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WITHDRAWAL SHEET

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Collection Name DANZANSKY, STEPHEN (NSC): FILES

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File Folder INTERNATIONAL TRADE VIII © DEBT - NEW IDEAS - BAKER PLAN (2)

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2

ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
49426	CABLE	061643Z DEC 85	1	12/6/1985	B1
49427	NOTE	RE RESPONSE TO BAKER PLAN	1	12/20/1985	B1
49428	NOTE	RE RESPONSE TO BAKER PLAN	1	12/21/1985	B1
49429	CABLE	060245Z DEC 85	1	12/6/1985	B1
49430	MEMO	DAVID WIGG TO JOHN POINDEXTER RE YOUR REQUEST FOR IDEAS	4	11/25/1985	B1
49432	MEMO	DONALD FORTIER, ET AL TO ROBERT MCFARLANE RE NSC-SPONSORED STUDY	3	11/22/1985	B1
49434	DRAFT CABLE	TO AMBASSADOR VELIOTES RE NSC-SPONSORED STUDY	2	ND	B1
49436	CABLE	RE TRADE MANAGEMENT MISSION	2	11/21/1985	B1
49437	REPORT	RE BAKER PLAN	1	11/7/1985	B1

The above documents were not referred for declassification review at time of processing

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ID Doc Type	Document Description	No of Pages	Doc Date	Restrictions
49438 MEMO	DAVID WIGG TO ROBERT MCFARLANE RE TRIP REPORT	4	11/5/1985	B1
49439 CABLE	191640Z NOV 85	1	11/19/1985	B1
49440 CABLE	190700Z NOV 85	1	11/19/1985	B1
49442 MEMO	~~JOHN LENCZOWSKI TO ROBERT MCFARLANE RE SOUTHERN AFRICA~~ ~~DOCUMENT PENDING REVIEW IN ACCORDANCE WITH E.O. 13233~~	~~2~~	~~9/26/1985~~	open 4/14/10 KML

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49427	NOTE RE RESPONSE TO BAKER PLAN	1	12/20/1985	B1

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49428	NOTE RE RESPONSE TO BAKER PLAN	1	12/21/1985	B1

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Debt
[illegible]

U.S. Delaying Money for Africa Fund

The Reagan administration is withholding a $75 million U.S. contribution to the World Bank's special fund for Africa to see if it will be cut under the new deficit-reduction law, a Treasury official said yesterday. The contribution, approved by Congress Dec. 19, was to have been paid to the World Bank by the end of 1985. The bank, owned by 149 governments, is the biggest single source of aid for poor countries seeking new investments to raise their standard of living. The U.S. government owns the most shares in the bank.

The Treasury official, who spoke on condition his name not be used, said the $75 million for the World Bank will be delayed until March 1 to see if it will be cut under the Gramm-Rudman deficit-reduction law.

Edwin L. Dale, spokesman for the Office of Management and Budget, said in a telephone interview that the funds could be released earlier, and that, at most, $3 million would be held back. He said he did not know if the U.S. Treasury would pay interest to compensate the bank for money it might have earned if it had the $75 million in hand—which for the two months could be an additional $1 million at current interest rates.

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49430	MEMO DAVID WIGG TO JOHN POINDEXTER RE YOUR REQUEST FOR IDEAS	4	11/25/1985	B1

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
49432	MEMO DONALD FORTIER, ET AL TO ROBERT MCFARLANE RE NSC-SPONSORED STUDY	3	11/22/1985	B1

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
49434	DRAFT CABLE TO AMBASSADOR VELIOTES RE NSC-SPONSORED STUDY	2	ND	B1

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ID	*Document Type* / *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
49436	CABLE RE TRADE MANAGEMENT MISSION	2	11/21/1985	B1

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
49437	REPORT RE BAKER PLAN	1	11/7/1985	B1

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I.

November 5, 1985

MEMORANDA OF CONVERSATIONS

SUBJECT: Latin American Economic Conditions and Reactions to the Baker Proposals

PARTICIPANTS: David G. Wigg
Members of the Country Delegations of Chile, Brazil, Argentina, Uruguay and Colombia

DATE, TIME AND PLACE: October 7-9, 1985, Seoul, Korea

Chile

The government planned to sign its rescheduling agreement with the commercial banks at the end of October. After three years of declining output and consumption, the government hopes to begin to revive internal forces for growth. Very limited resource inflows will, however, limit Chile's growth potential for some time.

