the level obtaining for much of the past year. Moreover, the future course of US interest rates remains highly uncertain. While these developments are on the whole encouraging, there is no general confidence that the recovery in industrial countries is yet broadly or firmly based.

The floating off hypothesis

International lending

Recent figures confirm the marked slowdown in international bank lending. The latest BIS statistics show that international banks' total net lending rose by $15 bn in the second quarter, compared with $30 bn in the corresponding period of 1982, and a quarterly average of $24 bn last year. Data for the third quarter from the London market suggest that the downward trend has continued. Within the total rise in the second quarter, net lending to non-oil developing countries increased by $4 1/4 bn, bringing the rise in the first half-year to some $6 bn. So new bank borrowing by ldcs in 1983 is likely to be much less than was expected at the beginning of the year; and the IMF, for example, have reduced their projection from $20 bn to $15 bn. Managed borrowing will predominate, and could "crowd out" other borrowers, who might then face severe balance of payments financing problems. For the most part, only prime borrowers are at present able to raise funds in the market.

Problems of this kind have already arisen for the Philippines, which has been forced to call a 90-day moratorium on its debts (estimated at $25 bn), pending a rescheduling. For the present, the market is responding calmly to this development, with no signs yet of any tendency to link the Philippines with other Far Eastern borrowers such as South Korea, Thailand and Indonesia, since these countries are considered to have managed their economies, and their external debt, extremely well. Indeed, some of them have already reacted swiftly to the situation in the Philippines by cutting back borrowing programmes and making the necessary adjustment to their economic policies. Nevertheless, there is still a risk that a further general cutback in lending would produce cash flow problems, even for these previously relatively creditworthy borrowers.

In contrast, minor OECD countries, over some of which question marks have been raised in the past, continue successfully to be able to raise funds. Moreover, the market is still prepared to lend, though modestly and at a price, to Latin American borrowers such as Panama, Paraguay and Colombia, which have not experienced debt servicing problems.

Current problems

The whole process of international rescues for problem countries is currently being severely tested on a number of fronts simultaneously.

In the key country, Brazil, rejection by Congress of law 2045 on wage determination, and two subsequent replacement decrees - the latest of which reduces its severity - has created renewed uncertainties, after the encouraging response to the "roadshow". It remains to be seen how the IMF and the banks will react to the latest decree. Meanwhile, efforts are being made to assemble the components of a financial package within the next three weeks. De Larosiere has asked for written assurances by 14 November that $6 1/2 bn will be available from banks, and $2 1/2 bn from governments, to enable him to recommend the Brazilian programme to the IMF Executive Board on 18 November. The sheer size of the bank credit, its softer terms and the need to muster a quorum of committed banks to make the syndication viable, make selling the loan package to the banks a formidably difficult task. In particular, the banks will watch closely for assurances that the official contribution is fully subscribed and represents genuine new money. Such contributions will be seen not only as a signal of confidence in the recovery programme, but may also influence the degree of bank commitment to the present and prospective packages for Brazil (and other countries).

In many ways, Argentina is even more worrying than Brazil, because domestic political uncertainties make breakdown more likely. The political will to tackle the debt problem seems to be lacking, and the IMF programme could be on the verge of collapse, while the central bank's liquid assets are dangerously low. By itself, the uniquely difficult domestic political situation in Argentina, combined with its essentially favourable balance of trade, should make it an isolable problem; but a breakdown in Argentina at this rather delicate stage elsewhere could lead to a damaging deterioration of confidence. Developments in Mexico, on the other hand, remain encouraging, with a government willing and able to undertake appropriate adjustment; and there is unlikely to be much difficulty in securing the requisite new funds for next year, even though the authorities seem certain to demand, and might well be thought to deserve, better terms.

Role of the IMF and BIS

The effectiveness of the IMF in providing leadership, as well as credible adjustment programmes, could be impaired by apparent lack of official support. Latest expectations are that the IMF bill, which is crucial to the Fund's ability to take part in rescues, should ultimately be passed by the US Congress before the Thanksgiving recess beginning 19 November. In the meantime, agreement on a special BIS credit facility of SDR 3 bn to the IMF (which will next be discussed on 7 November in Basle) has been delayed, because some central banks - notably the Bundesbank - will not give their approval until it becomes clear that the American quota increase will be forthcoming, and partly because some central banks have still to swallow more fundamental reservations about the tenor of the loan and the USA's non-participation in it. This has already obliged the IMF to restrain the granting of new commitments.

Conclusion

The next few weeks will severely test the informal coalition between borrowers, banks, creditor governments and the IMF, which has so far managed to contain the debt crisis. A successful outcome, especially on Brazil, will be vital if considerable knock-on effects are to be avoided, and if confidence in present case-by-case techniques of crisis management is not to be seriously weakened. Without such confidence, the outlook for next year will be bleak.

The following sections assess the current position in major debtor countries in rather more detail.

Brazil

Brazil is still the largest single problem country on the international debt scene, and prospects are now even more uncertain after the Brazilian Congress' rejection of the crucial wage de-indexation Decree (No 2045) on 19 October. Although the government lost little time in issuing a new substitute Decree (No 2064), this in turn has now been replaced by a further, and less severe, decree (No 2065): it is not yet clear whether the IMF will consider this adequate. The provisions of Decree 2045 were at the heart of the revised IMF programme, for which the Brazilians signed a letter of intent on 15 September. Indeed, the IMF Managing Director not only required sufficient finance to be committed in support of the programme, but was also not prepared to recommend the programme to the Executive Board until the Decree had passed into law. A financing gap of $11 bn has been identified for the remainder of 1983 and 1984, which it is proposed to fill through a $6.5 bn new commercial bank loan, a $2 bn Paris Club rescheduling, and $2.5 bn from export credit and other official sources. The bankers' Advisory Group has agreed to market the new money loan on significantly better terms than for earlier funds, which is likely to set a precedent for other Latin American countries to follow. (Indeed, the Argentines have already sought similar concessions, both for the 1983 debt currently being discussed and for 1984 debt to be rescheduled). Initial reaction from banks, who have been asked to commit themselves to the new money loan by 14/15 November, has been one of philosophical resignation. Although political uncertainties within Brazil may create nervousness abroad, bankers' general attitude to the defeat of Decree 2045 and its subsequent amendments, will doubtless be determined by the IMF's reaction.

Prospects for raising $2.5 bn from official sources also remain uncertain. The USA, through the Eximbank, has indicated a willingness to provide $1 1/2 bn export credit facilities, on condition that other countries also contribute. But we are not aware that any other firm commitments have yet been received, while HMG remains opposed to putting up further official money for Brazil (over and above rescheduling of Paris Club maturities).

The latest wage decree improves prospects of early Congressional approval; but if this were not forthcoming before mid-November, the IMF Executive Board meeting (scheduled for 18 November) would be delayed, and further increases in arrears (already nearing $3 bn) would result. Such a development would be of concern to many US banks, in view of the regulatory requirement to classify loans as non-performing when interest arrears reach 90 days.

Other problem countries

(i) Latin America

Foreign banks' debt negotiations with Argentina have been bedevilled in the last month by increasing political interference ahead of the Presidential elections on 30 October, and by continuing build-up of payments arrears. However, having overcome an attempt by an Argentine federal judge to freeze the rescheduling talks, the Government has now reaffirmed its intention of finalising all rescheduling agreements by 30 November. Disbursement of the long-delayed first tranche of the $1.5 bn medium-term credit is now unlikely before 30 November at the earliest. The further delay reflects continuing payments arrears and a decision by banks to await the outcome of the elections in order to test the authorities' commitment to the refinancing package. The banks' Working Committee is currently seeking to reach final agreement with the Argentines on revised conditions attaching to the disbursement, which will primarily be used to make a repayment under the $1.1 bn bridging facility. Meanwhile, the IMF programme appears to be on the verge of collapsing, and the central bank's liquid assets are now dangerously low.

Relations between the Venezuelans and the banks continue to be soured by the steady accumulation of interest arrears, now totalling around $600 mn. Several default suits are reported to be in the pipeline. Meanwhile, the banks have had no option but to agree to a further extension of the 90-day moratorium which expired at end-September. The Government had sought a 120-day extension, but the banks, conscious of the need to adopt a hard line if progress in rescheduling negotiations was to be made, have granted only 30 days.

If, in the Advisory Committee's view, the Venezuelans have made significant headway towards paying off interest arrears and negotiating an IMF economic adjustment programme, it will recommend a further 90-day extension until the end of January.

In sharp contrast to the other major problem countries, Mexico's position continues to provide grounds for optimism. Agreements to reschedule virtually all public sector maturities up to end-1984 have now been signed, and commitments to Mexico's private sector debt rescheduling scheme have risen rapidly in recent weeks. The authorities are soon to begin negotiations on new money requirements for next year, which are reckoned to be $4 bn from banks and $1.5 bn from official sources.

Elsewhere, Peru has been obliged to approach the IMF for a conditional waiver of the EFF performance targets for September and December. The breakdown of the programme will delay the next scheduled drawing from the Fund in November, and hold up the remaining $200 mn to be disbursed under the $450 mn new money loan from banks.

More encouragingly, the Chileans have reported that their standby arrangement returned to its original path by the end-September deadline, although the authorities are now seeking easier terms under the second year of the programme; and Ecuador's commercial bank refinancing package was signed on 12 October.

(ii) Far East

The liquidity crisis in the Philippines has now obliged the authorities to seek a 90-day moratorium on repayments of debt principal to banks. During this period, a new SBA is to be negotiated with the Fund and a financing plan agreed for the remainder of 1983 and 1984, which will no doubt include a formal rescheduling package. Continuing concern about political stability makes the situation even more delicate. However, there has been no evidence that the problems in the Philippines have weakened confidence elsewhere in South East Asia, although one report indicates that Indonesia may wait for more settled conditions before coming to the market again. Otherwise, both that country and South Korea appear to be making further progress in adjusting their economies in the light of lower oil prices.

(iii) Eastern Europe

Official contact with Poland (albeit still on a conditional and technical basis) has been renewed: the creditors' group sent a fact-finding team to Warsaw in early October and will meet on 26 October to review its report and decide whether to invite the Poles to Paris in November to resume rescheduling negotiations. The US position remains unclear. Meanwhile, the commercial banks are expected to sign their agreement in Luxembourg on 3 November to reschedule 1983 maturities. Although the 1983 support programme for Yugoslavia has for the most part still to be implemented, preliminary soundings are being taken by the IMF on the possible format for 1984.

(iv) Southern Europe

Although the external positions of Portugal, Spain and Greece are likely to remain under strain for some time, no debt servicing difficulties are expected in the short term. Indeed, there are positive signs of improvement from both Portugal and Spain. In Portugal, the fairly rigorous programme recently agreed with the IMF for a standby facility worth $475 mn over 18 months - approved in conjunction with a compensatory financing facility worth $275 mn - lays the basis for a staged return to a more sustainable external position, while the current account showed a strong improvement in the first half of 1983. The announcement of the IMF programme also seems to have improved market sentiment: the reception for Portugal's request for a seven-year $300 mn euro-credit was so favourable that it was raised to $350 mn. Meanwhile, Portugal repaid $300 mn of the $700 mn BIS facility arranged in two tranches earlier this year, and a further credit of $300 mn was advanced in August. The Spanish current account deficit has also improved somewhat this year, and faster progress seems likely in 1984. Foreign exchange reserves, however, have been severely depleted, and it will be some time yet before Spain is able to stabilise its external indebtedness, let alone reduce it. Even so, there are no signs of serious resistance to Spain's very considerable financing demands from the market. In Greece, on the other hand, with foreign exchange reserves already low (less than 1 1/2 months' imports at end-June), the current account deficit is expected to worsen slightly this year, reflecting a poor export performance and reduced invisible earnings. Nevertheless, the debt service ratio (including short-term debt) was only 24% in 1982 and should not be much higher this year. Borrowing on the international markets still appears to be well received, and $1 bn was raised in the first eight months of this year, compared with $1.7 bn in the whole of 1982.

INTERNATIONAL BANK LENDING: PROSPECTS TO THE END OF 1984

The IMF has shaded down its 1983 forecast for commercial bank net lending to non-oil ldcs as the year has progressed, and by mid-year had reduced it to a rise of only 5% on end-1982, or some $15 bn. The Bank of England has done likewise, with our latest October forecast coming out at 4%. On the other hand, the BIS, in its press release on the 1983 second quarter figures, sounds a more optimistic note. These forecasts include unspontaneous lending as part of rescue packages, and are based mainly on estimates of the supply of bank credit (ie the willingness of banks to lend), rather than on ex ante demand from borrowers. This slowdown in bank lending has made the borrowers more dependent than usual on official sources of financing: thus, in the first half of the year, the IMF and commercial banks each lent some $6 bn net.

In the next fifteen months, the attitude of the banks is likely to be strongly influenced by the contribution of the IMF, not only financially, but also in designing adjustment programmes which are seen to be effective. In this light, the outcome of the Annual Meetings is hard to interpret. The Fund still lacks the certainty of adequate resources and, without them, the Managing Director is less likely to succeed in persuading banks to extend sufficient new loans. However, the compromise on access limits still gives the Fund some flexibility. On balance, we believe that IMF finance in 1984 will be broadly the same in absolute terms as this year, subject to a number of provisos.

The first, and most important proviso, is that the informal coalition of borrowers and official and private creditors, holds together to make the rescue packages work. This is still assumed to be the case in our central forecast and, if it materialises, 1984 will in many ways resemble this year. But it will not be easy to sustain this coalition: it is subject to a number of risks which vary in their capacity to affect the international financial system. The worst outcome would probably arise from a breakdown of the Brazil package, which might coincide with a breakdown in Argentina and threaten the solvency of some major banks. Each new round of negotiations puts a further strain on the cohesion of the coalition, as the banks are becoming increasingly aware, in a mood of resignation, that they will be faced with requests for more managed lending over the next couple of years.

Another proviso is that banks' appetite for international lending does not become so dulled by unspontaneous lending that it crowds out lending to other ldcs. There is some anecdotal evidence that banks are undershooting their aggregate lending capacity; and any further reduction in lending could begin to create cash flow difficulties, even for creditworthy borrowers.

The current round of fund-raising for Brazil is a major test of the structure of rescue packages which has emerged over the last year or so. Success will strengthen it, failure probably destroy it. This structure reflects two principles which seem to be the key to success - leadership and burden-sharing. De Larosiere has already assumed the leadership role in this round, in relation to both commercial and official contributions. The Brazilian outcome has been made more difficult to assess by the recent rejection of legislation on wage indexation and its replacement by new - and less severe - legislation, to which the Fund's reaction is not yet known. The banks for their part will certainly be influenced by the amount of official assistance offered. In any case, there is likely to be some shortfall on the commercial bank target of $6.5 bn, as some banks with relatively small exposures refuse to take part. If, in addition, there were to be a shortfall on official funds, this might deter those contributors who have made their share in previous rounds conditional on a general response of close to 100% ie a strong demonstration of burden-sharing. In those circumstances, the package could well collapse and jeopardise other forms of financing, such as maintenance of exposure to Brazilian banks in the inter-bank market.

The reports are that de Larosiere wants commitments for a "critical mass" of 90% of the full amount of the new money from banks by 15 November to justify his recommending the programme to the IMF Board. Brazil does not require the full amount immediately, but it is debatable whether the banks would be ready to disburse the first instalment out of the initial commitments, unless and until these cover the whole $6.5 bn required. This target represents an average increase for all creditor banks of 10 1/2% of their exposure at the end of 1982. After allowing for their commitment to round 1, the total increase would be over 17% for 1983 and 1984 combined - considerably faster than the average net lending by banks to non-oil ldcs forecast over this period.

The outcome on Brazil will have an important bearing on banks' attitudes towards some of the other major borrowers.

Argentina has managed to survive so far without recourse to most of the 1983 rescue package. A complete breakdown now seems a distinct possibility, because of domestic political factors rather than because of the way in which the package has been assembled. Whether the impact of such an outcome could be insulated from the rest of the market would depend on timing and official reaction. For example, it would be easier to handle if the breakdown came after, rather than during, the formation of the Brazilian package. Other threats to the present policy of a case-by-case approach could be posed by the chaotic management of Venezuela's finances and by the Philippines. There is no sign yet that the effects will spread to the rest of the Pacific basin, but banks will be keeping a careful eye on South Korea after the assassinations.

By comparison, the outlook for Mexico is encouraging. The authorities are shortly to open discussions on financing for 1984: these are likely to proceed relatively smoothly, firstly in view of the track record so far, and secondly because negotiations will not be complicated by rescheduling of public sector debt, virtually all of which has now been completed. In the circumstances, the bankers may be ready to sign up for the $3.5 - 4 bn fairly quickly, although the Mexicans will certainly be demanding better terms.

By now, the East Bloc debts almost seem a problem of a separate kind. Poland apart, the other Bloc countries have in aggregate adjusted hard and have even been able to accommodate some (essentially involuntary) reduction in their net indebtedness to the West.

However, several of them (notably the GDR and Hungary) are almost certainly still under severe financial strain. The banks will continue to watch them with wariness. Yugoslavia remains in a very difficult position and will continue to need a managed approach for some time ahead.

Given the number of uncertainties, it would be surprising if there were not at least one breakdown in the relationship between borrowers and commercial banks. Nor does success in one round guarantee it in the following. For example, Brazil's programme may come to lack credibility because of a hardening belief that a financing gap will open up again in 1984. Moreover, performance under some of the other country programmes could be disappointing and give rise to a financing gap, which would make further - premature - rounds inevitable. If these factors were to be a prelude to a breakdown in the present case-by-case approach, their impact on other countries would depend essentially on speed and presentation: slow disintegration might provide an opportunity to patch up the coalition, while outright repudiation by a borrower could have very damaging consequences for the international financial system. Either would materially increase the clamour for a "long-term" solution.

The risks so far described concern structural areas in the international banking system. But a breakdown of IMF programmes for technical reasons is also a possibility: these are based in the final analysis on assumptions about the behaviour of the international economy, which may not be validated. One such assumption, which has quite wide acceptance, is that real growth of some 2 1/2% - 3% in the OECD countries would be sufficient to "float off" the debt problem. Even if this were to materialise, however, the present round of rescheduling has built up heavy capital repayments for the future: even with an appreciable improvement in world growth, combined with much lower interest rates, further rescheduling of such debt - which will almost certainly be necessary towards the end of the decade - may prove to be difficult to negotiate satisfactorily. But that is not a problem for 1984 - for which our central forecast, notwithstanding the downside risks that this overview, perhaps over-pessimistically, has emphasised, is still that the system should somehow scrape through.