Response to Baker Proposals

- The proposed increased role of the World Bank in structural adjustment and sector lending may create new, possibly more severe conditionality backlash among debtors because such medium and long-term changes will tend to cut deeper into their economies (and affect special interests) than the IMF's short-term fiscal and monetary recipes. As a result, the World Bank will need to reassess it's approach to conditionality and provide meaningful amounts of non-project funding to avoid serious difficulties in its "expanded" role.

- Conditionality is presently less of a problem for Chile as they have already endured three years of severe austerity (consumption has declined by 17% since 1981) and the government's fiscal deficit is currently less than 3 percent of 6 GDP.

Medium Term Prospects

- If the external economic environment for trade continues to deteriorate, it will almost certainly lead to an unprecedented international financial crisis. To offset the cost of economic reforms, the debtors must have free and expanding access to developed country export markets.

- Transitional needs for Chile include a continued decline in the value of the dollar, more resources

from the multilateral development banks (MDBs) in part to encourage commercial banks to reenter the lending market, and some recovery of commodities prices.

Brazil

According to Delegation members, Brazilian Government policies in the last half of the 1970's and early 1980's to take on the debt burden and intensify public ownership in the economy have damaged the country's development potential for the remainder of this century.

The Brazilian situation is increasingly precarious. The government has not been able to bring its fiscal and monetary policies under IMF compliance. As with many Latin debtors, a high proportion of the country's $100 billion plus debt (80 percent) is owed by the public sector which is unable to generate the necessary domestic revenues to meet its repayment commitments abroad except by running massive fiscal deficits (floating bonds and other revenue generating activities). The public sector debt load is exacerbated by the staggering need for social service spending to contain very high poverty and unemployment.

Medium Term Prospects

- o Brazil will require roughly $4 billion in "new" outside resources annually if it is to attain minimum growth needs and to meet its external obligations (they are paying $12 billion in interest on the debt in 1985). A "mere debt rescheduling" like Mexico's will not suffice. New money is a necessity.

- o Although exports to developed markets increased dramatically in 1984, 1985 levels will actually decline.

- o Industrial imports are running at 6 percent of GDP. They must reach 10-12 percent in order for Brazil to adequately expand its industrial base. At the same time, the large external surplus (1985 exports of $25 billion and imports of $13 billion) causes serious internal distortions that make compliance with IMF fiscal and monetary strictures extremely difficult.

- o Only 20 percent of Brazil's population consumes significant resources. The need to increase public spending to combat poverty and unemployment is critical. The Army is becoming increasingly nationalistic and is no longer a force to implement the kind of prolonged austerity (as in the past) that would be needed for Brazil to cope with its present resource limitations and yet meet external debt obligations.

Response to Baker's Presentation

- They were encouraged by Baker's presentation and see it as a step leading to greater Brazilian access to MDB funding and better leverage with the commercial banks. They continue to have serious disagreements with the banks over fees, spreads, down payments under rescheduling terms, etc.

Argentina

Argentina was singled out by Jacque de Larosiere as an example of what is possible for Third World governments to achieve in the adjustment process (inflation was 30% in June 1985 and only 2% in September following implementation of the austerity program). On the other hand, the cost of austerity has been extremely high.

Short and Medium-Term Prospects

- As with so many of the debtor nations, the Argentine public sector owes the bulk (80%) of the country's total debt ($46 billion). They accept that in order to meet external repayments it will be necessary to reduce already depressed fiscal spending and raise taxes. Even under ideal conditions, however, the delegation did not believe it is possible to reduce the outstanding principal and still avoid instability.

46bil

- At present the domestic interest rate is at its lowest level (in real terms) in 50 years. GNP will decline by 3 percent in 1985, GNP/capita is 15 percent lower than it was 10 years ago. In addition, they have suffered a serious decline in their terms of trade as their export commodity prices have declined by one-third since 1980. The price of wheat for example was $140/ton 2 years ago and $95/ton now. Yet, they need to generate a trade surplus of 6% of GNP (equivalent to a surplus of $180 billion for the U.S.) to pay their debt service. Over the pat 2 years they have paid an average of 70% of scheduled debt service, with the balance made up through rescheduling and IMF support (without rescheduling would have required 8% of GNP). They estimate that they will need $2.5 - 3.0 billion in additional cash/relief in 1986 to meet repayments and achieve modest growth .

- In the 1970's, Argentine investment was as high as 30 percent of GNP. It is now running around 18 percent. Domestic savings are being drained off to service the debt, and foreign sources are not available. Argentine imports in real terms are below levels of 15 years ago.

- With the Argentine population growing by 1½ percent/year, they will need 5 percent annual growth in GNP though 1990 to achieve per capita level of 1974. Out-year growth requirements will be even greater.

Reaction to Baker Proposals

- A step in the right direction. It is interpreted by Argentina as a recognition by the USG that there is a long-term Latin debt problem. But they believe much more is needed, including fundamental U.S. policy changes and commitments for much greater funding from all sources. They also continue to believe in the need for an interest rate cap or equivalent regulatory relief.

- For the region generally, if commodity export prices and terms of trade (export prices over import prices) stay depressed, the countries will need higher levels of funding from alternative sources. In the absence of either one, or further rediction in consumption to meet the debt service, an indeterminant increase in political instability is inevitable. The time frame for "problems" to begin to appear under these scenarios is probably quite short -- perhaps 1-3 years.

Uruguay

Present Situation

- "Depression" best characterizes the state of the economy since 1981. GNP has dropped 22 percent, with industrial output down by 27 percent. Real wages are down 35 percent and construction spending is down 40 percent. In 1984 alone, real wages declined by 10 percent and 6 percent of GDP was paid abroad as interest on Uruguay's debts. The level of imports has declined by 50 percent since 1981.

- The return to democratic rule in March, 1985 raised expectations, which have greatly complicated efforts at austerity. Pressures remain acute in the wake of the June signing of a preliminary agreement with the IMF, which will include a $150 million inflow during 1986.

- Once again, public sector debt amounts to about three-fourths of the total which the government hopes to successfully reschedule as soon as possible.

- Apparently $15 million of FY 1986 ESF funds have been promised to Uruguay and they are hopeful the funds will be released parri passu with the visit of President Sanguinetti.

Reaction to Baker's Proposals

- o While the proposals are a step in the right direction, the way in which Treasury orchestrated the announcement created high expections which were unfulfilled.

- o Baker's proposals to enlarge the funds pool were much too heavily conditioned on austerity performance, given the small increases proposed. Thus, the proposed $20 billion in commercial lending over three years is "much too low". It translates into only 2-2.5 percent net new lending by the banks as opposed to a more "realistic" level of 5 percent ($50 billion).

Colombia

Colombia's economy is improving. Reserve levels exceeded their target by $350 million in September. Growth is expected to reach 3 percent in 1985 and perhaps more in 1986. They expected to sign a $1 billion rescheduling package in the first half of November, and negotiations on structural adjustment with the World Bank are well advanced. (These comments were made before the leak of the IMF paper which outlined a tough austerity program for Colombia for 1986, the release of which has caused a storm of protest from Government officials, labor leaders and private sector spokesmen).

Positive Aspects of Baker Proposal

According to delegation members, the proposal indicates the U.S. realizes the political dimensions of the debt problem. They believe Baker's references to the need for economic growth parallel those of the Cartegena dialogue. They were generally in agreement with the three points summarized in the presentation.

Problems

They feel Baker's presentation can be summarized as heavy on ideology and light on resources and that the "heavy handed" references to the private sector will hurt chances of meaningful responses from debtor governments. They did not like the casual way Baker referred to the World Bank as "just another MDB". Colombia has a long and intensive relationship with the World Bank going back many years and has very high regard for its capabilities. The political image of the World Bank is much better in Colombia than that of the IMF, even though their relationship with the Bank has been much closer, and has involved extensive, reform-oriented lending.

I N T E R O F F I C E   M E M O R A N D U M

Subject: IIF Meeting to Discuss the Baker Plan

Rick Schwartz and I attended this meeting yesterday in Washington. The morning was devoted to discussions among the some sixty banks that attended; the afternoon was spent discussing the Plan with David Mulford, Asst. Secretary of Treasury, Ernie Stern, SVP Operations at the World Bank, Dick Erb of the IMF, and Mike Curtin of the IDB.