Elec. pol 58 Indebtedness Pt. 3

INDEBTEDNESS AND BRITISH EXPOSURE

$ billion

	Total external debt	British banks unguaranteed claims		ECGD amounts at risk
	End-Dec 1982	End-Dec 1982	End-June 1983	End-Dec 1982
Latin America				
Argentina	39	2.3	2.4	0.4
Brazil	83	4.4	4.6	2.3
Chile	18	1.1	1.1	0.05
Ecuador	6	0.5	0.5	0.1
Mexico	83	5.2	5.4	1.6
Peru	12	0.4	0.4	0.2
Uruguay	4	0.3	0.3	0.01
Venezuela	34	2.4	2.3	0.08
Eastern Europe (convertible currency)				
East Germany	15	0.8	0.6	0.2
Hungary	7	0.5	0.4	0.08
Poland	27	0.5	0.6	1.2
Romania	10	0.4	0.3	0.6
Yugoslavia	18	0.9	0.9	1.2
Southern Europe				
Portugal	14	0.8	0.8	0.4
Greece	11	0.7	0.9	0.4
Spain	28	2.4	2.4	0.2
Israel	21	0.4	0.5	0.2
Far East				
Indonesia	24	0.6	0.7	1.5
Philippines	24	1.2	1.3	0.3
South Korea	37	2.0	1.9	1.0
Other				
Morocco	11	0.2	0.1	0.2

Because of differences in definition, the ECGD exposure figures in the final column are not directly comparable with the figures in other columns.

cc Master
OPS

SUBJECT

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T172C/83

THE EXECUTIVE MANSION
OFFICE OF THE HEAD OF STATE
MONROVIA, LIBERIA

November 2, 1983

Dear Madam Prime Minister:

I take this opportunity to write your Excellency for the first time, on matters affecting the economic, social and political conditions in our country. I do so because of the long history of friendship between your country and the Republic of Liberia.

It is heartening to note that your government has been generous, over the years in providing assistance to our government.

As we have proceeded in our task of reconstructing our country, we have experienced severe economic setbacks due principally to two major factors:

1. The general decline in price and demand for our principal export commodities, caused by the worldwide recession, and

2. The debt burden we inherited which amounted to nearly a billion dollars at the time we came to power.

Therefore, much of the scarce resources we have endeavoured to obtain, since the encumbency of our leadership, have gone toward the payment of interest on loans which date as far as 1943.

Her Excellency Margaret Thatcher
Prime Minister of Great Britain
10 Downing Street
London, UNITED KINGDOM.

A careful survey has been made of most of the loans obtained by the government of Liberia between 1943-1980. Records indicate that our indebtedness to donor countries and international financial institutions exceed one billion dollars.

We are currently establishing a technical team to carefully examine each of the loans obtained to determine whether payment has been completed and how these loans utilized.

We shall also seek the possibility of having some of the loans converted to grants and we will also begin a systematic appeal to donor countries to have them cancel some of these long-standing commitments.

At the same time, we feel convinced that a large percentage of the funds acquired for national development ended up in private accounts, with the majority of Liberians obtaining no benefits. This has been an unfortunate situation affecting our country in the last few years.

I am bringing this situation to your attention with the hope that you will develop an indepth understanding of the great problems our nation is facing and to ask you to use your good offices in having your government examine our commitment to it.

THE EXECUTIVE MANSION
OFFICE OF THE HEAD OF STATE
MONROVIA, LIBERIA

We hope that after such an examination your government will help relieve us of some of the burden through any of the above mentioned conditions, whether cancellation or conversion of loans to grants.

We have thought to present this issue to your Excellency because of our firm belief in the friendship between our two countries and in the free enterprise system of government which our two nations have persistently pursued.

I am taking the liberty to forward you a copy of a document giving you an idea of some of our outstanding loans for the period covering the last 20 years.

Please accept, Madam Prime Minister, the assurances of my highest esteem and very personal regards.

Cordially yours,

CIC Samuel K. Doe
HEAD OF STATE AND CHAIRMAN,
PEOPLE'S REDEMPTION COUNCIL

APPENDIX 1

FOREIGN LOANS OBTAINED BY THE GOVERNMENT OF LIBERIA, 1943-1980

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
1.	U.S. Gol/Port of Monrovia	$18,922,682.39	Dec. 31, 1943	Construction of Monrovia Port	Left Open	23 years after first disbursement	$482,592.00	1999
2.	Eximbank 489/ GOL Various	$5,000,000.00	Feb.21, 1951	Improvement and maintenance of Highway Project	3½ per annum	12 years	-	1976
3.	Eximbank 479/	$1,350,000.00	July 7, 1951	Construction of Water and Sewer System for Monrovia	3½% per annum	1 year after first disbursement	-	1975
4.	Eximbank 596/ GOL Various	$15,000,000.00	Feb. 9, 1955	Construction of highway and acquisition of related facilities	4 3/4% per annum	2½ years	$906,300.00	1980
5.	Eximbank 1072/ GOL Various	$7,265,000.00	June 12, 1957	Power Project	5 3/4% per annum	3 years	-	1974
6.	Eximbank 1560/ GOL Various	$4,750,000.00	Oct. 27, 1961	Improvement and Expansion of Electric Power System in the Monrovia Area	5 3/4% per annum	2 years after first disbursement	$190,000.00	1976
7.	U.S.A. Govt. Loan PL 480	$658,695.00	April 12, 1962	To Expand trade in Agricultural commodities	4% per annum	1 year after	$ 38,447.29	1977
8.	Moche Alon/ Bassa-Sinoe	$2,610,247.50	June 4, 1962	For the Construction of Roads projects in Buchanan and Greenville -Sinoe County	6½% per	5 years	$124,841.00	1977
9.	Buccimazza Industrial Works	$2,303,000.00	Dec. 12, 1962	Construction of Telecommunication building and Warehouse; Construction of telephone Exchange Satelite Station	9% per and 6½% thereafter	1 year	$160,000.00	1977

NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
0. USAID Loan 669-H-005	$24,300.000.00	Sept. 16, 1963	Mount Coffee Hydro Project	3/4 of 1% per annum	10 year after first disbursement	$724,207.00	2004
1. Eximbank R-5 GOL Various	$13,250,000.00	Oct. 10, 1963	Project Credits	5 3/4% per annum	6 years	$1,325,000.00	
12. USAID Loan 669-H-006A	$ 1,700,000.00	Oct. 28, 1963	Construction and Equipments of Monrovia Junior & Senior High School	3/4 of 1% per annum	12 years after first disbursement	$ 49,802.73	2006
13. RCA Victor/	$ 1,388,000.00	Oct. 29, 1963	Export Credits Insurance Corporation	6% per per annum	2 years after first disbursement	$ 50,000.00	1977
14. USAID Loan 669-H-004A	$ 5,300,000.00	Dec. 5, 1963	Construction of National Medical Center	1% per annum for 10 years and 2½% thereafter	13 years after first disbursement	$156,141.26	2006
15. IBRD 368/ 1st Highway Project	$ 3,250,000.00	Jan. 8, 1964	Construction of Clay Pujehun & between Schiefelin-Robertsfield Roads	5½% per annum	8 years	$415,000.00	1982
16. USAID Loan	$ 7,000,000.00	Aug. 27, 1964	For the Construction & Equipping of an expanded Water System for Monrovia Area	3/4 of 1% per annum & 2% per annum thereafter	10 years	$ -	-

NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
17. USAID Loan 669-H-006B	$400,000.00	June 17, 1965	First Amendment to loan 006A (Monrovia Jr.&Sr. High School) and increase total loan to $2,100,00.00	1% per annum for 10 years and 2½% thereafter	10 years	-	-
18. USAID Loan 669-H-007A	$150,000.00	June 17, 1965	First Amendment to loan 007A and to increase total amount to $500,000.00	1% per annum for 10 years and 2½% thereafter	10 years	$ 5,141.00	2006
19. USAID Loan 669-H-007B	$150,000.00	June 17, 1965	Ministry of Education; Monrovia Elementary School Project	3/4 of 1% per annum	9½ years	-	2004
20. U.K. Export Credit	$ 24,757.50	1965	Road Equipment.	Rescheduled	10 -	-	1989
21. USAID Loan 669-H-009	$7,200,000.00	1965	To extend Monrovia Systems.	1% per annum for 10 years and 2½% thereafter	10 years	$246,704.00	2006
22. U.S. GOV'T Loan PL480	$813,207.02	Jan. 18, 1966	Purchase and sale of U.S. Rice	1% per annum up to April 28, 1968 and 2% per annum thereafter	2 years	$ 42,800.37	1986
23. USAID 669-H-010	$1,324,689.00	Feb. 18, 1966	For Foreign exchange and Local Costs of Commodities and services project	1% for the first 10 years and 2½ therefore	10 years	-	1976

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
24.	KFW 65-65-261/ Capital Bye-Pass	$ 960,662.00	Dec. 5, 1966	For the Construction within Monrovia, on the Capital Bye-Pass Project	2% per annum	8 years	$ 27,292.00	1991
25.	KRED-AL-328	$ 960,667.00	Dec. 7, 1966	Construction of Capital Bye-Pass	$\frac{1}{4}$% per annum on disbursed amount; and 3% per annum on disbursed amount	8 years	-	1991
26.	USAID Loan 669-H-012	$ 550,000.00	April 25, 1967	Technical Assistance for Commodities and Services	1% per annum 10 years and 2$\frac{1}{2}$% thereafter	10 years	$ 18,961.00	2004
27.	USAID Loan 669-H-013/ Commerce - RIA	$ 270,000.00	April 25, 1967	Improvements of Roberts International Airport's landing area, air traffic Control Systems, Navigational aids and supporting facilities	1% per annum for 10 years and 2$\frac{1}{2}$% per annum thereafter	9$\frac{1}{2}$ years	$ 8,940.96	2016
28.	USAID Loan 669-H-014	$ 850,000.00	Aug. 10, 1967	Airborne Geographical Survey of Liberia mineral Resources	1% per annum for 10 years and 2$\frac{1}{2}$% thereafter	10 years	$ 29,223.00	2007
29.	US GOV'T Loan PL 480	$ 812,000.00	Oct. 23, 1967	For Sales of Agricultural Commodities	1% per annum up to 1970 and 2$\frac{1}{2}$% thereafter	3 years	$ 42,718.92	1988
30.	USAID Loan 669-H-015	$ 525,000.00	March 17, 1968	Technical Assistance Projects	2% per annum	10 years	-	2009

	NAME-OF-LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
✓31.	Rediffusion Overseas/GOL	$1,[illegible]00.000.00	June 27, 1968	To operate and manage ELBC	6½% per annum	-	-	1989
32.	USAID Loan 669-H-004B	$1,510,000.00	Aug. 13, 1968	Costs of equipments, Commodities and services	1% per annum for 10 years and 2½% thereafter	-	-	2006
33.	Pan American/ Spriggs Payne Airfield	$ 500,000.00	Aug. 28, 1968	Development, Management and Operation of the Spriggs Payne Airfield.	6% per annum	2 years	$ 55,000.00	1980
34.	IBRD 617/Port Port Dredging Project	$3,600,000.00	1969	Financing of a Port Dredging Project	6½% per annum	2 years	-	1984
35.	Eximbank 126/ GOL	$5,297,230.00	April 23, 1969	To facilitate Exports Exchange of Commodities between U.S. and Liberia	6% per annum	-	-	-
✓36.	USAID Loan 669-H-016	$ 975,000.00	Nov. 18, 1969	Construction of two Rural access roads (Kolahun-Kamatahun and Zwedru-Ziah town)	2% per annum	10 years	$ 33,408.52	2010
✓37.	USAID Loan 669-H-017B	$4,000,000.00	Dec. 18, 1969	Construction, Supervisory to engineering services for the improvements to Roberts International Airport	2% per annum for 10 years, and 3% thereafter	10 years	$139,602.90	2011

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
✓ 38.	IBRD/PUA 684 LBR	$7,400.000.00	June 4, 1970	Loan agreement for PUA	7% per annum	5 years	$237, 00.00	1990
39.	U.S. GOV'T Loan PL480	$ 862,653.14	June 24, 1970	For Sales of Agricultural Commodities	2% per annum up to 1972 and 3% thereafter	2 years	$ 45,402.80	1990
✓ 40.	USAID Loan 669-H-019/ (Pleebo-Sanniquellie Project.)	$3,400,000.00	1972	Cost of goods and Services required for construction of two rural access roads. (Pleebo-Barclayville and Saclepea-Gbahn-Sanniquellie).	2% per annum for 10 years and 3% thereafter	10 years	$118,540.56	2012
41.	USAID 669-H-017A	$3,500,000.00	1972	First Amendment to loan #017 (Roberts International Airport) and provide additional funds	2% per annum for 10 years and 3% thereafter	10 years	$116,667.00	2013
42.	U.S. GOV'T Loan PL480	$1,281,000.00	April 26, 1972	For Sales of Agricultural Commodities	2% per annum up to 1974 and 3% thereafter	2 years	$ 67,421.05	1992
✓ 43.	IDA 305 Education Project	$7,200,000.00	May 17, 1972	Construction, furnishing and equipping of two new Multilateral High Schools; One New College of Agriculture and Forestry	½ of 1% per annum	10 years	-	2022

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	AGREEMENT PURPOSE OF LOAN	INTEREST RATE	INTEREST GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
44.	IBRD 839/ LBIDA	$6,000,000.00	June 26, 1972	Forestry Development Authority	7¼% per annum	3 years	$ 25,000.00	1990
45.	A/S Edelbe-tong Co. #1	$2,750.000.00	Jan. 24, 1973	Implementation of Low Cost Housing Project	8% per annum	-	-	-
46.	USAID 669-H-020/Road Maintenance Equipment	$4,400.000.00	Feb. 26, 1973	For the purchase of Road Maintenance Equipment	2% per annum for 10 years, 3% thereafter	10-years	-	-
47.	IBRD 907	$3,000.000.00	June 13, 1973	2nd Highways Project	3% per annum	5 years	$ 70,000.00	1997
✓ 48.	ADB-001 Sierra Leone-Liberia	$1,106,713.00	Dec. 5, 1973	Sierra Leone-Liberia Road Link	6% per annum	3 years	$ 31,165.00	1991
49.	Eximbank 5059/ Presidential Jet	$1,462,500.00	1974	Presidential Jet	6% per annum	3 years	-	1979
✓ 50.	KFW AL - 688	$2,247,191.00	Feb. 11, 1974	For the purchase of equipments for Greenville Habour	2% per	10 years	-	2004
51.	Morgan Greenfell #2	$8,807,540.00	April 24, 1974	Equipment for Tele-Communication	8% per	-	-	1979
52.	National Port Authority/GOL Various	$2,500,000.00	1957	-	3% per annum	1 year	$250,000.00	1981
53.	Italian Loan/ Monrovia Street Drinage	$9,360,000.00	Feb. 28, 1975	To implement the Monrovia road project- sewerage, construction and paving	8½% per annum	2 years	-	1981

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[illegible].	USAID Loan 669-H-023/ MPW	$4,000.000.00	Aug. 1975	Five years road maintenance and development project	2% per annum for 10 years and 3% thereafter	$9\frac{1}{2}$ years	$ 59,872.76	2024
55.	IDA 577	$6,000.000.00	Aug. 1, 1975	Lofa County Agricultural Development project	$\frac{1}{2}$ of 1% per annum	10 years	-	2025
56.	IBRD #1150	$1,800.000.00	Aug. 1, 1975	Loan Agreement	4% per annum	1 year	-	1981
✓57.	IBRD #1156	$27,500.000.00	Aug. 28, 1975	Highway Projects	3/4 of 1% per annum	5 years	$910,000.00	2000
✓ 58.	IBRD #1156	$6,000.000.00	Aug. 28, 1975	Third Highway Projects	$8\frac{1}{2}$% per annum	5 years	$655,000.00	2000
✓ 59.	IBRD #1156 3rd Highway Project	$27,500,000.00	Aug. 28, 1975	Construction of a two Lane bridge (about 1,400 ft.) across the Mesurado River in Monrovia	3/4 of 1% per annum and $8\frac{1}{2}$% per annum	5 years	-	2000
60.	ADB/005 - Totota-Ganta Highway	$6,073.550.00	Sept. 8, 1975	Construction of two Lanes Bitumea Standard of approximately 40 miles of the Ganta portion of the Totota - Ganta road project	6% per annum	4 years	-	1997
61.	USAID 669-	$5,000,000.00	Nov. 10, 1975	Rural development in Lofa County involving improvement of upland agritural project	2% per annum for 10 years and 3% thereafter	$9\frac{1}{2}$ years	-	2024

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
62.	ADB-003/LEC PUA	-	Dec. 31, 1975	To improve and increase Water Supply Systems in Monrovia	6% per annun	3 years	-	1988
63.	IBRD/2nd Educational Project	$4,000,000.00	June 7, 1976	To design, construction, furnishing and equipping of about 100 primary Schools Units in about 50 villages in the counties of Bong, Lofa, Bassa, Cape Mount, Nimba and Montserrado. Improvement and expansion of a primary Teacher Training institute at Zorzor	6½% per annum	-	-	1989
64.	U.S. Department of Defense (Federal financing Bank). FFB	$1,700,000.00	June 30, 1976	For the purchase of Defense Articles	-	1 year	$170,000.00	1982
65.	U.S. Military Assistance 761	$1,700,000.00	June 30, 1976	For the purchase of Defense Articles	-	1 year	$170,000.00	1982
66.	KFW/Buchanana Water Supply	$3,000.000.00	July 6, 1976	Buchanan Water Supply	(To be determined)	10 years	-	2009
67.	Chase Manhattan Limited (London)	$30,000,000.00	Jan. 11, 1977	Proceeds to be provided to Liberian Public Corporations for use by them for general corporate purpose.		2 years	$5,454,556.00	1984

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
68.	ADB-007/4th Educational Project	$4,342,860.00	May 5, 1977	South Western Liberian Educational Project	4% per annum	5 years	$931,430.50	2001
69.	KFW/Water Supply	$8,235.294.00	May 25, 1977	Water Supplies for the towns of Voinjama, Sanniquellie and Gbarnga	(To be determined)	6 years	-	2007
70.	IBRD 1417/	$6,300,000.00	May 26, 1977	3rd Educational Project	8.02% per annum	5 years	$150,000.00	1997
71.	Eurodollar Credit Agreement	$1,010,000.00	Aug. 27, 1977	Loan Agreement	2% per annum	2 years	$167,372.00	1982
72.	Grindlay & Caravelle & Samas Glory Maritine Corporation	$5,500,000.00	Sept. 15, 1977	To assist: Grindlay limited to refinance other short term loans; Caravelle and Samas to prepay the principal amounts outstanding	1 3/4% per annum	1½ years	$550,000.00	-
73.	ADB-008/Tubman Bridge Bomi Hills Road	$6,073,500.00	Sept. 16, 1977	Construction of the Tubman Bridge - Bomi Hills road	7% per annum	4 years	-	1996
74.	IDA 700	$7,000,000.00	Dec. 29, 1977	Bong County Agricultural development project	½% of 1% per annum	10 years	-	2026
75.	USAID 669-T-025	$6,600,000.00	1978	Upper Bong County Integrated Rural development	2% per annum	9½ years	-	2027