It was clear that all the banks were seeking clarification on a number of critical aspects of the Plan. A number of issues were discussed at the meeting of 25 U.S. bank CEO's on October 17th; Hans Angemueller of Citibank enlarged on a number of issues of interest to them. These included questions about who sets and enforces conditionality and the role to be played by the banks; concessions to be offered by the MDB's; specific steps by the governments; and who is the first out of the box--Mexico, Ecuador, Argentina?? He also elaborated on their idea of a Trust Fundalso called the Superbank. This idea is a device to take care of the smaller banks; they would put their loans into a fund administered by the IBRD or the IDB. The Fund would be assessed a contribution each time one is needed for new money. Why any small bank would want to go along with this is hard for me to understand.

Mulford's presentation was low key and was received rather well. He was upfront in appealing to the banks self-interest in support the concept of the Plan. He explaned that they really had not worked out the crucial details of all this was to take place, but that he needed a clear and public pledge from the banks to go along with it in order to maintain momentum with the debtor countries. This was his first key point; the other was that the banks had to put up new money, in the range of 2.5-3.0%, in order for him to go along with increased lending from the various multilateral Development Banks MDB's. He ended his presentation by listing some 6-8 open issues on which he welcomed comment by the banks.

Stern was confident that the targets of the plan could be met by the World Bank. All of these countries have economic problems and require money to think about them. He said there would be no problem in making the new loans quickly,etc. We hear different things from his staff. Erb emphasized the need to move quickly and to develop a new broad framework in which to work. He later explained that the Fund expected that many of these countries would have Fund programs and that this would cushion the decline in the Fund's lending to the group of 15 countries. He emphasized the need for the Fund to be repaid. Curtin explained that the IDB had already increased disbursements over 50% during thelast three years. It would be difficult to meet the increases targeted for the IDB in the program. This was especially true for Argentina, Brazil, Mexico, andVenezuela.

With this rousing build-up , it was not surprising that the banks were less than enthused by the invitation to join in the Baker Plan. The meeting ended with the IIF trying to set up some study groups. Rod Wagner reminded the IIF that the Group of 14--now the Club of 15 due to the addition of one of the UK banks--was also working on several things and the IIF should stay away.

Nothing much is likely to come of the various initiatives of the IIF. The action is likely to be with the key banks in the Club of 15. There will be a period of several months of discussions before something is worked up to present to the larger group of banks. It is critical to begin talking to the key players here in New York and inWashington if we are to have a role to play in these discussions.

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WASHINGTON POST, Oct. 16, 1985

VIII (C)

ROBERT J. SAMUELSON

Baker's Timid Plan

Give Treasury Secretary James A. Baker III credit for trying. His idea of solving the Latin American debt crisis with faster economic growth is sensible. But his plan for doing it is the economic equivalent of a wet noodle. To use a worn phrase, we have "muddled through" the debt crisis so far, and Baker's proposal—floated at last week's annual meeting of the World Bank and International Monetary Fund—amounts to more muddling. We can, and should, do better.

You need a sense of the absurd to grasp how Latin America's economy now affects us. Latin countries are impoverishing themselves so that we can enjoy higher unemployment and protectionist pressures. They have had to export more and import less to generate trade surpluses in dollars to repay dollar debts. Our overseas markets have been devastated while their living standards have dropped. Between 1981 and 1984, our slipping Latin trade accounted for one-fifth of the rise in the trade deficit; that's about equal to the increase with Japan.

We have a huge economic and political interest in stopping this self-destructive cycle. After Canada, Latin America is our most natural trading partner. Its rapidly expanding population ought to spur brisk trade growth. Politically, how we handle the debt crisis may color our relations with Latin America for decades. Democratic governments in Argentina and Brazil (and, to a lesser extent, Mexico) need to succeed economically if they are to survive politically. If they don't, we will be blamed.

Latin countries are sacrificing future growth to pay their debts. In 1981, the imports and exports of the seven major Latin countries balanced. Last year, their export surplus totaled $40 billion, largely because imports dropped sharply. Domestic

See SAMUELSON, F2, Col. 5

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investment has plunged, in part because imported equipment often is required. In 1984, Mexico's investment was down 44 percent from its peak. Latin governments "are scared out of their minds that low investment today means too few jobs tomorrow," says economist Rudiger Dornbusch of the Massachusetts Institute of Technology.

Baker's plan to escape this trap is too timid. He wants debtor countries to reform their economic policies. Fine. But what does he offer in return? If debtor countries take painful political steps, they may reasonably ask what will be done to make their sacrifices worthwhile. Baker has only vaguely promised higher lending from private banks and the World Bank. It's not enough. What's needed is a tougher compact, exchanging reforms for debt relief and sounder credit. Here are the essentials:

- **Economic reforms.** Latin countries desperately need to denationalize industry while dramatically cutting inflation and budget deficits. It's true that Latin America's economic distress is largely self-inflicted. Government budgets are overburdened with subsidies and inefficient state companies. Between 1960 and 1980, the number of state-owned firms in Brazil rose fourfold to nearly 500. In Mexico, the number more than doubled to about 500. Rampaging inflation has eroded economic confidence and the willingness to invest. If these problems persist, any economic recovery is likely to be brief or lackluster. Governments can't invest efficiently, and private business won't.
- **Debt relief.** In exchange for reforms, private banks should be forced to write down their debts by 10 to 15 percent. Banks could exchange their existing loans for new securities that would be issued by the IMF. The debtor countries would pay interest to the IMF, which would pay the banks. Interest rates should be cut, too, reflecting the lower risk to banks. The combination would cut debt-service requirements by 15 to 20 percent, enabling Latin countries to use more of their export earnings to buy imports.
- **Sounder credit.** Latin countries still may need more dollar loans temporarily to sustain imports. Argentina, for example, already has adopted policies cutting monthly inflation from more than 30 percent to about 2 percent. But the initial effect also is to depress the economy. As it has in the past, the IMF should create a special lending program, with most funds coming from Japan, whose huge current account surplus (estimated at $46 billion in 1985) acts as a drag on the world economy. If Japan can't buy more imports, it can help others.

The idea that the full servicing of the private banks' Latin loans is in our national interest is a myth. When the debt crisis broke in 1982, the main fear was that a chain reaction of defaults would trigger a global financial crisis and intensify the worldwide recession. Banks might become insolvent, deposits might be frozen, lending might collapse. All efforts were aimed (correctly) at avoiding defaults and their possible aftermath. Protecting banks was the mechanism for a broader economic purpose.

The goal today ought to be the same: to foster economic growth. But the exposure of the biggest banks (in relation to their capital) to developing-country loans already has dropped by one-quarter from its peak. A 15 percent write-down of their Latin American loans, for example, would cut their capital by less than one-fifth. Big banks that overlent to developing countries would suffer, just as any business that makes bad decisions suffers. Government's role is not to protect bankers from their mistakes.

What's essential is that reforms, debt relief and new loans be rigidly linked. The idea is not to provide temporary help but to restore the confidence necessary for sustained growth. Capital flight—local residents converting their currencies into dollars and investing abroad—has crippled Latin countries. Between 1979 and 1982, an estimated two-thirds of Argentina's foreign loans and half of Mexico's flowed back out as capital flight. Attracting even some of these funds back home would improve Latin America's ability to import and invest.

Everyone was to blame for the debt crisis. The banks lent irresponsibly, and Latin debtors borrowed irresponsibly. America's irresponsible economic policies—fostering inflation and low interest rates—encouraged them both. But most of what needs to be done in Latin America must be done by the Latins, just as Europe's recovery after World War II lay mostly with Europeans. Just as 40 years ago, however, we are not uninvolved bystanders. Muddling through wasn't good enough then, and it isn't now.

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TAGS: EFIN, NI, US
SUBJECT: NIGERIA AND THE USG DEBT STRATEGY

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1. SUMMARY. AMBASSADOR SMITH HAS REQUESTED INFORMATION ON THE USG DEBT STRATEGY AND HOW IT RELATES TO NIGERIA, AS WELL AS SOME EXAMPLES OF SUCCESSFUL ADJUSTMENT. THIS CABLE PROVIDES A BRIEF OUTLINE OF THE DEBT STRATEGY AND REVIEWS ASPECTS OF THE RECENT ADJUSTMENT EXPERIENCE OF TURKEY, MEXICO, AND BRAZIL THAT ARE MOST RELEVANT FOR NIGERIA. END SUMMARY.