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURI-TY YEAR
76.	ADB-009/Monrovia Water Supply	$2,612,841.21	Jan. 23, 1978	For a 15,000 ft. 36 inches gravity raw water main will be laid from Mount Coffee Hydro Electic Power dam to the existing treatment works of Monrovia Supply at White Plains	7% per annum	3 years	-	1993
77.	IBRD-1544/LRDU	$7,000,000.00	April 21, 1978	For Rubber development Project	7½% per annum	5 years	$235,000.00	1997
78.	IBRD-786	$6,000,000.00	April 21, 1978	Rubber Development Unit	½ of 1% per annum up to 1998 and 1½% thereafter	10 years	-	2028
79.	IBRD-1544/LBR	$7,000,000.00	April 21, 1978	Additional financial assistance	7½% per annum	5 years	$235,000.00	1998
80.	Citibank/AGRIMECO	$7,800,000.00	May 31, 1978	Loan Agreement	1 3/4% per annum	2 years	$100,000.00	1985
81.	IBRD-1573/4th Power Project (LEC)	$13,800,000.00	June 2, 1978	The construction and inprovement of the Paynesville-Totota road (about 71 miles) and reconstruction of the Paynesville-Robertsfield road (about 28 Miles)	3/4 of 1% per	4 years	$460,000.00	1998
82.	IBRD-1573 4th Power Project (LEC)	$13,800,000.00	June 2, 1978	4th Highway project	7'% per annum	5 years	$270,090.00	1998

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
83.	IBRD-1573/ LBR	$13,800,000.00	June 2, 1978	To assist in financing part of the project on the terms and conditions set forth in the Kuwait fund loan agreement.	$7\frac{1}{2}$% per annum	5 years	$460,000.00	1998
84.	Commonwealth Development Corporation/ Rubber Development Project	$7,128,275.00	June 9, 1978	Rubber development Unit	$7\frac{1}{4}$ per annum	6 years	-	1997
85.	Saudi Fund/ Tubman Bridge Bomi Hills roads Project	$9,000,000.00	June 12, 1978	Tubman bridge, Bomi Hills roads and St. Paul bridge project	2% per annum	5 years	-	1997
86.	BADEA/LIFZA	$3,200,000.00	June 14, 1978	For the financing of the Industrial Free-zone Project	-	-	$577,192.00	1984
87.	Eximbank 6449/ Citibank Boeing 737	$11,543,850.00	June 30, 1978	To purchase New 737 Boeing Air Craft and Spare parts	8 5/8% per annum	-	$577,192.00	1984
88.	KFW-65-231/ FDA	$4,975,124.00	June 30, 1978	Wood Processing and Training Center for Bomi Hills Project	6% per annum	5 years	-	2009
89.	KFW-Greenville Harbour	$5,814,799.00	July 1978	Rehabilitation and Extension of the Greenville Harbour	2% per annum	8 years	-	2005
90.	Republic of China/GOL	$23,000,000.00	July 1, 1978	Developing National Economy	Free	10 years	-	2000
91.	IBRD #1600	$10,000,000.00	July 7, 1978	4th Power Project (LEC)	_	5 years	_	1997

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
92.	Kuwait Fund/ Road Rehabilitation	$7,500,000.00	July 18, 1978	Reconstruction and improvement of the Paynesville-Totota road (about 71 miles) and reconstruction and improvement of the Robertsfield road (about 28 miles)	3½% per annum	4 years	-	1995
93.	IDA-839/FDA	$6,000,000.00	July 28, 1978	The first phase part A: Institutional support for FDA, Part B: Industrial trail Plantation, Part C: Training	3/4 of 1% per annum	10 years	-	2028
94.	Eurodollar Credit Agreement	$60,000,000.00	August 2, 1978	Credit Agreement	1 3/4% per	2 years	-	1985
95.	Chemical Bank/ LPRC	$15,000,000.00	Aug. 9, 1978	Finance the acquisition and improvement by LPRC of the assets of a refinery	3¼% per annum and 2¼% thereafter	2 years	$100,000.00	1985
96.	KFW-78-65 575/OAU 79	$4,696,150,00	Sept. 4, 1978	Procurement of goods and services which are required for the holding of the Summit Conference of the OAU	2% per annum	10 years	-	2008
97.	U.S. Military Assistance	$500,000.00	Sept. 19, 1978	To purchase defense articles.	-	1 year	$ 50,000.00	1984
98.	ADB-010-FDA	$5,101,782.00	Sept. 27, 1978	To finance part of the foreign exchange costs of the Forestry Project	7% per annum	5 years	-	1998

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
99.	DG Bank/GOL #LB01	$5,000,000.00	Nov. 24, 1978	Development project in Liberia.	10 3/8% per annum for 5 years and 12% thereafter	4 years	$357,142.86	1986
100.	KFW/LEC 77-65-357	$3,118,017.00	Nov. 30, 1978	Import Costs of the extension of power distribution system, Monrovia II project	6% per annum	3 years	-	2008
101.	Republic of Liberia/ LBIDI	$5,000.000.00	Dec. 4, 1978	Financial development project in Liberia.	10 3/8% per	5 years	$30,000.00	1993
102.	OPEC Fund TBRI Bomi	$3,000,000.00	Dec. 19, 1978	For the construction of a two-lanes Tubman bridges and Bomi Hills road.	4% per annum	5 years	$93,000.00	1998
103.	Amman and Whitney Engineers USAID-669-T-024	$5,200,000.00	Dec. 22, 1978	Consulting services for Rural road III for the Belle Yella-Kolahun Road.	2% per annum for 10 years	11 years	-	1999
104.	CITIBANK N.A/ MATADI	$10,000,000.00	Dec. 31, 1978	Construction of the Matadi Housing project.	1 3/4% per	1 year	$100,000.00	1985
105.	LWSC# 859	$8,000,000.00	Jan. 8, 1979	Loan agreement.	½ of 1% per annum up to 1998 and 1½% thereafter	10 years	-	2028
106.	Eurodollar Credit Agreement	$,300.000.00	Feb. 1, 1979	Loan Agreement	1 3/4% per annum	2 years	$167,372.00	1982

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
107.	Japan/OECF Federal Roads	$20,000,000.00	March 30, 1979	Loan agreement.	4% per annum	1 year	-	1981
108.	LWSC-AL 73-66-230	$1,568,629.00	April 2, 1979	For water supply for for Zwedru town.	2% per annum	10 years	-	2009
109.	IBRD #1664 Feeder Roads Project	$10,700,000.00	April 4, 1979	Construction, improvement and subsequent maintenance of feeder roads.	3/4 of 1% per annum and 7% thereafter	5 years	-	1998
110.	Taiyo Kobe Bank	$30,000,000.00	April 23, 1979	The proceeds of this loan is to be used towards the financing of the Local Cost requirements of various development projects.	From 1979-1985 =8% and from 1985-1989=8.06% per annum	4 years	$2,076,923.04	1989
111.	P.K. Bank/ GOL	$ 950,000,00	June 20, 1974	Purchase of three Coast guard Cutters.	6% per annum	1 year	$ 50,699.00	1990
112.	L.B.D.I.- DG/GOL	$5,000,000.00	June 28, 1979	To finance development projects within the Republic of Liberia.	10 3/8% per annum	5 years	-	1987
113.	Commonwealth Development/ GOL.	$2,000,000.00	Aug. 14, 1979	Liberia Water and Sewer Corporation	8½% per annum	5 years		1998
114.	KFW/GOL 65-346 Commodity Aid	$277,839.00	Oct. 4, 1979	For the payment of foreign exchange and goods & Services and water supply systems of Harper & Greenville.	2% per annum	11 years	-	2009

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
15.	KFW-79-65-270/Kakata Water Supply	$ 427,321.00	Oct. 4, 1979	The project is for test Drilling including evaluation of the findings and further planning work for the water supply scheme of Kakata.	2% per annum	11 years	-	2009
116.	A.D.B./011	$7,978,580.00	Nov. 16, 1979	Financing of the Decoris oil palm project.	7% per annum	5 years	-	1999
117.	IBRD 1765/ DOPC	$12,000,000.00	Dec. 21, 1979	Decoris Oil Palm project.	8% per annum	6 years	$400,000.00	1999
118.	IDA/WP#L-1092-A	$3,380,000.00	1980	To assist in the financing and development of SME's Investment Enterprises through grants or Sub-Loan	½ of 1% each instal; and 1½% thereafter	10 years	-	2030
119.	Eximbank/ #6736 Hydro	$2,125,000.00	March 10, 1980	For the completion of a feasibility study for the St. Paul hydro electric Power project	½ of 1% per	-	-	-
120.	U.S. Department of Defense (Federal Finance Bank) FFB.	$1,400,000.00	Aug. 11, 1980	For the Purchase of Defense Items.	-	1 year	$140,000.00	1986
121.	OPEC Fund #205 P	$5,000,000.00	Oct. 24, 1980	Bushrod Power Expension	4% per annum	4 years	$156,200.00	2000
122.	IBRD #1907/ GOL	$5,000,000.00	Nov. 21, 1980	Exporation for Hydro Carbon Resources in Liberia.	9½% per	6 years	$165,000.00	2000

	NAME OF LOAN	AGREEMENT AMOUNT	AGREEMENT DATE	PURPOSE OF LOAN	INTEREST RATE	GRACE PERIOD	ESTIMATED YEARLY REPAYMENT	MATURITY YEAR
123.	Norweign Loan #1.	$3,000,000.00	Dec, 19, 1980	Commercial Credits Granted to Liberia.	8% per annum	5 years before first Installment	-	1985
124.	Norweign Loan #2.	$8,317,056.00	Dec. 19, 1980	Commercial Credits Granted to Liberia.	8% per annum	5 years final installment	-	1989
125.	KFW/LEC	$3,118.017.00	Feb. 11, 1974	Distribution of Power to Monrovia.	6% per annum	3 years	-	2004
126.	Gov't of Liberia Telecommunications.	$6,500,000.00	Jan. 20, 1977	Improvement and Expansion of Telecommunication Operations.	3½% per annum	2 years	$590,910.00	1984

RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE FRENCH MINISTER FOR THE ECONOMY, FINANCE AND THE BUDGET AT 9.15AM ON 21 OCTOBER 1983 AT NO 11 DOWNING STREET

Present:-

Chancellor	M. Jacques Delors
Mr Middleton	M. Philippe Jurgensen
Mr Littler	M. Sauvel
Mr Unwin	
Mr Kerr	

International Financial System

The Chancellor suggested that further work, following up Williamsburg, on international monetary issues should be kept in the G5/G10 framework; and that the Commission proposals on the "economic and monetary environment" should be considered in ECOFIN, rather than the Athens European Council. M. Delors agreed on both points. A G5 meeting in Paris in January might be helpful. Within the Community, it would be unrealistic to imagine that progress on completing the ERM, enhancing the status of the Ecu, and establishing a new financial zone could be taken very far within the framework of current EC negotiations aimed at the Athens European Council. It would be necessary to persuade M. Ortoli that all three subjects needed to be pursued separately, and in separate timescales. The urgent issue now, to which M. Ortoli should be directing his attention, was the future financing of the Community.

Brazilian Debt

2. The Chancellor thought that the Americans would probably go on pressing for new Governmental money to fill the "financing gap". His instinct however was that, when they had concluded that they could get no more, they would either fill the gap themselves, or decide that it was smaller than had previously been thought. The UK position was

that our new contribution to Brazil took the form of agreement to the Paris Club rescheduling. Given that we, unlike the Americans, would also contribute to the proposed BIS loan to the IMF, he did not feel that the case for further support for Brazil from the UK taxpayer had been made out. He also saw considerable dangers in talk of "financing gaps". If it came to be accepted that Governments would step in when such gaps were "discovered", commercial banks would tend to back out, and the gaps thus to grow.

3. M. Delors said that the French attitude was very similar. He was concerned that BIS might be asked to produce a new bridging loan for Brazil in order to fill the "gap"; and he agreed that the "gap" theory could set a very damaging precedent. Nor did he approve of the US pressure for pledges of new Government credit: such pledges would be wrong in principle, and also quite impracticable. It would be desirable to agree once again with the Americans that policy, vis a vis Brazil and other similarly placed countries, must rest on firm agreement on strong Fund programmes unlocking Fund financing, backed as necessary by "Paris Club" and commercial bank rescheduling. The UK and France should maintain their common line.

UK and French Economies

4. The Chancellor gave an account of current UK economic developments. Inflation would rise to some 5½ per cent by the turn of the year, but would be back below 5 per cent next year, and was clearly still on a downward trend. Growth this year would be some 3 per cent, largely thanks to a continuing revival of domestic demand: developments next year would be more dependent on the world scene, and a better export performance. The fiscal and monetary policies of the last four years would be maintained. Unemployment was now rising more slowly, and could peak in 1984-85. Having taken our anti-inflationary measures earlier than most of our partners, we had gone into recession earlier and were coming out earlier: it was now clear that the low point had been in early 1981.

5. M. Delors said that he expected nil growth in France this year. The Government's measures had brought an unexpectedly rapid turn-round on exports, and the balance of payments, though French industry was still targeted too narrowly to Eastern Europe, the developing world, and OPEC, and must learn to compete more effectively in the industrialised world. The root problem was still inflation; price rises were decelerating, but not fast enough. The rigidities in the French economy were still very strong; and he envied the UK Government's success in diminishing parallel rigidities.

Community Financing

6. The Chancellor suggested that it would be important for the UK and France to remain in very close contact at all levels in the run up to the Athens European Council. The greater the degree of Anglo-French agreement which could be reached, the better the chances of overall agreement. We already agreed that the two problems to be solved were that of controlling total expenditure, and financing it equitably. On the former, we were clear that the key lay in control of the growth of agricultural expenditure. We certainly wished to see the Community develop, and develop new policies, but we could not agree to any increase in own resources until a proper system for budgetary control had been established, together with an equitable financing system. On the latter, we were clear that the key lay in basing the system on net contributions: hence our "safety net" proposal.

7. M. Delors said that his personal and longstanding view was that it was essential to have a proper financing system in order to provide a lasting solution to the budget problem - and prevent its regularly souring the atmosphere of Community discussion at the highest level, and thus imposing a brake on the Community's development As a Finance Minister, obliged to impose economies at home, he also agreed that it would be quite wrong to release substantial new resources to the Community until it had acquired an effective budgetary

system. To deal with the former problem, the UK had proposed the "safety net": he himself thought that the alternative of an ecretement scheme deserved careful consideration, together with the latest Danish ideas. As for the latter problem, he of course agreed that it was crucial to control agricultural spending; but it would be very much easier - particularly in France - to sell such control if it stemmed from the nature of the CAP, rather than from an external constraint, as the UK had proposed. He was pleased that the UK envisaged the development of new Community policies: he himself thought that regional policy, the modernisation of decaying industries, and scientific and technological co-operation deserved further Community support. But, given that enlargement would be costly, there would be little scope for such desirable additional expenditure unless proper economies were introduced on current programmes.

8. The Chancellor said that, on the financing issue, he had indeed studied the latest Danish proposal. The French amendments to it had improved it considerably, but he feared that it was still flawed, and could not produce a satisfactory outcome: it dealt only with the problem of inadequate receipts, and ignored that of excessive contributions, and would still leave us unprotected against increases in our uncorrected net contribution. It would be important to discuss the matter further - first on a bilateral Anglo-French basis, and later bringing in the Germans. We were certainly not wedded to every last detail of our "safety net" proposal; but he remained convinced that an arrangement satisfactory to all parties could be built on it.

9. The meeting ended at 10.45am.

J O KERR
21 October 1983

DISTRIBUTION:

Those Present
PS/Chief Secretary
PS/Economic Secretary
Mr Fitchew
Mr Battishill
Mr Mountfield
Mr Edwards
Mr Bostock
Mrs Case
Mr Bottrill

Mr Coles: No 10
Mr Fall: FCO
Mr Lowson: MAFF
Mr Williamson: Cabinet Office
Sir John Fretwell: Paris
Sir Michael Butler: UKREP EC

The Case of Brazil

Sir A Walters Washington Post Oct. 20

A financial crisis that threatens the social order.

In discussing the world debt problem, the abstract comes down to reality when looking at a single country's problems. The focus at the moment is Brazil, which literally exploded in an economic boom in the 1960s, fed by gung-ho banks working with a privileged upper class in Brazil, and which now threatens to come apart at the seams. Horror of horrors for the financial world, a repudiation of Brazil's $90 billion debt looms as a real possibility.

Recently Timothy W. Stanley and Ronald L. Danelian of the International Economic Policy Association explored the situation in Brazil for their business clients, and came away with the conclusion that Brazil has about two years in which to turn things around, or social upheaval and worse can result.

"On balance," Stanley said in an interview, "if a restoration of economic growth is delayed longer than that, a dangerous explosion could occur with unpredictable consequences." His own guess is that Brazil will "lurch from crisis to crisis," but finally recover.

He could be overoptimistic. Economic chaos, strikes and widespread looting have symbolized the opposition to the austerity measures to which the military-backed government has agreed as the price for emergency help from the IMF and big commercial banks. A key condition—limiting wage increases to 80 percent of the rate of inflation—has been voted down by the Brazilian Congress.

Since last May, both the IMF and the commercial banks have cut Brazil off from further loans, and the country is about $3 billion behind in its interest payments—to say nothing of having, in effect, defaulted on the principal. This all makes a mockery, as former Thatcher aide Sir Alan Walters said the other day, of the way the banks keep their books.

The first basic mistake made in Brazil was the combination of overplanning, overbuilding, overspending, and overborrowing. The Brazilians failed to face the implications of the oil-price shocks of 1973 and 1979. The high cost of imported oil and double-digit interest rates ate up all of the foreign exchange earned on exports.

"The Brazilians' second mistake," Stanley said, "was to assume they could run a giant 'Ponzi' game indefinitely—paying off the first lenders with loans from new lenders. In the end, all Ponzi schemes collapse."

Whether Brazil can "make it" was the primary topic of conversation at the recent IMF annual meeting. With a great deal of hoopla, the IMF announced an $11 billion loan "package" to keep Brazil afloat, including a new chunk of $6.5 billion to come from the banks.

"But the fact is," a New York banker confided, "that no one has agreed to give them another thin dime. All we agreed to was the statistical measurement of the problem."

In Brazil, there is a sense of desperation and multiple evidence of great social tensions among one of the world's large poor populations. Much is written about Brazil's technological achievements, great resources and riches, its "advanced" status for a developing nation.

Little is said about its slums, abject poverty and extensive malnutrition. Stanley and Danelian were "astounded" to discover that there is no such thing as unemployment compensation in Brazil. And except for what Catholic charities provide, there are no welfare programs.

The top 1 percent of the Brazilian population had 18 percent of the income, or almost as much as the bottom 60 percent, at the time of the 1980 census. (In the decade 1970-80, the rich got richer; the top 1 percent increased their share from 14 to 18 percent.)

Celio Borja, a director of the Social Democratic Party told a Washington Post reporter in Rio de Janeiro: "People are accepting the idea that they are not going to get a job. They see no hope."

What happens in the longer term, Stanley says, depends on whether the bulk of Brazil's exploding population can be made to feel it has a stake in the system and the country's future. Without economic growth, he guesses, the extremists will gain power, and debt repudiation could be a reality.

The truth is that the situation is so volatile in the short run that no one can predict the outcome in Brazil. But it will do little good to put Humpty-Dumpty together again with loan "packages" and austerity programs if, in the long run, the industrial nations bar exports from these countries.

American producers are already clawing at their congressmen and senators to provide new restrictions on steel imports from South Korea and Brazil.

If the world is lucky enough to survive the debt crisis, the struggle of the poor nations to expand their exports—while industry and labor moguls in the United States, Canada and Europe fight to close the doors to imports—could define the scope of the next big international struggle.

Marxist principles. One charge is that ... soft on private enterprise.

By this argument, Bishop was not necessarily a lost cause; he was made a lost cause by self-fulfilling prophecies. By early last year, Ronald Reagan had reached his conclusion. Grenada, he said, "bears the Soviet and Cuban trademark, which means it will attempt to spread the virus among its neighbors."

That left him in no doubt about the right remedy: a clampdown on economic aid and an almost total diplomatic break. When Bishop visited the United States, the Reagan administration gave him the silent treatment: no official recognition. He wrote Ronald Reagan twice. The first letter reported went unanswered; the second received a one paragraph reply from the U.S. ambassador responsible for nearly a dozen eastern Caribbean mini-nations, stiffly questioning his sincerity.

European allies discovered they got in trouble with Washington by trafficking with Grenada. The French, for example, see that long airport runway as at least somehow related to Grenada's tourist trade. (So do the U.S. airlines that have shown interest in landing rights.) For helping build it, however, the French got a dressing down from Washington.

Nobody can say for sure that a different line in Washington might have produced a different result. But neither can anyone prove that a certain subtle, civil exploration of the possibilities of closer relations might not have strengthened Bishop's hand internally. As it was, he had nothing to show but unalloyed American hostility.

We will never know what an alternative policy would have produced, because none was tried. We do know the result of writing off Grenada as a hopeless case: far from emboldening or encouraging moderate forces, or those from the right, the Reagan approach has apparently played handsomely into the hands of the extremists on the left.

...w: The Roadblock in the House

... with bankruptcy are not limited ... that led the court last ... the powers Congress ... courts in the Bank- ... early this year that would correct the defects identified in the law by the experts who testified before my subcommittee. Favorable action in the full committee came only after prolonged ...

The grain elevator issue, however, is only one part of the total legislative package. The comprehensive Senate bill contains provisions that would eliminate uncertainties presently ...

amendments to substantive law that are incorporated in the Senate bill, Rodino refuses to move any legislation unless it is on his terms and ...

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INFO SAVING RIO DE JANEIRO, SAO PAULO (ACTIONED)

MY TELNO 404: BRAZILIAN DEBT CRISIS

1. TWO IMPORTANT EVENTS HAVE OCCURRED THIS EVENING:
A) THE PRESIDENT, HAS DECREED A MODIFIED STATE OF EMERGENCY IN BRASILIA: AND

B) CONGRESS HAVE, AS EXPECTED, THROWN OUT DECREE LAW 2045, WHICH THE GOVERNMENT WILL REPLACE TOMORROW WITH A SIMILAR BUT AMPLIFIED DECREE LAW.

2. THE SO-CALLED 'EMERGENCY MEASURES' WERE DECIDED UPON THIS EVENING AT AN EMERGENCY MEETING OF THE ARMED FORCES MINISTERS AND THE MINISTER OF JUSTICE. THEY FALL WITHIN THE TERMS OF THE CONSTITUTION AND INCLUDE THE PROHIBITION OF UNAUTHORISED PUBLIC MEETINGS AND THE RIGHT OF HOUSE ARREST WITHIN THE FEDERAL DISTRICT OF THE CAPITAL FOR A PERIOD OF 60 DAYS.
THEY DO NOT INCLUDE PRESS CENSORSHIP.

3. THESE MEASURES ARE SAID TO HAVE BEEN TAKEN AT THE REQUEST OF THE ACTING PRESIDENT OF THE CONGRESS, AND APPEAR TO HAVE THE BACKING OF ALL GOVERNMENT PARTY LEADERS. THEY ARE DESIGNED IN PARTICULAR TO FORESTALL PUBLIC DEMONSTRATIONS FOCUSSED ON THIS WEEK'S CRUCIAL DEBATES IN CONGRESS, WHICH HAVE ATTRACTED COHORTS OF OPPOSITION SUPPORTERS TO BRASILIA. THEY HAVE UNDERSTANDABLY BEEN GREETED WITH SURPRISE AND ANGER BY OPPOSITION LEADERS WHO HAVE CHARACTERISED THEM AS UNNECESARY AND ILL-CONSIDERED.

4. THE REJECTION OF DECREE LAW 2045 AND ITS REPLACEMENT BY ANOTHER (NO 2064) UNDERLINES THE GOVERNMENTS FAILURE TO STICTCH TOGETHER IN TIME A COMPROMISE WHICH CONGRESS (INCLUDING ITS OWN REBELS WITHIN THE PDS) COULD ACCEPT. THE DETAILS OF 2064 WILL NOT BE PROMULGATED UNTIL TOMORROW: BUT THEY ARE SAID TO INCLUDE PROVISION OF WAGE RISES EQUIVALENT OF ONE HUNDRED PERCENT OF INFLATION FOR THE LOWEST PAID , SHARPLY DECREASING INCREMENTS FOR MIDDLE RANGE SALARIES AND FREE BARGAINING FOR THE HIGHER PAID. NO CALCULATION OF THE LIKELY IMPACT ON INFLATION AND PUBLIC EXPENDITURE OF THIS REPLACEMENT DECREE LAW, AS COMPARED WITH THAT OF ITS PREDECESSOR, IS YET AVAILABLE: BUT THE GOVERNMENT ARE ALREADY CLAIMING THAT IT WILL 'MEET THEIR REQUIREMENTS' (VIZ THOSE OF THE IMF).

5. AT THE PRICE OF ANTAGONISING CONGRESS THE GOVERNMENT APPEAR TO HAVE REGAINED THE INITIATIVE , AT LEAST TEMPORARILY. THE CRACK OF THE WHIP REPRESENTED BY THE EMERGENCY MEASURES WILL HAVE REASSURED THEIR POLITICAL SUPPORTERS, AND NO LESS IMPORTANT, ELEMENTS IN THE ARMED FORCES WHO HAVE SHOWN RESTLESSNESS OVER THE GOVERNMENTS RECENT INDECISION. BUT THE CHANCES OF ACHIEVING A CONCENSUS FOR A REVISED ECONOMIC PROGRAMME HAVE UNDOUBTEDLY RECEDED: AND ATHE POLITICO-ECONOMIC OUTLOOK IS AS BLEAK AS EVER.

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THE INTERNATIONAL DEBT PROBLEM
DIAGNOSIS AND PROGNOSIS

by George Soros

July, 1983

INTRODUCTION

From time to time we publish papers written outside the Firm because we feel the view of a problem they express is fresh and enlightening. The opinions articulated in these papers are those of the author and may not conform in whole or in part with my views or Morgan Stanley's. The test is whether the thinking and analysis is original and if they help our clients to better understand a crucial issue. The papers we have issued in the past on supply-side economics and the gold standard meet these criteria, as does the attached essay, which deals with the international debt problem -- perhaps the most dangerous, difficult, and complex enigma of our times.

The author, George Soros, has been called "the best money manager in the world." His unique ability to analyze dispassionately the probabilities of a chain of events occurring and then make big bets has been his trademark for 20 years. He looks at the stock market as an historical process and has developed his "theory of reflexivity" for analyzing it.

For some time now George has been intrigued with the international lending system. He brings the same analytical approach to bear on the subject which he has used so successfully in the financial markets. As usual, his perception is different but compelling. He is not an economist or an international banker, thus, he has no institutional axes to grind. In my opinion, this paper is well worth the effort required to read it.

Barton M. Biggs
July 1983

MORGAN STANLEY

THE INTERNATIONAL DEBT PROBLEM
- DIAGNOSIS AND PROGNOSIS -

BACKGROUND

The international banking system passed through a crisis in 1982 and survived. The timely and imaginative intervention of the monetary authorities prevented a collapse. Financial markets were reassured; interest rates declined; bond and stock markets boomed; and economic activity has begun to pick up.

The position of the heavily indebted countries remains precarious. They are unable to borrow in the open market and have to be sustained by emergency arrangements. Their debts continue to mount, albeit at a much reduced rate, and their ability to bring them back to manageable proportions remains in doubt.

Discussion of the international debt problem is muted by fear that it may touch off a renewed crisis of confidence. The fear is not unfounded: a general recognition that some of the major debtor countries cannot or will not meet their obligations would seriously undermine confidence. But the attempt to sustain confidence can also have adverse consequences: it hinders proper understanding.

The crisis of 1982 is generally regarded as a temporary breakdown in an otherwise viable system of international trade and finance. That is a misconception. The system of international lending that prevailed prior to 1982 was inherently unsound and unsustainable. It was permanently shattered by the crisis of 1982. It is not likely to reappear for many decades to come, and when it does it is likely to prove as unsound and unsustainable as it did on previous occasions. It has been replaced by a different system of international lending which is even more unsound and unsustainable than the prior one. In fact, the problems involved in international lending are still awaiting a successful solution.

Under the old system, commercial banks acted individually and in competition with each other. Under the new system, commercial banks act collectively in cooperation with each other and with international monetary institutions. The old system created explosive growth in international lending which led to the crisis of 1982. The new system is designed to prevent a credit implosion and is likely to fulfill its function imperfectly or not at all. It works only in an emergency situation and is so constructed as to generate the emergency conditions which are necessary for its functioning. The flow of credit toward the heavily indebted countries will remain restricted, and their ability and willingness to meet their obligations will remain problematical. We are liable to hover on the brink of disaster for an extended period, and everything will have to go right to prevent a collapse.

The international financial system is amenable to reform as the Bretton Woods agreements have demonstrated. But there is no consensus at present for reform. The prevailing view is that adjustments are best left to the market mechanism.

The purpose of this article is to examine the international lending system that has emerged from last year's crisis and to assess its prospects. Recognition of what the future has in store may "shorten the birthpangs" that must precede any major reform.

THE COMPETITIVE SYSTEM

To put the problem of international debt in perspective, it is necessary to go back at least as far as the oil crisis of 1973 and the introduction of floating exchange rates. The sudden jump in the price of oil was followed first by a rise in the general price level and then by a worldwide recession. The industrialized countries sought to counteract the loss of effective demand by stimulative monetary and fiscal policies. The United States, Europe, and Japan were supposed to act as "locomotives" pulling the rest of the world out of a recession. As it turned out, Europe and Japan lagged, but the world economy received an unplanned and uncontrolled boost from the international lending activities of commercial banks.

The payments surplus of the OPEC countries resulted in an enormous increase in the volume of deposits available to the international banking system. Flush with funds, the banks became aggressive lenders, and they found plenty of takers. Less developed countries without oil sought to finance their deficits by running up large debts; those with oil embarked on ambitious expansion programs, which they financed by borrowing on the strength of their oil resources. This was the time of detente, which meant that Eastern European countries borrowed huge amounts from Western banks in the hope of repaying them with the products of the factories they built.

At first, the banks were recycling the OPEC surplus. As time passed, the OPEC countries increased their own capacity to put their surplus to work while demand for bank financing continued to build. Increasingly, the banks became the source of credit. Each loan creates deposits elsewhere so that the banks were able to generate the funds they were lending by their own activity. There was a veritable explosion of international credit between 1973 and 1979.

Why the commercial banks were willing and able to sustain such explosive growth in their international loan portfolios is a fascinating question that will be hotly debated for years to come. Banking is an intensely competitive business which is, however, subject to regulation. Each bank seeks to maximize its profits in the secure feeling that the regulatory authorities are there to protect it against the system breaking down. Much of the international lending activity in the 'Seventies, however, took place outside the direct supervision of the central banks, yet the central banks acknowledged their responsibility as lenders of last resort. In fact, they mapped out their respective spheres of responsibility as early as 1975.

Banks did not have to maintain minimum reserve requirements against the liabilities of their offshore affiliates. There was nothing to stop those affiliates from creating a seemingly unlimited supply of credit except self-restraint. But international lending was too profitable to leave much room for caution. Business could be transacted on a large scale, the risk of adverse interest rate movements was minimized by the use of floating rates, and administrative costs were much lower than in the case of corporate loans. Fierce competition kept spreads between borrowing and lending rates quite narrow; nevertheless, international lending became one of the easiest and most profitable forms of banking activity, attracting many banks which had no previous experience in the area. With no regulatory constraints and individual banks competing for market share, the market as a whole grew by leaps and bounds. Standards were relaxed, and banks expanded their role from financing trade to financing balance of payments deficits. In effect they took over one of the functions the International Monetary Fund had been designed to fulfill. They financed deficits on a much larger scale than the IMF would have been able to and with much less interference in the debtor countries' affairs. No wonder that debtor countries stayed away from the IMF. During this period, mainly industrialized countries like the United States and the United Kingdom resorted to the IMF; developing countries preferred to deal with commercial banks whenever possible.

International lending grew so rapidly that the banks involved became overextended: their capital and reserves could not keep pace with the growth of their balance sheets. But the quality of their loan portfolios remained sound -- at least from outward appearances. Indeed, one of the most striking features of the situation was that the borrowing countries countinued to meet the traditional yardsticks used to determine their creditworthiness even as their overall debt burden grew at an alarming rate.

Banks use ratios -- such as external debt as a percent of exports, debt service as a percent of exports, and current deficits as a percent of exports -- to measure creditworthiness. The international lending activity of the banks set in motion a self-reinforcing and self-validating process that increased the debt servicing ability of the debtors, as measured by these ratios, almost as fast as their debt.

The key to the process is to be found in the very low and, eventually, negative real interest rates that prevailed during this period. Since the Eurocurrency market was outside the control of the central banks, its growth did not directly influence monetary policy in any country. As the banks graduated from recycling OPEC surpluses to creating credit, the monetary policy of the United States remained relaxed.

The dollar started to depreciate, and interest rates failed to keep up with the rise in prices. The decline in real interest rates lowered the cost of debt service and rendered the borrowing countries more creditworthy. It also made them more eager to borrow. The expansion of credit stimulated the world economy and helped export performance all around. The less developed countries enjoyed strong demand for the commodities they exported, thus their terms of trade also tended to improve. The combination of declining real interest rates, expanding world trade, improving commodity prices, and the depreciating dollar enabled and encouraged the debtor countries to increase their indebtedness.

The self-validating process of credit expansion -- inflation for short -- was unsound in more ways than one. Prices and wages rose at accelerating rates. Balance of payments deficits and surpluses were perpetuated. The balance sheets of the banks deteriorated. Much of the investment activity financed by bank lending was misdirected. The creditworthiness of the debtors was illusory. Yet, as long as the process validated itself, the world economy prospered. Consumption remained high while saving was discouraged by low or negative interest rates. Investment was stimulated by the availability of cheap loans, and there was a flight from monetary to real assets. The combination of high consumption, high inventories, and strong investment activity created boom conditions.

The boom kept the demand for energy growing. The OPEC countries grew richer and less in need of current income while negative real interest rates made it more attractive to keep oil in the ground than cash in the bank. This provided the setting in which the disruption of Iranian production caused a second crisis and a second jump in the price of oil.

This time the response was different. Inflation had become a dominant concern especially in the United Kingdom and the United States. Continental Europe and Japan had escaped the ravages of inflation by following a more restrictive monetary policy and allowing their currencies to appreciate. Since the price of oil is fixed in dollars, their cost of oil fell, and, in the absence of inflation, their exports remained competitive despite the appreciation of their currency. The U.K. and the U.S., by contrast, developed large budgetary and trade deficits, and inflation became a serious problem. Britain had to turn to the IMF for help. The United States, controlling as it did the reserve currency of the world, could inflate with impunity; nevertheless, the domestic and international consequences of inflation led to a shift in political preferences. The specter of accelerating inflation took precedence over the fear of recession. In response to the second oil shock, monetary policy turned restrictive and remained so even after the economy started to decline.

Monetarism became the doctrine that guided monetary policy. Previously, central banks sought to influence economic activity by controlling interest rates; then the emphasis shifted to controlling the quantity of money. Interest rates were allowed to find their own level. Unfortunately, the level they found was inordinately high. The main reason was that fiscal policy remained stimulative, and it required a highly restrictive monetary policy to keep the growth in money supply in check.

Fiscal policy was influenced by supply-side economics. It was believed that lower tax rates would stimulate economic activity to such an extent that the impact on the budget would be neutralized. The deficit could then be reduced by cutting government spending. But the decision to increase defense expenditures at the same time as taxes were cut made a balanced budget unattainable. The interaction between a swelling budget deficit and strict monetary targets sent interest rates sky high. High interest rates swamped the stimulative effect of the tax cuts. The budget deficit widened, and the economy plunged into a deep recession.

The impact on the rest of the world was awesome. The debtor countries were hit by a threefold increase in oil prices, plunging commodity prices, soaring interest rates, a strong dollar, and a worldwide recession. They engaged in a final binge of borrowing which increased their total debt outstanding another 30%. The ratios that measure their creditworthiness rapidly deteriorated. The situation in Poland and the Falklands conflict helped to undermine confidence. There was a twilight period during which banks continued to lend but only reluctantly. Maturities were shortened, and some countries developed liquidity problems. Then the Mexican debt crisis erupted, and voluntary lending to the heavily indebted countries came to a virtual standstill.

The liquidity of the international banking system was in jeopardy. The monetary institutions whose task it is to act as lenders of last resort -- the central banks and the Bank for International Settlements, which is an organ of the central banks -- recognized that it was not possible to protect the banks without bailing out the debtor countries. The amounts that had been loaned far exceeded the banks' own capital; if the countries in question had been allowed to go into default, the banking system would have become insolvent. Accordingly, the central banks exceeded their traditional role of providing liquidity to the banking system and banded together with the IMF to provide liquidity to the debtor countries.