2. DURING AMBASSADOR SMITH'S RECENT CALL AT TREASURY HE ASKED FOR FURTHER INFORMATION REGARDING THE LATEST USG INITIATIVES ON DEVELOPING COUNTRY DEBT FOR USE IN AN UPCOMING SPEECH TO THE NIGERIAN-AMERICAN CHAMBER OF COMMERCE. FULL TEXT OF SECRETARY BAKER'S STATEMENT TO THE IMF-WORLD BANK ANNUAL MEETINGS HAS BEEN SENT TO ALL POSTS IN REF. IN ADDITION, POINTS BELOW ARE TREASURY DEPARTMENT SUGGESTIONS FOR FRAMING THE USG DEBT STRATEGY IN TERMS OF NIGERIA'S SITUATION. THE AMBASSADOR'S SPEECH MAY PROVIDE THE USG WITH AN APPROPRIATE OPPORTUNITY TO EXPRESS SOME VIEWS REGARDING NIGERIA'S CURRENT THE PROCESS. IT COULD PROVIDE AN OPPORTUNITY TO HELP SHIFT THE FOCUS OF DEBATE FROM NIGERIA VS. IMF -- AND ALL THAT THIS CONVEYS FOR NATIONAL PRIDE -- TO A DISCUSSION OF THE TYPE OF ECONOMIC PROGRAM THAT WILL ACCOMPLISH NIGERIAN GOALS. AMBASSADOR MAY DRAW ON THIS INFORMATION AS HE WISHES.

2. BEGIN TALKING POINTS:

-- THERE HAS BEEN A GREAT DEAL OF REPORTING IN THE PRESS ON STATEMENTS MADE BY SECRETARY OF THE TREASURY BAKER AT THE ANNUAL MEETINGS OF THE WORLD BANK AND IMF IN SEOUL AND THE U.S. GOVERNMENT'S STRATEGY FOR DEALING WITH DEBT PROBLEMS OF DEVELOPING NATIONS. IT IS PERHAPS OPPORTUNE AT THIS POINT IN NIGERIA'S NATIONAL DEBATE OVER ITS ECONOMIC POLICIES TO DISCUSS THE U.S. STRATEGY AND HOW IT RELATES TO NIGERIA.

-- THE USG HAS PROPOSED TO BUILD UPON AND STRENGTHEN THE CURRENT APPROACH TO DEBT PROBLEMS, WHILE CONTINUING TO TAILOR ACTION TO THE CIRCUMSTANCES OF INDIVIDUAL COUNTRIES. CONSISTENT WITH THIS ORIENTATION, SECRETARY BAKER HAS ENUNCIATED A PROGRAM FOR SUSTAINED GROWTH. THIS PROGRAM CONTAINS THREE ESSENTIAL AND MUTUALLY REINFORCING ELEMENTS: ADOPTION BY PRINCIPAL DEBTORS OF COMPREHENSIVE MACROECONOMIC AND STRUCTURAL POLICIES TO PROMOTE GROWTH AND REDUCE INFLATION; A CONTINUED CENTRAL ROLE FOR THE IMF, COMPLEMENTED BY INCREASED WORLD BANK DISBURSEMENTS OVER THE NEXT THREE YEARS; AND AN INCREASE IN NET COMMERCIAL BANK LENDING IN SUPPORT OF THESE EFFORTS.

-- THESE THREE ELEMENTS ARE ALL INTERRELATED: INCREASED LENDING BY EITHER THE WORLD BANK OR COMMERCIAL BANKS MUST BE SUPPORTIVE OF COMPREHENSIVE MACROECONOMIC AND STRUCTURAL POLICIES IN THE BORROWING COUNTRY TO PROMOTE GROWTH AND REDUCE INFLATION. THIS IMPLIES MACROECONOMIC POLICIES DESIGNED TO RESTORE SUSTAINABLE, NON-INFLATIONARY GROWTH AND BALANCE OF PAYMENTS ADJUSTMENT. IT ALSO IMPLIES GROWTH-ORIENTED STRUCTURAL POLICIES TO PROMOTE DOMESTIC SAVINGS, INVESTMENT, AND RETURN OF FLIGHT CAPITAL BY GIVING GREATER REIN TO MARKET FORCES: FOR EXAMPLE, LIBERALIZED TRADE REGIMES, A REDUCED ROLE FOR PARASTATALS, LESS GOVERNMENT INTERFERENCE IN MARKETS, AND MARKET-BASED PRICES, EXCHANGE RATES, AND INTEREST RATES.

-- IT SHOULD BE CLEAR THAT AFTER FIVE YEARS OF ECONOMIC DECLINE AND ACCELERATING DOMESTIC INFLATION THAT NIGERIAN POLICIES HAVE NOT BEEN CONSISTENT WITH THE DEVELOPMENT OF

CONDITIONS SUSTAINING GROWTH. NIGERIA'S CHOICE IS BETWEEN DISORDERLY ADJUSTMENT, AS EXEMPLIFIED BY A CONTINUATION OF THE PRESENT SITUATION, WITH IDLE INDUSTRIES, HIGH UNEMPLOYMENT, AND PERVASIVE SHORTAGES; OR THE IMPLE-

MENTATION OF NEEDED MACROECONOMIC AND STRUCTURAL POLICIES THAT LEAD TO SUSTAINABLE ECONOMIC GROWTH.

3. WE BELIEVE THAT SUCH POLICIES ARE IN THE LONG-TERM INTEREST OF NIGERIA. NIGERIANS HAVE LONG RECOGNIZED THE NEED TO DIVERSIFY THEIR ECONOMY. THEY KNOW THAT OIL IS A DEPLETABLE RESOURCE AND THAT IT IS A MEANS TO DEVELOP THE REST OF THE ECONOMY. THE PRESENT SITUATION ONLY REINFORCES THE REALIZATION THAT OIL AS A SOURCE OF GOVERNMENT REVENUE AND FOREIGN EXCHANGE EARNINGS LEAVES THE ECONOMY OVERLY VULNERABLE. THEREFORE, IT SEEMS TO BE NOT TOO LATE TO BEGIN A PROCESS OF RESTRUCTURING WHICH DIVERSIFIES SOURCES OF FOREIGN EXCHANGE TO MAKE THE ECONOMY LESS VULNERABLE TO DISRUPTIONS IN PARTICULAR MARKETS. ENHANCING DOMESTIC PRODUCTION THROUGH RATIONAL, MARKET-ORIENTED POLICIES WOULD MAKE NIGERIA MORE SELF-RELIANT BY INCREASING THE PRODUCTION OF THOSE GOODS THAT CAN BE PRODUCED MORE EFFICIENTLY AT HOME.

-- THE ISSUE BEFORE THE COUNTRY TODAY IS NOT A TEST OF WILLS BETWEEN NIGERIA AND THE IMF, BUT A SEARCH FOR THE MOST EFFICIENT WAYS TO TRANSFORM THE ECONOMY INTO ONE WITH A DIVERSIFIED PRODUCTIVE BASE. THIS CANNOT BE ACCOMPLISHED THROUGH GOVERNMENT FIAT. WHAT THE GOVERNMENT CAN DO, HOWEVER, IS TO PROVIDE THE APPROPRIATE INCENTIVES TO ENCOURAGE SAVINGS, INVESTMENT, AND PRODUCTION. THIS MEANS ESSENTIALLY FOLLOWING APPROPRIATE FISCAL AND PRICING POLICES -- INCLUDING THE PRICE FOR FOREIGN EXCHANGE.

4. THE IMF NOTED IN ITS 1985 WORLD ECONOMIC OUTLOOK THAT FISCAL POLICY IS THE PRIMARY TOOL AVAILABLE TO DEVELOPING COUNTRY GOVERNMENTS TO INFLUENCE THE OVERALL LEVEL OF

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PRIVATE SAVINGS.

-- REDUCING THE SHARE OF SUCH SAVINGS THAT ARE PREEMPTED TO FINANCE BUDGET DEFICITS IS IMPPORTANT, GIVEN THE RELATIVE SCARCITY OF SUCH SAVINGS. SUCH ACTION ALSO SLOWS RATES OF MONETARY AND CREDIT EXPANSION, WHICH SHOULD REDUCE INFLATIONARY PRESSURE.

-- A NECESSARY COMPLEMENT IS AN EMPHASIS ON KEY ELEMENTS OF THE PRICE SYSTEM -- ESPECIALLY THE EXCHANGE RATE, CONTROLLED OR SUBSIDIZED PRICES, AND INTEREST RATES -- SINCE DOMESTIC INFLATION RESULTS IN DISTORTIONS IN RELATIVE PRICES AND THEREFORE THE ALLOCATION OF SCARCE PRODUCTIVE RESOURCES.