For one country after another a rescue package was put together. Typically, commercial banks extended their commitments; the international monetary institutions injected new cash; and the debtor countries agreed to austerity programs designed to improve their balance of payments. In most cases, the commercial banks also had to come up with additional cash. The rescue packages constituted a remarkable achievement in international cooperation. The participants included the debtor countries, the International Monetary Fund, the Bank for International Settlements, a number of governments and central banks, and a much larger number of commercial banks. In the case of Mexico, for instance, there were more than 500 commercial banks involved. The process was repeated several times within a short time.

At the same time, the Federal Reserve decided that averting an international banking crisis should take precedence over controlling the money supply. Without admitting it in so many words, monetarism was abandoned, and the Federal Reserve turned to a policy of controlling interest rates. The aim apparently was to keep interest rates at the lowest possible level consistent with stability; that implies not lowering them so much that they would have to be raised in the near future.

The rescue packages combined with the policy changes by the Federal Reserve achieved the desired result: a collapse of the banking system was avoided. The debtor countries gained access to additional funds albeit on a much reduced scale, and the commercial banks averted catastrophic loan losses. The debtor countries implemented austerity programs they could not avoid; the commercial banks got a little deeper into troublesome situations from which they couldn't have escaped; and the monetary institutions fulfilled their obligation as lenders of last resort. The operation was a great success: fears of a liquidity crisis have abated. Under the impact of lower interest rates, the bond market recovered and the stock market soared. Housing and auto sales have improved. Confidence has been reestablished, and the economy is on its way in a classic cyclical recovery.

THE PRESENT JUNCTURE

What next? So far, success is purely temporary. The rescue packages have actually increased the overall debt burden of the assisted countries but also have bought time for them to improve their ability to service their debt. Will the debtor countries ever be able to stand on their own feet again? What are the implications of the international debt problem for the world economy? These are the questions that need to be answered.

Expert opinion is genuinely divided. There are those who argue that time is all that is needed. After all, the crisis has been brought on by an exceptional confluence of adverse conditions: record-high interest rates, a worldwide recession, undervalued commodities, and an overvalued dollar. Conditions are improving: led by the United States, the world economy is recovering. Interest rates have declined and should fall even further. Commodity prices have firmed and should rise further. The dollar has been recalcitrant but can be expected to weaken as the U.S trade deficit widens. In the meantime, the austerity programs pursued by the debtor countries are doing their work. Eastern European countries, with the exception of Poland, already achieved export surpluses in 1982, and both Mexico and Brazil have been reporting positive figures in recent months.

There are others who question the strength of the recovery. The Federal Reserve has done everything it can to stimulate the economy, but it is operating under severe constraints. The policy mix is wrong: the budget deficit is too big to allow interest rates to decline as much as they should. Money supply is already excessive: if the recovery gains momentum and commodity prices improve, interest rates will rise again. It is true that the trade balances of most debtor countries are showing a dramatic upswing, but the improvement so far has been achieved by slashing imports to the bone. With so many countries retrenching at the same time, how can exports recover? Only by the industrialized nations, notably the United States, absorbing a lot more imports. To some extent that is already occurring, as the trade figures attest. But the negative balance of trade is a major drag on the economy as well as a potent source of protectionist pressures. Undoubtedly, there will be some improvement in the export performance of the debtor countries as the recovery continues, but there may be little or no improvement in the ratios which measure their creditworthiness because interest charges continue to mount. It is not at all clear whether time is working to ease or to aggravate the situation of the debtor countries. One thing is certain: when interest rates start to rise again, the game will be up!

In keeping with the prevailing mood of the financial markets, the optimists seem to be gaining the upper hand in the debate. There has been some very real improvement both in the U.S. economy and in the trade performance of the debtor countries since the rescue packages were put together. That is taken as evidence that the adjustment process is working, and the passage of time is helping to relieve the international debt problem if not to resolve it.

I happen to agree with the optimists as far as the economic outlook for the industrialized world is concerned. But I also believe that, irrespective of the pace of the recovery, the loan problem will continue to cause serious financial and political difficulties unless and until measures are taken to resolve it.

I contend that the focus of the debate has been misplaced: it hinges on the world economic outlook, which is the least predictable aspect of the situation. The debt problem lends itself to a more definitive analysis. Undoubtedly, the pace of the recovery is important, but it is not the central issue. Making the debt problem contingent on the economic outlook fosters a wait-and-see attitude. Events are moving in the right direction. Let us not stand in the way with self-fulfilling prophecies of gloom and doom!

I regard this attitude as shortsighted. Every economic prediction has a self-fulfilling -- or self-defeating -- quality. That is no reason for refusing to look beyond the mood of the moment. If we fail to confront the debt problem while markets are calm and constructive, we may have to do so in less favorable circumstances.

I propose reversing the order of discussion. We shall examine the debt problem first and the economic outlook afterwards. To strengthen the argument I shall assume the most optimistic scenario for the world economy. It will be seen that even with a strong economic recovery, international debt constitutes a problem which will not resolve itself. The sooner measures are taken to deal with it, the better.

DIAGNOSIS

The system of international lending that prevailed prior to 1982 has broken down. Heavily indebted countries no longer have free access to the international capital market, and even countries that would be considered good credit risks in normal times have had trouble refinancing their debt. Commercial banks no longer lend competitively in pursuit of future profits; they lend collectively to protect their past commitments. If they were guided by individual self-interests, the flow of new credit would come to a standstill.

Irrespective of the world economic outlook, a return to voluntary competitive lending as practiced prior to 1982 is simply not possible. Debtor countries would have to demonstrate that they are willing and able to service their debt before they could regain access to the international capital market, but they need a continuing flow of credit in order to meet their obligations. There is a time gap during which the flow of credit has to be assured by some special arrangements. Those arrangements, once established, cannot be discontinued without causing a breakdown in debt service. Even if a breakdown is avoided, a system of collective lending is here to stay. Moreover, if it takes the threat of a breakdown to induce collective action, while collective action is necessary to avoid a breakdown, it follows that we shall hover on the verge of disaster for the indefinite future.

Let me try to substantiate these sweeping statements. We need an analytical framework that takes into consideration not only the ability of the heavily indebted nations to service their debt but also their willingness to pay.

Discussions of the international debt problem in terms of liquidity and solvency can be misleading. The assets of a sovereign nation do not serve as collateral against its liabilities. As bankers used to point out in the heyday of international lending, sovereign nations cannot go bankrupt, but as history has amply demonstrated, they may fail to pay. Banks cannot lay claim to assets that are within a debtor nation's sovereign jurisdiction; they must rely on its willingness to live up to its obligations.

Willingness to pay is determined by a calculation that sets the cost of paying interest against the benefit of maintaining good debtor status. Cost is measured in terms of the net transfer of resources. That is to say, the inflow of new credit is offset against the outflow resulting from the payment of interest and principal on maturing debt.

The greater the flow of new credit, the smaller the cost according to this measure. Net resource transfers were positive for most countries until 1982; that is why willingness to pay was not an issue. Since then the various rescue packages have kept negative net resource transfers to a minimum; consequently, willingness to pay has not yet emerged as a major issue. It will become important only when the rescue packages are reduced or terminated.

Debtor countries are willing to service their debt even if it involves negative net resource transfers for two reasons: (1) to maintain access to the international capital markets; and (2) to avoid seizure of their assets abroad.

The benefit of free access to the international capital market unquestionably outweighs the cost of servicing the debt. It makes no sense to renounce future obligations as long as one can borrow freely at present: one can always renounce those obligations in the future. A cost/benefit calculation becomes appropriate only when access to the capital markets has been lost.

The debt ratios banks used prior to 1982 to determine the creditworthiness of sovereign borrowers failed to anticipate the possibility that the international capital markets may be closed in the future. They measured only the debtor country's ability to pay and disregarded the question of willingness. Bankers were inclined to forget the question during the great lending boom, but they have been forcefully reminded. A 1982 survey by the Group of Thirty showed that banks were beginning to pay more attention to political analysis than to debt ratios. The change in bankers' attitudes is one reason why lending cannot return to its pre-1982 state in the foreseeable future.

Now that the benefit of free access to the international capital market has been lost, how potent is the threat of seizing a country's external assets? That is one of the great mysteries of international banking because the threat has rarely been exercised. Even Rumania has not been declared officially in default, although it had defaulted in practice and was treated accordingly: trade credits were withheld and foreign trade had to be carried on by barter. To guarantee payment for imports, Rumania had to put gold in escrow. But the banks stopped short of seizing the country's assets abroad. Doing so would have interfered with the country's ability to earn foreign currency by export. As it happened, Rumania has improved its trade balance and is more current on interest payments than it was at the height of the crisis.

Generally speaking, seizing a country's foreign assets is a desperate move. If a country were to openly repudiate its debt, there may be no choice. But a country has many ways of failing to pay short of public repudiation. Mexico has declared a moratorium; Argentina has imposed unilateral rescheduling. So far, no country has tampered with the interest rate on outstanding debt because such a move would have rendered the rescue packages and other emergency arrangements impossible. But if and when rescue packages diminish in size, the debtor countries are likely to broach the question of interest rates. After all, that is the only way they can keep negative net resource transfers to a minumum.

The threat of punitive action is more potent in some cases than in others. Brazil is relatively vulnerable because it has a large and varied export trade while Argentina is relatively impervious. Its main exports are agricultural; seizing them would merely be playing into Russian hands.

How the threat is perceived depends on the political and ideological complexion of the government concerned. Interestingly, the Soviet Union and its satellites are the most susceptible, probably because of the difficulties the Soviet Union experienced in establishing its credit standing after the Revolution. Yugoslavia is less vulnerable: in fact, blaming Western bankers for the economic ills of that country would perhaps be an attractive option for a regime that is in deep political and economic trouble. Receiving large injections of foreign aid is, of course, even more attractive. In Latin America, there is much latent and not so latent resentment of Yankee bankers, which could render punitive actions counterproductive. Argentina is probably the worst case at present.

Banks know that the lower the volume of new credit they are willing to extend the weaker their bargaining position becomes. That is one of the reasons why they are no longer willing lenders to heavily indebted countries.

Debtor countries may be willing to repay more than they are receiving for a limited period of time, especially if the prospect that credit markets will open up again is clearly visible, but it is unrealistic to expect them to tolerate negative resource transfers for an extended period of time.

It is important to realize that the debtor country's willingness to pay is reflexive in the sense that it is depends on the banks' willingness to lend which in turn depends on the debtor country's willingness to pay. There is a self-reinforcing relationship which can lead to excesses in either direction. During the great credit boom bankers disregarded the fact that sovereign countries were unlikely to tolerate negative net resource transfers. Since 1982, self-reinforcement has worked in a negative direction: the greater the danger of default, the less willing the banks are to lend, and the less credit there is available, the greater the temptation to default.

Unfortunately, the mutually self-reinforcing process operates on a global rather than a national scale. As the events of the last twelve months have already demonstrated, events in one country can touch off reactions in others. The events in Poland precipitated a liquidity crisis in Hungary; the Mexican moratorium made the position of Brazil untenable. Similarly, when willingness to pay becomes an issue, it is likely to take on global dimensions.

The issue is likely to come to the fore when the liquidity crisis abates. The adjustment process that follows a liquidity crisis has two stages: in the first, imports are cut; in the second, exports rise. It is in the second stage that the willingness to pay will become a central issue.

The first stage is more or less automatic: imports are cut because either foreign currency is not available or domestic demand has been reduced in compliance with an IMF austerity program. Either way, the balance of trade turns positive for the simple reason that there is no credit to support a trade deficit. The economy goes into shock, and there is a severe recession and a drastic cut in the standard of living. Still, the country in question cannot meet its debt service obligations. Special arrangements are necessary to avoid default. Ability to pay -- not willingness -- is the central issue.

Brazil is something of an exception. Trade credits were maintained so that imports were not cut off, and the economy did not go into shock as occurred in Mexico. Subsequently, the government failed to reduce living standards as much as the IMF program demanded. In a sense, Brazil entered the second stage without having passed through the first. Willingness to pay has become a major issue. The IMF met Brazil's demands and relaxed its requirements. But it remains to be seen whether Brazil can avoid the pains of stage one. Commercial suppliers and banks have been somewhat shaken by the relaxation of the IMF program and trade credits may erode, disrupting imports. Brazil may enter stage one belatedly.

The real adjustment takes place in the second stage. The currency is devalued in real terms, and productive resources, idled by the reduction in domestic demand, are reoriented toward exports. The trade surplus increases to a level where the country in question can pay the interest and some amortization as well. The process takes time, and its success is far from assured. The first stage may degenerate into a downward spiral in which the lack of imports disrupts the production process, shortages develop, and exports suffer. Centrally planned economies are particularly vulnerable. In the case of Poland, political turmoil aggravated the situation, but the downward spiral occurred also in Rumania and Yugoslavia. Hungary teetered on the edge for a while but managed to stabilize its economy.

It is to assure the passage from the first to the second stage that an economic recovery in the industrialized countries is indispensable. Exports can rise only if there is demand; with so many debtor countries cutting back at the same time, demand can only come from the industrialized countries.

It is in the second stage, when a debtor country is in a better position to service its debt, that its willingness to do so becomes an important consideration. There has been a substantial reduction in the standard of living and a significant improvement in export performance. But there is no reward as the surplus has to go to pay the bankers. The loans were contracted when dollars were cheap and have been used in unproductive ways: to maintain overvalued currencies in Argentina and Chile; to maintain subsidies in Brazil and Mexico, not to mention Yugoslavia; to finance the flight of private capital in Mexico and Venezuela; to finance ill-conceived investment programs in Eastern Europe. Rumania and Yugoslavia have actually benefited from shutting down some of their newly acquired industrial capacity. Only Brazil has some real improvement in production and export capacity to show for all the money that was spent. The loans now have to be paid back with expensive dollars, while the home economies are in shambles. There is bound to be tremendous political pressure to use the export surplus for reflating the economy rather than servicing the debt.

The only way to ensure that the debtor countries will honor their debt is to make credit available in quantities that approximate debt service obligations. That means that the flow of new credit must be maintained even after the export performance of a debtor country has started to improve.

This point has been generally ignored in discussions of the international debt problem. Various studies show that if economic recovery in the industrialized countries is strong enough, the ability of the debtor countries to service their debt will start improving within a few years. The calculations disregard the fact that debtor countries will be unwilling to tolerate negative resource transfers over an extended period. In this respect these studies perpetuate the original error that the banks committed when they built up their loan portfolios. If the assumptions were changed so that, say, negative resource transfers were limited to two consecutive years for any country, the figures would look quite different. The accumulation of debt would be much larger. There may still be an eventual improvement in the debt servicing ability of the heavily indebted countries, but the process would take much longer than the various studies envisage. It would take even longer before commercial banks would be willing to lend again on a voluntary basis. The time period involved is likely to be measured in decades rather than years. After all, nearly fifty years passed between the foreign lending booms of the 1920s and the 1970s.

It can be seen that the crisis of 1982 was not a temporary breakdown in an otherwise viable system of international lending but the beginning of a period of troubles.

Trouble will develop in one of two ways -- either the adjustment programs work or they do not. If they do not work, further emergency assistance will be necessary. If they do work, the problem is more complicated, but there is still need for further assistance. Without a continuing flow of new credit, debtor countries would be unwilling to meet their obligations. In either case, collective action is necessary to assure the flow of funds. But, in the latter case, collective action may be more difficult to arrange because the sense of emergency may have dissipated.

THE COLLECTIVE SYSTEM OF LENDING

Let us take a closer look at the international lending system as it is currently evolving. Its main feature is that the commercial banks have been forced to act in collaboration with each other and with the International Monetary Fund. Whether it is recognized or not, something akin to a club or cartel of international banks is emerging. I shall call it the Collective. Its membership varies from country to country but overlaps to a great extent. It has the active cooperation of the central banks and of the IMF, which helped bring it into existence.

Collective action does not come naturally. The self-interests of the commercial banks often conflict with each other and with the interests of the monetary authorities. Only a common danger, such as the threat of a major default, can unite them. Faced with that threat, banks with lesser involvement could be persuaded to cooperate in order to save the system as a whole.

The danger has been overcome by lending the debtor countries enough money on a collective basis to enable them to meet their obligations. In some cases, such as Poland, the arrangement was little more than a subterfuge, to avoid a declaration of default. In other cases, as in Brazil, banks actually had to put up new money in order to receive interest on existing loans.

Once the arrangements have been introduced, they can be modified, but they cannot be discontinued. As we have seen, the flow of new credit must approximate the debt service requirements if the debt is to be serviced. Credit will not be available on a voluntary basis until some time after debt service is assured; therefore, it must be provided by the Collective over an interim period, which may last for a long time.

How is the Collective going to hold together if it has an innate tendency to disintegrate? It is so constructed as to generate the crises which are necessary for survival. There are two other tendencies built into the system which ensure a persistent shortage of lendable funds: the number of countries needing Collective loans has a tendency to expand and membership in the Collective has a tendency to shrink.

For present purposes, membership of the Collective can be divided into two broad categories: there are the majors whose very existence is at stake and the marginals who can be persuaded to cooperate only because the survival of the banking system is at stake. As the sense of urgency diminishes, the marginals will withdraw, leaving only the majors to provide the flow of fresh credit. The categories are flexible. The large U.S., U.K., and Japanese banks will always remain majors; U.S. regionals and many continental banks are marginal to start with. In between the two groups there are many banks whose existence is at stake today but which may be able to build up sufficient reserves over a period of time to qualify as marginal in the future.

Because of the actual or potential shrinkage of membership, the resources of the Collective are liable to remain fully stretched. Members will be hard put to meet their Collective obligations and will be unwilling or unable to carry on lending on an individual basis even if they find the business atractive in more normal times. As a consequence, countries needing Collective loans are likely to increase. In a twentieth century version of Gresham's Law, bad debtors will drive out the good ones.

Take the case of Hungary. Hungary is in a much better situation than any of the problem countries. It has not rescheduled or delayed interest payments; it has an economic program endorsed by the IMF which is on target. Its only problem is that it has some $1 billion of medium-term loans coming due in each of the next three years. It can repay some but not all of the maturing debt, and it is encountering great difficulties raising new loans in the open market. This year the shortfall has been made up by the international monetary institutions. It will be instructive to see whether Hungary will have to resort to the Collective next year.

East Asia and Western Europe have been able to carry on outside the Collective so far, but there are several countries in both regions that are in much worse shape than Hungary. For instance, both Indonesia and the Philippines are weak spots in Asia. Indonesia has taken drastic action, but the Philippines has not. South Korea is much sounder, but its debt has a very bad maturity structure. If the Philippines gets into trouble, South Korea may also have to turn to the Collective.

The international monetary institutions can relieve some of the pressure on the Collective, but they are operating under severe financial constraints. Capital contributions to the IMF are in the process of being increased, but the idea of using taxpayers' money to bail out the banks is not a very popular one. It is hard to see how additional funds could be forthcoming until the banks have taken some losses.

Banks can treat their international debt portfolios in two ways. One is to maintain the fiction that the portfolio is sound and show all income booked as earnings; the other is to build up bad debt reserves with all possible speed. We shall call one the high road, the other the low road. The high road is dangerous; it may necessitate a sudden, catastrophic adjustment. The low road uses the earnings capacity of the bank to accomplish a gradual adjustment. The major U.S. banks have no choice but to follow the high road. Any realistic reserve policy would impinge on their financial position too severely. They are recognizing the rescheduling fees and improved spreads as current earnings, and several have actually increased their dividends in 1983. The policy may pay off if banks are able to sell shares to the public but may be subject to severe criticism if things go wrong in the future. So far, Chemical Bank has raised equity capital in the market, while Citicorp has actually used part of the proceeds of a debenture issue to buy in its shares from the market. It was a daring maneuver, to say the least.

Many European banks, by contrast, have taken the low road. As their reserves strengthen, their membership in the Collective becomes more marginal.

The divergent reserve policies of the banks may eventually weaken the cooperation between central banks. When the survival of a country's commercial banks is no longer directly threatened, its central bank may become less flexible about committing resources to rescue packages. Already the Bank for International Settlements in Basle has announced its intention of staying out of future rescue operations. And some continental central banks are much less willing to pressure their commercial banks to maintain interbank credit lines to Brazilian banks than are the Bank of England and the Federal Reserve. (The Federal Reserve has the added problem that some regional banks are state chartered and not members of the Federal system.)

It can be seen that the financial position of the Collective is subject to countervailing influences. The withdrawal of marginal members and the addition of new borrowing countries will constitute a drain; while the increasing participation of international lending institutions as well as some net resource transfers from some debtor countries will make a positive contribution. To a large extent the positive and negative influences are self-adjusting, keeping the Collective finely balanced on the brink of disaster.

Whether core members will generate a positive cash flow from Collective lending is doubtful. Rescheduling fees and sharply higher interest spreads boost reported earnings but do little for the banks' cash flow; indeed, they merely add to the debt service costs that must be approximated by the volume of new lending. Core members may well have to redirect cash flow from the rest of their business in order to finance their Collective lending. They can be expected to do so since, by definition, their survival is at stake. The additional cash flow should serve to keep the Collective from going over the brink.

Eventually, the prospect of disaster would recede because the positive influences are cumulative while the negative influences are likely to culminate in the next few years. On the positive side, the most important factor is the positive cash flow of the core banks from their non-Collective business. On the negative side, both the number of countries that may be forced to turn to the Collective and the number of banks that may seek to withdraw is limited.

If the Collective survives these adjustments, it will have become a viable institution. Membership would come to be considered a privilege rather than an obligation. The period of crisis will have come to an end, and a new system of international finance will have been established.

Let us consider what success would entail. Living standards in debtor countries would have suffered a severe setback; governments would be following economic policies dictated from the outside; economic growth would be export oriented and the growth in exports would be used mainly to service a growing debt burden. Not a very attractive prospect by any stretch of the imagination.

Whether success, as defined here, can ever be reached depends on the debtor countries' willingness to continue acknowledging their obligations. The greater the setback in living standards and the heavier the burden of debt service, the greater the temptation to renege. In this context, the rescheduling fees and high interest spreads act as additional irritants.

At present, a simple calculation prevails: as long as the flow of new credit approximates debt service charges, future obligations may be freely accumulated because they can always be renounced or renegotiated in the future. In the future, the situation will be much more complicated because debtor countries may not be willing to amass future obligations indefinitely. The issue will be political rather than economic. In the midst of economic hardship, resentment is likely to focus on the Collective and on the foreign influence it embodies. Governments may feel obliged to challenge the Collective. If they failed to do so, they may be replaced and new governments may be committed to a policy of renouncing the debt.

Generally speaking, democratic regimes are more likely to press the issue than autocratic ones. Unfortunately for the banks, autocratic regimes find it hard to justify their existence in the absence of economic progress. Peru and Bolivia have returned to democracy; Brazil is on the way; the military dictatorship in Chile is beleaguered. Either the level of repression has to be stepped up with the assistance of the U.S. government -- not an inconceivable development -- or the demand for debt reorganization will gather momentum. It is the most serious challenge the Collective is likely to face.

With the passage of time, the Collective may be strong enough to absorb a reduction or absence of interest payments from an individual debtor country even if it is as large as Argentina. But concessions to one country would inevitably generate demands from others. Similarly, if one country can successfully defy sanctions, others will be tempted. In either case there would be a snowball effect.

The Collective could not survive a widespread reduction in the interest or principal of outstanding obligations. The resources of its members would be depleted and even more importantly their motivation for belonging to the Collective would be destroyed. As long as there is a chance of protecting the loan portfolio already in place, core members may be willing to draw on the cash flow of their other businesses in order to preserve the Collective. But once that chance is lost, there is no point in throwing good money after bad. Protecting the integrity of past commitments, both as to interest and principal, is the make-or-break issue for the Collective.

If and when the break comes, it is likely to be radical. As long as the Collective is effective, debtor countries may be willing to acknowledge their past obligations in full in order to secure the flow of new credit. But if the Collective disintegrates, the way to minimize the outflow of capital is to suspend interest payments altogether. Only much later, when there is a chance of reestablishing some kind of credit standing will it make sense to renegotiate the debt.

The collapse of the Collective does not necessarily mean the collapse of the banking system. There are other ways of protecting the banking system than by allowing it to protect itself through the Collective. Unfortunately, these other ways require resources which are available only in a crisis. Therefore, if the Collective collapsed, the banking system would have to face a crisis of major proportions before the resources necessary for its protection could be mobilized.

It can be seen that the prospects of the Collective are not too bright. It is destined to hover on the verge of collapse for the next several years and the most serious challenge, the demand for reduced interest charges, is yet to come. The odds favor that each individual crisis will be successfully resolved, but when all of them are taken together, the chances are against the Collective emerging as a permanent institution: the world would have to change a great deal before the point is reached where membership is a privilege rather than an obligation.

In the meantime, the heavily indebted countries will remain chronically short of money, and political pressures will approach or pass breaking points. Nevertheless, the Collective can be expected to go on until it breaks down for the simple reason that there is no alternative.

Any alternative would require an enormous amount of funding, partly to replace bad debts which have been created in the past and cannot be repaid and partly to provide for the ongoing liquidity needs of the heavily indebted countries. At present, there is no political backing for bailing out either the banks or the debtor countries. Banks are strenuously opposed to any kind of government intervention because they know they would have to pay a heavy price for it. The Reagan Administration has no desire to intervene. Advocates of intervention have lost credibility because their predictions of gloom and doom have not materialized. Conditions would have to deteriorate a great deal before a political consensus could develop in favor of committing resources to any kind of debt reorganization.

What are the prospects for such a deterioration? At this point we must consider the outlook for the world economy. We shall find that the situation is surprisingly favorable.

THE ECONOMIC OUTLOOK

There were two sources of credit expansion in the 1970s: international debt and national debt. Indeed, since a large part of international lending went to finance the budget deficits of the borrowing countries, it is possible to speak of a binge of deficit financing on a worldwide scale. When it was decided that inflation had to be brought under control, interest rates rose to over 20% before the trend was broken. The U.S. government did crowd out other borrowers, but it did not happen as expected. Instead of domestic firms it was the heavily indebted countries that were forced out of the market.

The international lending boom came to a bad end, but the U.S. budget deficit is still going strong. Will the U.S. government's spending spree also come to a bad end? As we shall see, the process may yet culminate in some kind of credit crisis, but that is further down the road. In the meantime, the U.S. budget deficit serves to compensate for the demise of the international lending boom. It has saved the world from depression and made an economic recovery possible.

This view runs contrary to the prevailing wisdom, which regards the budget deficit as the source of all evil. As usual, the prevailing wisdom relates to the preceding traumatic experience. Budget deficits did lie at the root of the international lending crisis of 1982. But after international lending ground to a halt, the world was badly in need of some inflationary stimulus. What saved us from an experience similar to that of the 1930s was the budget deficit. Without it, the U.S. economy would not have responded so quickly when the monetary restraints were removed, and Keynes' famous dictum, "you can take a horse to water, but you can't make him drink" would have applied. It was doubly fortunate that the deficit was already in place because in light of the prevailing wisdom it would be difficult to put it into place now.

The breakdown in international lending has created more room for the U.S. budget deficit, and the deficit in turn is facilitating the repayment of international debt. Reduced imports and increased exports from the debtor countries tend to keep down the prices of internationally traded commodities and the need to repay loans tends to keep the dollar firm. Both influences serve to stabilize the domestic price level in the U.S. At the same time, the budgetary stimulus helps to offset the depressing effect of a large shortfall in the balance of trade. As a consequence, the transfer problem that Keynes first observed in connection with German reparation payments is largely neutralized. As long as the debtor countries are willing to pay, the U.S. could continue to run large budget deficits combined with large trade deficits in a non-inflationary environment. Resource transfers would serve to suppress inflationary pressures which budget deficits would otherwise generate.

The outlook on wages is similarly encouraging. Having passed through a very difficult period, firms are likely to stay lean, so that the growth in output is likely to help productivity rather than employment. As long as the level of unemployment is high, wage pressures are unlikely to develop. In sum, the outlook of sustained, non-inflationary growth seems better than it has been in preceding cycles.

From the point of view of the U.S. economy, one could speak of a virtuous circle between international debt repayment and the U.S. budget deficit.

From the point of view of the debtor countries, the situation is quite different. The budget deficit is pushing up interest rates and the exchange rate of the dollar. Having borrowed when dollars were cheap, these countries have to service their debt with dollars that are expensive. From their perspective, the circular connection between debt repayment and the United States budget deficit is a vicious one.

The plight of the debtor countries cannot be expected to influence the creditor countries unduly as long as their own economies are doing well. When resource transfers serve to render budget deficits less inflationary, why should one eliminate them? If the outlook for the United States economy is so favorable, why should one think of debt reorganization?

THE CASE FOR DEBT REORGANIZATION

There are two major arguments in favor of tackling the international debt issue; one is political and one is financial. There is also a moral argument: it is unfair that the debts were contracted when dollars were cheap and have to be repaid when dollars are expensive. It is unjust that the United States should prosper while Latin America wallows in depression. But questions of debt repayment are rarely settled on grounds of morality. What makes the moral argument relevant is that it has far-reaching political implications.

Depressed economic conditions in Latin America are fostering political turmoil. The Soviet Union and its allies can easily exploit the situation, and events can be interpreted in geopolitical terms. Plain anti-American, anti-capitalist sentiment can be translated into communist conspiracy. The United States will be inextricably drawn into political conflicts. El Salvador is only the beginning. Already, the Administration is propounding a new domino theory with Mexico as the ultimate domino. It may turn out to be a self-fulfilling prophecy.

The United States is likely to ally with unpopular political forces. Its policies will be influenced by the interests of the Collective, and, as we have seen, the Collective is bound to become a focal point of resentment. The United States is likely to find itself on the losing side of political conflicts, and to redress the balance military solutions will have increasing appeal. A timely decision to confront the debt issue could prevent a Latin American domino sequence from developing.

The financial argument in favor of debt reorganization is more speculative. It has to do not so much with economy as with the financial markets. We have concluded the U.S. economy could flourish even while Latin America wallowed in depression. What we have not considered is the reaction of the financial markets to the combination of an unresolved international debt problem with continued high budget deficits.

We shall take the same approach as we did in the analysis of the international lending boom, but our conclusions are bound to be much more speculative. The reason is that in the case of international lending we were dealing with a self-reinforcing, self-validating process which was complete. Here the process is still ongoing. A completed process is easier to analyze than an incomplete one because explanation is inherently more reliable than prediction. That is why we chose to reverse the usual order of discussion and deal with the debt problem first. It is hoped that the speculative character of our predictions will not detract from our analysis of the debt problem. What follows is a highly personal view.

Credit creation through persistent budget deficits is inherently unsound and unsustainable. It played a constructive role in getting the economy going again, but if it persists it will eventually have to come to a bad end just as international lending did. The question is, how?

Financial markets are bound to play a crucial role in the process. We have seen that the economy could tolerate a high degree of fiscal stimulation without inflationary consequences, but the financial markets cannot. Traumatized by the inflationary experience of the recent past, they are allergic to deficit financing. Their fears find expression in a strong upward pressure on interest rates.

One possibility is that high interest rates will abort the recovery. Another is that the Federal Reserve will be successful in allaying the fears of the financial markets so that the recovery is slowed down but not reversed. In that case, private credit demand for business purposes would remain subdued; liquid assets that do not find employment in business would shun fixed rates of return and continue pouring into the stock market. There would be a tremendous boom, setting up the preconditions for a crash. The banks, in their weakened state, could not withstand a severe decline in the stock market. A crash would therefore coincide with a breakdown of the Collective, and it would be impossible to say which one precipitated the other. In this way, the inflationary binge of deficit financing may yet culminate in a full-scale financial crisis.

The latter scenario is somewhat fanciful, but it is not beyond the realm of possibility. Reality is likely to combine elements of both extremes. We already have a stock market boom behind us; now, rising interest rates threaten to abort the recovery. My guess is that the Federal Reserve will resist the pressure as long as possible, and there will be a tug of war between higher interest rates, which tend to depress the stock market, and excess liquidity, which tends to propel it higher.

Whatever the actual course of events, the unresolved debt problem is bound to be a negative influence. Financial markets are aware that the Federal Reserve is hamstrung by the precarious state of the banking system. The monetary brakes are booby-trapped: if the Federal Reserve tightens credit to any significant extent, the various rescue packages are apt to blow up. No wonder that the financial markets doubt the Federal Reserve's ability to control money supply!

It would be unrealistic to advocate debt reorganization in order to reassure the financial markets. It would, after all, be much simpler to reduce the budget dificit -- a task that seems to exceed the capabilities of the political process; how, then, could a consensus be reached on the much more complex issue of debt reorganization? The fact is that nothing can be expected to be done about the debt problem until some of the adverse prospects outlined here have actually materialized. As in a Greek tragedy, a pronouncement by the Delphic Oracle is not sufficient to prevent the drama from unfolding.

That is a pity. It makes all the difference in the world how the debt problem is resolved. An orderly, negotiated process is necessary if catastrophic breaks are to be avoided.

That is a pity. It makes all the difference in the world how the adjustment is accomplished. An orderly, negotiated process is necessary if catastrophic breaks are to be avoided.

The debt problem constitutes unfinished business. It casts its shadow on financial, political, and economic developments. It has a decisive influence on monetary policy and is an important factor in world politics. If events are allowed to follow their course, catastrophic breaks could occur in a number of areas: in the politics of debtor countries; in our relations with them; in the banking system; and eventually even in the stock market and in the economy. These developments could be preempted by the mere decision to engage in negotiations to reorganize international lending. Here are two examples.

We have seen that the major U.S. money center banks have no choice at present but to take the high road in setting up reserves for their international loan portfolio. The moment it was decided to reorganize international lending, U.S. banks would be forced to switch to the low road and the clock would start ticking in the adjustment process.

Similarly, we have seen that if and when debtor countries stop interest payments, the break is likely to be radical. If the move were not unilateral but part of an international agreement, the reduction in interest rates could be kept more moderate.

Let us suppose that Brazil consolidates its debt in twenty-year bonds -- a proposition that is gaining increasing attention. If the move were part of an international agreement which would assure Brazil limited access to new financing, Brazil could pay a higher coupon on the bonds than if it acted unilaterally. Obviously, the losses suffered by the banks would be commensurately lower.

Are the banks strong enough to sustain even moderate losses? That is where the lenders of last resort come into play. The bonds could be discounted by the Federal Reserve at par. The cost of borrowing from the Federal Reserve would be higher than the yield on the bonds. Banks that cannot make up the loss from their current earnings are insolvent and need to be liquidated. To avoid panic, depositors would have to be guaranteed against loss. The others would gradually work their way out of the hole they are in now.

I contend that much of the discussion about international debt has been misdirected. The question is not whether the debt needs to be reorganized but when. It would be clearly more propitious to start now than it would have been six months ago. Will not the same be true six months hence? After all, the financial position of the banks improves with every passing day.

The answer is no. At present, the decision to reform international lending would be received calmly. The economic recovery and the improvement in the financial position of the banks would continue, but the danger of a financial calamity at a later date would be greatly reduced. If our analysis is correct, the longer the international debt problem dominates monetary policy, the greater the danger of an eventual crash. At the height of the liquidity crisis, investors were quite liquid; the longer the bull market lasts, the more exposed they become. International negotiations take a long time; the best time to initiate them would have been at the Williamsburgh conference.

CONCLUSION

Our analysis leads to the inescapable conclusion that commercial banks acting individually or collectively do not provide a suitable mechanism for the recycling of balance of payments surpluses and the financing of balance of payments deficits. There is credit creation (or liquidation) involved, and credit creation needs to be controlled. Commercial banks can play a role, but they must be under the supervision of a central banking institution. This principle is accepted as far as domestic credit is concerned, but it has not received sufficient recognition in the international arena. International monetary institutions exist, but they are not equal to their task. They could not take care of the recycling of petrodollars, and they could not control credit creation by the commercial banks.

The commercial banks got involved in the recycling of petrodollars because there was no other mechanism available. They moved into an institutional vacuum, and their activities created a much bigger deficiency than what any responsible international agency would have been willing to countenance. The deficiency has to be made up one way or another in order to avoid a credit implosion, but the institutional vacuum has also got to be filled by a mechanism yet to be designed. The uncontrolled creation of international debt has caused not one problem but two. One is the accumulation of bad debt, and the other is the lack of an adequate mechanism for international lending.

The first problem is easier to solve than the second. The broad outlines of a debt reorgainzation scheme are readily visible. The debt has to be consolidated, the maturity extended, and the coupon reduced. Details are subject to negotiation. To protect the integrity of the banking system, the loans would be eligible to be discounted by the central banks at par. Ironically, such a scheme would require no additional resources. The money lent by the banks has already been spent by the debtor countries; the reorganization scheme would merely allocate the losses. By allowing the central banks to make up any deficiency, we merely avoid the havoc that an unallocated deficiency would play with our banking system.

It is the second problem that poses the real difficulties. Any debt reorganization scheme would trigger the dissolution of the Collective. Some other institution would have to take its place. Debtor countries need ongoing financing if international trade is to continue and the reorganized debt is to be serviced. The institution in question would have to do more than just provide credit: it would have to regulate, or at least take into account the implications of the growth in money supply and fluctuations in exchange rates on a worldwide scale. In sum, problems that have eluded successful solutions thus far would have to be tackled.

In contrast to the reorganization of past debts, the strengthening of international monetary institutions would require the commitment of additional resources. Trade-offs are involved where resource transfers to developing countries have to be weighed against continuing domestic budget deficits. The political stability of Latin America has to be weighed against the needs of the military; financial stability has to be weighed against welfare and the needs of the bureaucracy. To some extent, the commitment of additional resources serves to reduce the losses arising out of debt reorganization: as we have seen, the debt servicing capacity of the debtor countries is greatly dependent on their access to ongoing financing. Nevertheless, it will take political vision and leadership to recognize and fill the need for stronger international monetary institutions.

It is beyond the scope of the article to prescribe the solution. Indeed, my purpose is to show that there is a problem, or, more exactly, that there are two problems. Strange as it sounds, there is no agreement on this point. Once the problems are recognized, it will be the task of a Bretton Woods type of conference to agree on a solution.

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FLS 87

10 DOWNING STREET

From the Private Secretary

17 October, 1983

Argentina's Debt Problems

The Prime Minister was grateful for the report on current developments on Argentina's debt problems. She agreed with the line which the Chancellor is proposing to take.

I am copying this letter to Brian Fall (Foreign and Commonwealth Office) and John Bartlett (Bank of England).

ANDREW TURNBULL

John Kerr, Esq.,
H.M. Treasury

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KM

FINANCIAL TIMES EXTRACT - 17 October 1983

Financial Times Monday October 17 1983

Companies and Markets

CREDITS

Argentina given date for first drawing on rescue package

AFTER MORE than two weeks of anxious nail-biting, Argentina's leading creditor banks have finally set a new date of October 28 for the country to draw the first $500m instalment of the $1.5bn loan it is to receive as part of its debt rescue package.

A recommendation to this effect has been telexed over the weekend to all 300 creditor banks by their advisory committee in New York. The drawing, previously scheduled for today, was thrown into doubt by the arrest two weeks ago of Sr Julio Gonzalez del Solar, the country's central bank president, and a freeze on debt rescheduling imposed by a provincial judge in the Patagonian city of Rio Gallegos. The freeze has now been lifted by an appeals court in Buenos Aires.

Mr William Rhodes, chairman of the Advisory Committee, confirmed over the weekend that Argentina has agreed to bring all arrears of public sector debt interest outstanding as of September 30 up to date as a precondition for drawing on the loan. A statement over the weekend also said that the International Monetary Fund has assured creditor banks that its standby credit for Argentina, in jeopardy becouse of the arrears, remains in effect. The Government in Buenos Aires has meanwhile confirmed that it will proceed with the rescheduling of some $6bn in public sector debt falling due this year, Mr Rhodes said.

The statement follows a marked change in the mood prevailing a week ago when the debt rescue effort was still bogged down in nationalistic fervour ahead of Argentina's elections in October 30.

Since then creditor banks have forcibly reminded Argentine officials that the country will need the $1.5bn credit whoever wins on October 30. This argument has obviously had considerable impact which suggests that commercial banks are not as entirely at the mercy of political developments in Latin America as some observers had previously thought.

Indeed Brazil, which is in the process of swallowing unpopular austerity measures, provides another example of a country being prepared to pay a heavy political price for commercial bank credit. At the moment, however, the main preoccupation of the lending banks is with arranging the credit itself. Tomorrow Sr Affonso Celso Pastore will address banks in London on the last leg of a world tour designed to drum up support for the country's proposed $6.5bn credit.

Mr Guy Huntrods, an executive director of Lloyds Bank International who has been accompanying Sr Pastore, said over the weekend that response to the tour so far had been generally positive. During the latest stop-over in Bahrain, he said, there had been a "constructive discussion" with about 30 creditor banks. Middle Eastern banks were among the least responsive to Brazil's previous rescue effort but were now showing "a mood of realistic appreciation of Brazil's needs," according to Mr Huntrods.

Brazil, as already reported, has asked for the initial disbursement of the credit to total "up to $3bn." It is understood that this drawing should become available before the end of the year, allowing the country to eliminate debt service arrears now being held just below the critical level of 90 days. If the drawing can be made this quickly Brazil will be able to avoid the need for further bridging finance.

Meanwhile Portugal has scored a notable success with its current loan. On Friday the 16 lead managers offered to increase the amount to $350m from the $300m previously sought. The country's credit rating has been enhanced by its recent agreement with the International Monetary Fund and the loan's success will clearly be used to help public opinion accept the austerity which the IMF programme implies.

The Trans-Tunisian Pipeline Company has mandated a group of banks led by Bank of America International and Credit Lyonnais to raise an ECU 150m eight-year credit with a margin of ⅜ per cent over London interbank offered rate (Libor) for the first 3½ years rising to ½ per cent thereafter.

Peter Montagnon

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Prime Minister

To note and agree X.

AT 10/10

ACAW

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

10 October 1983

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Agreed

Dear Andrew,

ARGENTINA'S DEBT PROBLEMS

The Chancellor has suggested that the Prime Minister might like to have a brief report on the latest developments in Argentina.

Generally, the prospect of a complete Argentine default is closer now that the authorities have had to suspend foreign currency payments to protect dwindling reserves. The suspension has been announced as a temporary one, pending the establishment of a system of foreign currency priorities. So far as we are aware these new restrictions have been imposed on a non-discriminatory basis. Our limited experience before the latest clamp down suggested that Argentina was honouring the assurances given in August to the IMF to lift discriminatory restrictions against UK companies. The DTI are continuing to monitor the position. Any resumption of discriminatory practices will of course lead to suspension of the IMF programme, preventing further drawings and in turn disbursement of the new commercial bank loan.

A key factor in the current situation is the breakdown in the commercial banks' refinancing of Argentine public sector debts. It hinges on a rescheduling agreement, negotiated with the state airline Aerolineas Argentinas, which is intended to serve as a model agreement across the board. Progress has been halted by an Argentine judicial ruling that the agreement infringes the constitution because it would be subject to US, rather than Argentine, law. The ruling also led to the arrest of del Solar, the Governor of the Central Bank, because of his part in negotiating the agreement. His subsequent release and an appeal court ruling in favour of the Government on the rescheduling agreement suggests that the immediate crisis may have passed.

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But the events have caused self-inflicted damage to any confidence that the rescheduling negotiations will be concluded before the elections on 30 October, as was originally intended.

The rescheduling is one of the conditions of the commercial banks' $1.5 billion loan agreed in August. The first drawing of $500 million has thus been postponed until 17 October. Without the drawing, or resumption of IMF drawings, the Argentines will be unable to make a $350 million repayment under the $1.1 billion bridging loan from the banks which has already been postponed once.

The third drawing under the IMF standby is also postponed pending the elimination of payments arrears. Continued delay in gaining access to commercial bank loans could lead to pressure on the IMF to waive the arrears condition for disbursement of the next tranche. So far the IMF management has shown no disposition to alter the terms of the loan. This is clearly right. Disbursement also depends on Argentina continuing to meet the IMF performance criteria. Although the programme was on course in the middle of this year there are signs tht it may be under strain because of increasing pressure on the Government to ease wage restraint, accelerating inflation and an increase in the public sector deficit. The longer the delay, the less likely it seems that drawings will be resumed.

Although the situation seems to have been held for the present, further deterioration in Argentina's financial position cannot be ruled out in the period before the election and there can be no certainty about developments thereafter. The present exposure of British banks in Argentina is $2.3 billion.

x The Chancellor feels that the right public line to take on Argentina's debt problems is that her recent difficulties are entirely of her own making. It is therefore for her, as for other debtor countries, to put her own house in order by making the necessary adjustments in line with the IMF programme, and removing obstacles to agreement with the commercial banks.

Copies of this letter go to Brian Fall (FCO) and John Bartlett (Bank of England).

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

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FM BRASILIA 202200Z SEP 83

TO IMMEDIATE FCO

TELEGRAM NUMBER 350 OF 20 SEPTEMBER

AND TO IMMEDIATE BANK OF ENGLAND ECGD

INFO IMMEDIATE HMT, DTI, PARIS, UKDEL IMF/IBRD WASHINGTON

INFO SAVING RIO DE JANEIRO, SAO PAULO

(2)

Prime Minister

MCS 21/9

MT

BRAZIL'S DEBT

1. I CALLED TODAY ON THE NEW PRESIDENT OF THE CENTRAL BANK. MCQUIBBAN ACCOMPANIED ME. FULL RECORD FOLLOWS BY BAG. MAIN POINTS WERE AS FOLLOWS.

2. PASTORE LED OFF BY SAYING THAT BRAZIL NEEDED THE BRITISH GOVERNMENT'S HELP IN SECURING A PLEDGE FROM ECGD FOR EXPORT FINANCE BETWEEN NOW AND END-1984. THIS, TOGETHER WITH SIMILAR PLEDGES BY EXIMBANK (US DOLLARS 1.5 BILLION ALREADY SUBMITTED TO US CONGRESS) AND BY THE CANADIANS, JAPANESE AND OTHER EUROPEANS, WOULD ENCOURAGE THE BANKS TO TAKE THEIR SHARE OF THE RISK ELEMENT IN MEETING BRAZIL'S FINANCIAL REQUIREMENTS FROM NOW UNTIL END-1984, AMOUNTING TO 11 BILLION DOLLARS. OF THIS SUM, SOME 2 BILLION DOLLARS WOULD BE FOUND FROM PARIS CLUB RESCHEDULING AND A FURTHER 2.5 BILLION DOLLARS FROM THE WORLD BANK AND IADB TOGETHER. THE REMAINDER WOULD HAVE TO BE FOUND FROM THE PRIVATE BANKS: AND THIS WAS WHERE THE GOVERNMENT-GUARANTEED FINANCING REQUESTED ASSUMED SUCH IMPORTANCE. THE FINANCE MINISTER WAS HOPING TO HAVE AN OPPORTUNITY OF DISCUSSING THIS QUESTION WITH HIS COLLEAGUES IN THE MARGIN OF THE IMF MEETING IN WASHINGTON NEXT WEEK.

3. I ASKED PASTORE HOW HE SAW THE GOVERNMENT'S ECONOMIC STRATEGY PROGRESSING. HE SAID THAT THE IMF NEGOTIATIONS HAD BEEN SATISFACTORY SO FAR. THE TARGETS SET WERE, IN HIS OPINION, VIABLE, INCLUDING THE PUBLIC SECTOR DEFICIT OF 0 PERCENT (IN REAL TERMS) OF GNP BY END-1984 (7 PERCENT NOMINAL), WHICH PROMPTED HIS PREDECESSOR'S RESIGNATION. THE BOARD'S APPROVAL WAS EXPECTED AT THE END OF OCTOBER. THE TRADE BALANCE PROJECTION FOR 1983 (6.3 BILLION DOLLARS) WOULD PROBABLY BE OVERSHOT BY SOME 10 PERCENT, WHILE THE 1984 TARGET (9 BILLION DOLLARS) WAS ENTIRELY FEASIBLE, SO LONG AS COMMODITY PRICES AND WORLD ECONOMIC ACTIVITY HELD UP. IF THEY DID NOT, IMPORTS WOULD HAVE TO BE CUT FURTHER. IN REPLY TO MY QUESTION ABOUT THE FORECAST FOR ARREARS IN PAYMENTS BY THE END OF 1983, WHICH WAS QUOTED IN ONE NEWSPAPER AS REACHING 3 BILLION DOLLARS, HE SAID THIS WAS A WORST-CASE FIGURE, ASSUMING NO NEW INFLOWS FROM THE IMF OR THE COMMERCIAL BANKS AND RELYING PURELY ON REVENUE FROM EXPORTS. IF THE EXPECTED INFLOWS DID MATERIALISE, THE ARREARS SHOULD BE REDUCED TO ZERO BY THE END OF DECEMBER 1983. I ASKED ABOUT RESERVES: AND HE SAID THAT

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/THESE

THESE SHOULD REACH A FIGURE OF 5 BILLION DOLLARS BY END 1984, THOUGH SOME OF THEM WOULD BE ILLIQUID.

4. ON THE POLITICAL FRONT, I ASKED HOW HE VIEWED THE PROSPECTS FOR GETTING DECREE LAW 2045 (PROVIDING FOR THE PARTIAL DE-INDEXATION OF WAGES, SALARIES AND RENTS) THROUGH CONGRESS. HE SAID THAT IF DECREE LAW 2045 WERE TO BE REJECTED IT WOULD MERELY BE REPLACED BY A FURTHER DECREE LAW WITH SIMILAR PROVISIONS. THE GOVERNMENT WERE NOT TO BE SIDETRACKED BY STRIDENT OPPOSITION CALLS FOR A UNILATERIAL MORATORIUM OR A BREAK WITH THE IMF. INDEED, SOME OPPOSITION LEADERS - NOTABLY THE STATE GOVERNORS, WHO HAD HEAVY RESPONSIBILITIES OF THEIR OWN - WERE MARKEDLY LUKEWARM IN PRESSING THE GOVERNMENT TO CHANGE COURSE. IT WAS DESIRABLE THAT PUBLIC OPINION SHOULD BE EDUCATED ABOUT THE HARSH ECONOMIC FACTS OF LIFE AND THE JUSTIFICATION FOR THE CURRENT ECONOMIC STRATEGY: BUT THERE WERE SEVERE LIMITS AS TO WHAT COULD BE SAID TO THE PRESS AT THE MOMENT WITHOUT JEOPARDISING THE DELICATE NEGOTIATIONS AT PRESENT IN PROGRESS. I ASKED HIM FLATLY WHETHER HE EXPECTED PRESIDENT FIGUEIREDO TO LAST OUT HIS TERM OF OFFICE UNTIL MARCH 1985, TO WHICH HE REPLIED: QUOTE OF COURSE UNQUOTE.

COMMENT

5. PASTORE WAS REMARKABLY CANDID IN ANSWERING ALL MY QUESTIONS AND IMPRESSED ME WITH HIS FORTHRIGHTNESS AND CALM DETERMINATION. HE MADE IT QUITE CLEAR THAT HE IS LOOKING FOR OUR URGENT HELP IN SECURING AN ECGD PLEDGE (PARA 2 ABOVE), WHICH HE REGARDS AS AN IMPORTANT PIECE IN THE REFINANCING STRUCTURE WHICH THE ECONOMIC TEAM ARE PUTTING TOGETHER. HE PROMISED TO GIVE ME A COPY OF THE LETTER OF INTENT TOMORROW (AS SOON AS THE FINANCE MINISTER HAS TRANSMITTED ITS TEXT FORMALLY TO CONGRESS) AND SAID THAT HE WOULD LIKE TO SEE ME AGAIN WHEN HE RETURNS FROM WASHINGTON ON 3 OCTOBER.

FCO PLEASE ADVANCE TO:
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→ Robin Butler

Prime Minister (2)

To see

MCS 23/9

MCS 20/9

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

M C Scholar Esq
10 Downing Street
London SW1

19 September 1983

Dear Michael,

INTERNATIONAL FINANCIAL SCENE

I enclose the latest assessment of the international financial scene by the Bank of England, which the Treasury have discussed with the Bank and other Departments. The Prime Minister may find it useful background for her forthcoming visit to Canada and the United States.

2. The general tone of this latest assessment is little changed from the last assessment in July. The Chancellor has however asked me to draw attention to the following particular points which arise from our consideration of the assessment.

3. On the positive side, the Bank's note points to the improvement in economic activity in the major industrial countries, particularly in the US, which is of direct help to many of the major debtors. This more optimistic tone, as regards the US economy at least, has been reflected in the recent IMF World Economic Outlook paper.

4. The outcome of the conference on debt held by the Organisation of American States in Caracas from 5-9 September was better than anticipated. Speeches by the delegates were on the whole moderate, and there was no call for a debtors' cartel. Ministerial sessions at the end of the meeting endorsed a factual paper analysing the present position on international debt. Attempts to agree a draft resolution on policy were abandoned. It is encouraging that the Brazilians and Mexicans took a particularly moderate line in the discussions.

5. On the debit side, it is still not clear how the wrangle in Congress over the IMF quota legislation will be resolved. Sittings of the Conference Committee of both Houses have now begun but are not expected to be completed for some weeks. The odds still are that the legislation will go through, subject to a number of restrictive provisions. But meanwhile the uncertainty also casts a shadow over operational decisions on such issues as IMF access limits, and hence over the forthcoming IMF/IBRD Annual Meetings.

6. On individual countries Brazil remains the main focus of concern. The assessment does not on this occasion include a detailed section on Brazil, in view of the Prime Minister's discussion with the Chancellor and the Governor earlier this week. It is, however, worth reporting that at a meeting of G5 deputies in Paris this week our representative, with strong support from his French and German colleagues, made it clear to Beryl Sprinkel that we were not prepared to go further than support through the Fund and official (Paris Club) rescheduling. Sprinkel will report this back to the Fund Managing Director. We shall let the Prime Minister have up to date briefing on Brazil before her visit to the US.

/7.

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7. Of the other countries, the Philippines are becoming a bit worrying, given the political tensions. A JIC assessment is in preparation and the Fund have promised an assessment for the informal group of G5 officials.

8. I am sending copies of this letter to Brian Fall (FCO), John Rhodes (DTI) and John Bartlett (Bank of England).

Yours ever,

John Kerr.

J O KERR

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INTERNATIONAL FINANCIAL SCENE

General Situation

1 There seems, in so far as one can generalise, to have been marginally encouraging progress on the international debt scene over the past two months, evident most noticeably in Mexico and Chile, helped by - on balance - more favourable developments in the world economy, Fund programmes and domestic retrenchment. However, the Brazilian situation remains on a knife edge. The problems of the Philippines have been rendered more acute by political uncertainties and differences with the IMF over the standby arrangement; and a few more countries have applied for debt relief (eg Morocco) or are preparing to do so (Liberia). Although their problems add little to the size of the global debt problem they do contribute to the cumulative impact on banks' reluctance to lend more to ldcs.

Economic background and interest rates

2 The pick up in economic growth in the major industrial countries overall is proceeding a little faster than seemed likely earlier this year. Certainly this is true in the United States where GNP grew at an annual rate of more than 9% in the second quarter. This exceptional pace may now be slackening but growth of 5-6% in the year to 1983 Q4 now seems likely compared to the US Administration's January forecast of 3%. Renewed growth is also evident in Canada and Japan, both of which are benefitting from the US upturn. In Europe the recovery is less impressive: the positive growth of around 1/2% now forecast in Germany for 1983 as a whole is an improvement on the earlier forecast GNP decline, but France and Italy have yet to show much sign of a sustained revival. The improvement in the industrial world generally is directly helping a number of major LDC debtors, particularly in Latin America, where one-third of exports go to the United States. The impact is likely to be felt not only in improving export volumes terms but also in their terms of trade: the Economist index of dollar commodity prices, for example, has risen by 25% since its October 1982 trough.

3 Against this, however, US short-term interest rates touched a peak for 1983 in August, although they have since eased somewhat; and high US interest rates and the strength of the dollar remain, for countries whose debt is largely dollar-denominated, a major impediment to any more significant improvement in the general debt situation.

Lending attitudes

4 Another adverse factor for ldcs is the continuing slowdown in international lending. The interbank market has shared in this slowdown but major difficulties in it have been avoided. Nevertheless there is evidence that some as yet credit-worthy developing countries are finding it more difficult to obtain financing needed for imports.

Problem countries (other than Brazil)

(i) Latin America

5. The atmosphere surrounding Venezuela's negotiations with creditor banks has worsened significantly. The talks continue to be hampered by substantial interest arrears (some $600 mn) leading to a growing gulf between the Venezuelan authorities and creditor banks, and some banks are taking legal action. The authorities have ruled out an approach to the IMF prior to December's elections and although this will jeopardise the Venezuelan's chances of reaching an outline agreement with the banks by end-September, a further 90-day extension of the existing moratorium appears inevitable. Final agreement on a rescheduling is thus unlikely to be reached until next year.

6. In contrast, Mexico's position continues to improve. IMF targets are being met and the first three rescheduling agreements were signed on 26 August. Mexico's liquidity is underlined by a surplus on current account in the first half of the year which has notably led to a punctual repayment of the outstanding balance of the BIS facility. There are signs of improvement also in Chile where access to IMF resources is restored, agreements have been reached with the banks for new medium- and short-term credits and reserves seem to have stabilised after earlier dramatic losses.

7. In Argentina, the IMF's approval of the steps taken by the authorities to remove discriminatory restrictions against the UK, has paved the way for the release of the final tranche of the banks' bridging loan and agreement over the $1.5 bn new money loan. The Department of Trade continues to monitor Argentina's fulfilment of her commitments to ensure that restrictions are not reimposed. The banks, meanwhile, have delayed disbursement of the new loan because of the discriminatory interpretation of the Bankruptcy Law by an Argentine judge. More seriously, the IMF fears that the standby agreement programme for Argentina may be under strain because of increasing pressure on the Government to ease wage restraint, accelerating inflation and an increase in the public sector deficit.

8. Elsewhere refinancing agreements have been signed for Peru (Paris Club) and Uruguay (commercial banks) whilst the rescue package for Ecuador has been effectively finalised apart from a few relatively minor difficulties. This should be completed in the near future.

(ii) Eastern Europe

9. Recent developments in Eastern Europe suggest slow and patchy progress. Official creditors have agreed in principle to resume rescheduling negotiations with Poland in October and the commercial banks have agreed in principle to reschedule 1983 maturities, but the underlying situation offers little ground for optimism. The 1983 international support package for Yugoslavia is nearly complete. Signature of the commercial bank element is proceeding and disbursement is now expected before the end of October. As soon as the IMF have been advised of the availability date for the first advance of the commercial bank agreement the Fund will be able to release the blocked drawing of $110 mn originally scheduled for 15 August. Disbursement of the $200 mn gold-backed tranche from the BIS (which had as an interim measure postponed the repayment due in August) now seems imminent following the waiver of a negative pledge clause by a Kuwaiti-led syndicate. The Bank of England's participation has been eliminated by the second instalment of HMG's loan. With the assistance of international agencies Hungary appears to be having success in raising sufficient new funds to meet 1983 debt maturities but there is concern for 1984 when commitments are set to rise. Timar, President of the National Bank of Hungary, who met the clearers on his visit to London, looked for their support in the smaller syndicated loans which the Hungarians hoped to raise towards the end of this year or in early 1984. There has been no confirmation of earlier reports that the GDR has opened bilateral negotiations with a number of (unnamed) creditors to reschedule some of its maturing debt.

(iii) Southern Europe

10. Several countries in this area are faced with uncomfortably large borrowing programmes to refinance their continuing external deficits and although none seems likely to run into debt difficulties in the foreseeable future their position needs watching. Portugal has recently concluded talks with the IMF on terms for an 18-month \$480 mn standby arrangement which should assist market sentiment towards an expected approach in the autumn. In the meantime there are reports of an approach to the BIS for a \$300 mn gold-linked loan in addition to the facilities arranged in March and June. Growing concern is being expressed about Greece as poor export performance and reduced invisible earnings have led to a widening of the current account deficit and placed increased strain on already sharply reduced foreign exchange reserves. Although Spain seems potentially a larger problem because external earnings have been growing more slowly than the rising service on external indebtedness and progress in improving the current account is slow, the recently concluded \$750 mn loan suggests continued market confidence. Although sheltered by financial support from the United States, increasing awareness of the weakness of the Israel economy has prompted introduction of a number of measures including a 7.5% devaluation and public sector expenditure cuts. If a period of political instability follows Begin's resignation the external situation could deteriorate further.

(iv) Far East

11. There have been no major developments in the economies of the Far Eastern problem countries. In the Philippines, however, the assassination of the prominent opposition politician Aquino, and renewed speculation about the health of President Marcos, by raising concern about the prospects for political stability, may further weaken international banking confidence. The Philippines' chances of avoiding rescheduling, in the short-term, remain delicately balanced, but Indonesia and South Korea look reasonably placed at least for the remainder of the year.

SUBJECT
cc MASTER
~~OPS~~

CONFIDENTIAL

MR. COLES ✓ A.J.C. 15/9

Please see last paragraph of this letter.

10 DOWNING STREET

From the Private Secretary

15 September 1983

Dear John,

Brazil

The Prime Minister held a meeting on Brazil yesterday evening. The Chancellor of the Exchequer, the Governor of the Bank of England, Mr. Middleton, Mr. Unwin and Mr. Loehnis were present.

The Governor said that at the recent BIS meeting it had been agreed that the repayment date for the overdue BIS facility should be extended to 30 November. This would give time for the IMF to come to a conclusion about whether the Brazilians were performing satisfactorily under the terms of their adjustment programme - in particular on whether their de-indexation policy was being implemented satisfactorily. There might be problems in the Brazilian Congress about ratifying the law on wage de-indexation, and it might prove necessary for the President to ratify the law by decree.

In discussion it was noted that Brazil's financing requirement in 1983/84 was some $11 billion over and above the funds they would be receiving from IMF sources. Of this there were indications that the commercial banks would provide $6 billion or perhaps as much as $7 billion. The agreement in the Paris Club to reschedule Brazil's official debts might produce a further $1.9-2 billion; $0.3 billion was expected to come from the IBRD, and $1.5 billion from the US Exim bank, if the Administration was successful in securing Congressional approval this week. This left a financing gap of between $500 million and $1 billion, and it was likely that there would be pressure for Brazil's creditors to bridge this gap through additional export credits. British participation in the Paris Club rescheduling was likely to have a PSBR cost of around £200 million. It seemed likely that there would be general agreement in principle to such rescheduling, and it would be very difficult for the United Kingdom to stand out against the other countries. To go beyond agreement to the rescheduling, and to agree new export credit cover for Brazil might well take the pressure off the commercial banks. On the other hand, if the banks came to believe there was a lack of commitment by governments to find a solution to Brazil's financing problems their contribution might fall short of $6 billion.

/ The Prime Minister

CONFIDENTIAL

The Prime Minister said that our involvement in a Paris Club agreement should be a sufficient earnest of the Government's wish to see a satisfactory outcome to Brazil's financing problems. We could not, however, contemplate the additional costs, contingent or otherwise, which would be involved in offering new export credit money to Brazil. If, at some later stage, Brazil's problems reached a critical stage it might be necessary to reconsider this decision. In view of the comparatively forthcoming position, particularly in relation to that of the United States, that Britain was taking on a range of international financial issues - for example the IMF quota increase and enlarged access to the Fund - this decision ought not to be difficult to defend. Finally, the Prime Minister noted the Chancellor's and the Governor's view that it would be desirable during her forthcoming discussions with President Reagan, to urge him to do all he could to secure passage through the Congress of the IMF bill.

I am sending copies of this letter to Brian Fall (Foreign and Commonwealth Office), John Bartlett (Governor's Office) and Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

John Kerr, Esq.,
H.M. Treasury.

CONFIDENTIAL

(1)

Prime Minister

Agree that the BIS deadline may be extended as proposed in para 5?

Yes

I imagine you will have serious reservations about the export credits proposal. Shall I arrange a meeting with the Chancellor, Governor and P Middleton?

MCS 9/9

Yes please

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

PRIME MINISTER

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.

?

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.

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 (1) rescheduling and the new proposal for additional export credits described above. (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.

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

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

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 very 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.

John Kerr

PP. NIGEL LAWSON
8 September 1983
(Approved by the Chancellor)

-9 SEP 1983

4.31 CONFIDENTIAL (PA) (1)

Prime Minister

There is ~~We have~~ no time for a discussion with the Chancellor and Governor "towards the end of next week" (the Governor is abroad).

Discuss with the Chancellor, ~~[illegible]~~ at Chequers?

MCS 2/9

Yes [illegible]

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

1 September 1983

W F S Rickett Esq.
10 Downing Street
LONDON
SW1

Dear Willie,

BRAZIL

I promised to let you have a further report on Brazil following John Kerr's letter of 5 August. This letter summarises developments during the past month.

Renewed negotiations at technical level have taken place between the Brazilian authorities and IMF officials, and there have also been the informal (but widely publicised) contacts between the senior Brazilian economic Minister, Delfim Netto, and the Managing Director of the IMF in Paris. Last week the Advisory Group of Brazil's commercial bank creditors met in New York, with the Brazilians present (as were observers from some central banks, including the Bank of England). The Brazilians have applied to the Paris Club for rescheduling of maturities due in 1983 and 1984 on official and officially guaranteed debt, and, as foreshadowed in John Kerr's letter of 5 August, have told the BIS that they are not at present in a position to pay the next instalment due on their BIS loan on 31 August. With the agreement of BIS Governors, the BIS are for the time being treating this instalment on the same basis as the overdue 31 May instalment, ie neither formally rolling it over nor calling it in default.

On Monday the IMF's Managing Director gave a moderately encouraging report to the Executive Board about the Fund's negotiations with the Brazilian authorities. In brief, agreement has been reached on some exacting objectives, notably deceleration in the inflationary path from the present monthly rate of 13 per cent to about 5 per cent by the end of this year and about half that level by the end of 1984; and limitation of the 'operational' budgetary deficit to 2.7 per cent of GDP in 1983, and a targetted surplus of between 0.2 per cent and 0.3 per cent of GDP in 1984. Budgetary objectives will be underpinned by monthly ceilings to be monitored jointly by the Fund and the Brazilian authorities, applicable to all public sector entities. The Fund still need more specific undertakings from the Brazilians on certain aspects of the programme and the monthly monitoring mechanisms, but de Larosiere was confident that these would be forthcoming. He told the Board that he had been personally heartened by the degree of co-operation and responsiveness of the Brazilian team in Paris. Nothing had been 'left under the carpet'. The Fund envisage that the programme, including a Brazilian letter of intent, will be ready to go forward to the Board in the second half of September, for Board discussion probably in late October. It is hoped this will coincide with clearance by the Brazilian Congress of the key law on wage de-indexation.

The Fund put the overall requirement for external financial support at some $10-11 billion from now to end 1984. At last week's meeting in New York the commercial banks indicated willingness to put up $6 billion in new money; official rescheduling is likely to yield between $1.5 and 2.0 billion; and up to a further $0.5 billion is believed to be available from the World Bank and other multilateral agencies. All reports indicate, however, that the banks are increasingly taking the strong view that private funds have hitherto borne a disproportionate share of the cost of the Brazilian operation, and that the remaining gap - which is unlikely to be less than some $2 billion - should now be covered by official funds. De Larosiere has apparently indicated to the bankers that they could count on IMF support in pressing G5 Governments, and Switzerland and Canada, to put up sums of this order.

Brazil is likely to be the main subject on the agenda of a private meeting of G5 officials concerned with debt issues in Washington next Tuesday and Wednesday (5 & 6 September). There are indications that the US are likely to use this as an opportunity to press the case for a G5 financial effort to complement whatever the banks can do. Our line will be non-committal, and we shall give the US no encouragement to expect any UK Government financial support for Brazil.

The next monthly meeting of BIS Governors will take place in Basle the following weekend. As you know, the BIS had previously set an informal (and unpublished) deadline of 15 September for repayment of the overdue instalments of the bridging facility granted to Brazil last December. The Governors will need to decide whether it would be right to enforce that deadline in the light of the progress made in Brazil's negotiations with the IMF and the commercial banks.

On 15 September there is to be a preliminary and informal discussion of the Brazilian request for official debt rescheduling in the Paris Club. In the UK's case, rescheduling could add about £190 million to the PSBR spread over the current and following financial year. The rest of the G5 are believed to have heavier exposure (with the Germans likely to be the worst affected) and the total amount which the Brazilians are asking to be rescheduled is around $2 billion.

The domestic political background to these various discussions between creditors continues to be difficult and unstable. Opposition within Brazil to the IMF austerity programme now spans the whole political spectrum (including a splinter group from the Government's own party), as well as trade unions, businessmen and industrialists.

In the Brazilian Congress, the opposition is currently engaged in trying to overturn the wages de-indexation Decree Law, referred to at the end of paragraph 3 above. The Government may now be hard pressed to drive this through the Chamber of Deputies. Even if they succeed, and the various pieces of the financial jig-saw fall into place over the next 2-3 months, a break with the IMF and a unilateral moratorium still cannot be ruled out. There is a danger that the nationalist alternative may continue to gain in appeal. However, early confirmation of agreement with the IMF, a continued understanding with the BIS, a settlement with the commercial banks, and a satisfactory Paris Club negotiation would demonstrate the continuing support of the international community and strengthen the hand of the Brazilian Government in sticking to the necessary adjustment course. But the situation will require very careful handling if the present delicate balance is not to be upset.

In brief, our best assessment at present is that there are grounds for cautious optimism about the prospects for agreement between the IMF and the Brazilian authorities on a satisfactory programme (though not formally before late October at the earliest). But doubts must remain about the ability of the Brazilian Government to put the programme through in the face of growing domestic political opposition. And the cost to creditor Governments of supporting the programme is likely to be significant.

No immediate decisions are required and no new propositions are on the table. But BIS Governors will need to decide at the Basle meeting on 11-12 September whether to continue to roll forward informally the overdue instalments beyond 15 September; and Brazil will almost certainly come up at the informal meeting of EC Finance Ministers in Greece earlier that same weekend. Brazil is also likely to be discussed at the IMF annual meeting in Washington later in the month.

The Chancellor therefore thinks that, as suggested in your letter of 9 August, it might be useful if the Prime Minister were able to discuss the position with the Governor and himself towards the end of next week. They would then be able to have a report on the outcome of the G5 officials' meeting in Washington next Tuesday and Wednesday, and possibly further news of the negotiations with the Fund. The Chancellor also thinks that these developments show that we shall need to have a more fundamental look at current international debt issues and he has put this in hand.

I am copying this letter to John Bartlett at the Bank of England.

Yours sincerely,

Margaret O'Mara

MISS M O'MARA
Private Secretary

ECON POL: Indebtedness Pt 2

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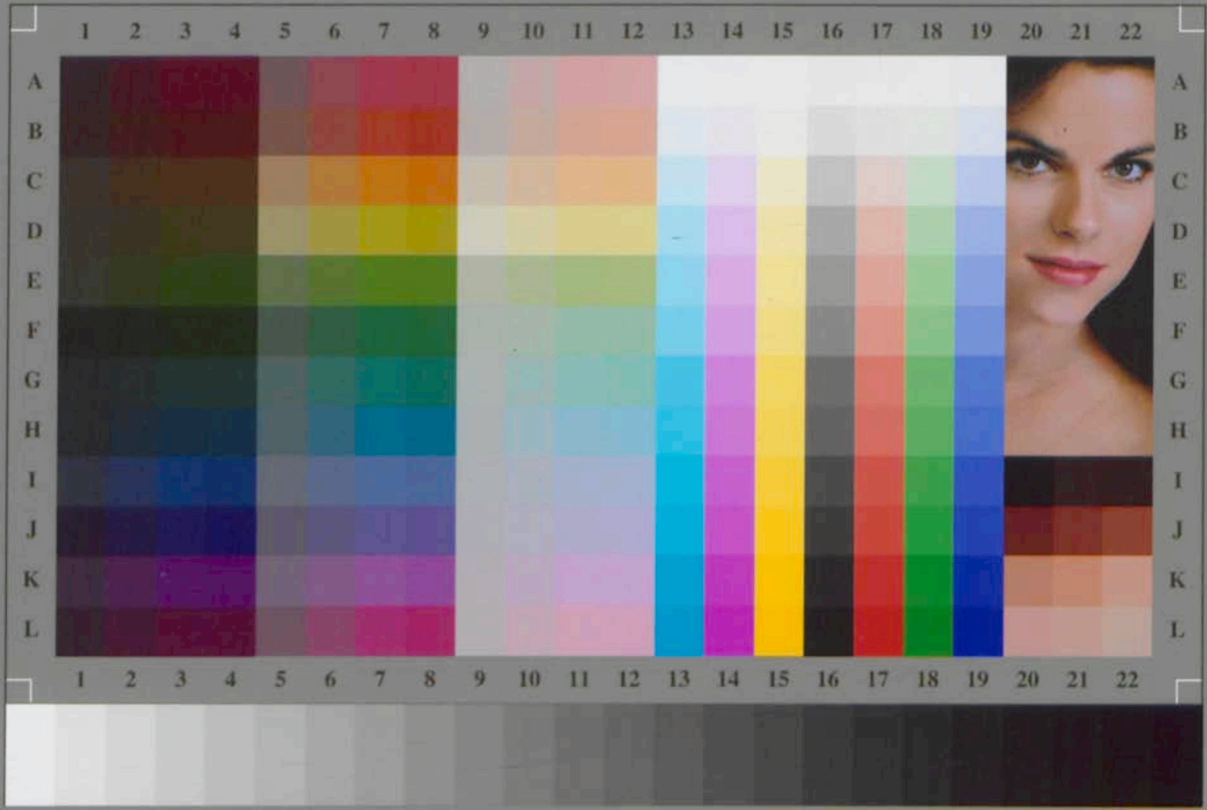

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