-- DESPITE THE ADJUSTMENTS IN THE NAIRA EXCHANGE RATE OVER THE PAST SEVERAL YEARS, THESE HAVE NOT BEEN SUFFICIENT TO COMPENSATE FOR THE DIFFERENCE IN INFLATION BETWEEN NIGERIA AND ITS TRADING PARTNERS (THE REAL EFFECTIVE EXCHANGE RATE). THE RESULT IS THAT THE INEFFICIENCIES OF AN OVERVALUED EXCHANGE RATE PERSIST AND DOMESTIC COMPETITIVENESS IS NOT RESTORED.

-- IN THE LONG-TERM, AN OVERVALUED CURRENCY -- ESPECIALLY WHEN COUPLED WITH CONTROLLED PRICES AND INFLATIONARY BUDGET POLICIES -- DISCOURAGES DOMESTIC PRODUCTION AND PREVENTS THE DEVELOPMENT OF PRODUCTIVE ECONOMIC ACTIVITIES. THE POSITIVE SUPPLY ASPECTS OF AN APPROPRIATE EXCHANGE RATE CAN RESTORE COMPETITIVENESS TO DOMESTIC PRODUCTION AND MAKE A SIGNIFICANT CONTRIBUTION TO RESTRUCTURING THE ECONOMY.

5. HAVE THESE POLICIES WORKED IN OTHER COUNTRIES?

-- COMPARISONS WITH THE CENTRAL AFRICAN REPUBLIC, UGANDA, OR OTHER COUNTRIES IN AFRICA MAY NOT BE VALID. DESPITE THE RELATIVE UNDERDEVELOPMENT OF NIGERIA OUTSIDE THE OIL SECTOR, IT HAS RESOURCES AND WEALTH BEYOND THE SCALE OF ANY OTHER AFRICAN COUNTRY AND APPROPRIATE MODELS MAY LIE ELSEWHERE. THE PROBLEMS OF EACH COUNTRY ARE UNIQUE AND TO A LARGE EXTENT REQUIRE AN INDIVIDUAL APPROACH. NONETHELESS, THE EXPERIENCES OF MEXICO, BRAZIL, AND TURKEY MAY BE INSTRUCTIVE.

6. TURKEY PROVIDES A GOOD EXAMPLE OF THE EFFECTS OF EXCHANGE RATE CHANGES ON PRODUCTION AND EXPORTS. IN THE LATE 1970S, TURKEY WAS FACED WITH AN INFLATION RATE OF OVER 100 PERCENT AND A SHARP FALL IN ITS RATE OF ECONOMIC GROWTH. IN 1980, THE GOVERNMENT ANNOUNCED A SHIFT TO AN OUTWARD-LOOKING DEVELOPMENT STRATEGY, WITH INCREASED RELIANCE ON MARKET FORCES. A CENTERPIECE OF THIS STRATEGY WAS A LARGE EXCHANGE RATE DEVALUATION, FOLLOWED BY A FLEXIBLE EXCHANGE RATE POLICY TO OFFSET DIFFERING INFLATION RATES WITH TURKEY'S TRADING PARTNERS AND TO MAINTAIN EXPORT COMPTETITIVENESS.

-- RESULTS HAVE BEEN DRAMATIC. THERE HAS BEEN A LARGE INCREASE IN EXPORTS IN RECENT YEARS, ACCOMPANIED BY A MARKED STRUCTURAL SHIFT IN THE COMPOSITION AND THE DIRECTION OF TURKEY'S TRADE. THE SHARE OF NON-TRADITIONAL EXPORTS, INCLUDING PROCESSED AGRICULTURAL PRODUCTS AND MANUFACTURED GOODS IN TOTAL EXPORTS DOUBLED FROM 1978 TO 1982 (27 PERCENT VERSUS 60 PERCENT) AT THE EXPENSE OF TRADITIONAL AGRICULTURAL EXPORTS. THIS INCLUDED A RAPID INCREASE IN THE VARIETY OF PRODUCT LINES EXPORTED, INCLUDING MEAT AND LIVE ANIMALS, TEXTILES AND CLOTHING, CEMENT, IRON AND STEEL, METAL PRODUCTS AND MACHINERY, AND ELECTRICAL EQUIPMENT.

-- FROM 1978 TO 1982, EXPORT VALUE INCREASED BY MORE THAN 151 PERCENT -- AN ACHIEVEMENT THAT IS ALL THE MORE IMPRESSIVE GIVEN A WORLD RECESSION AND A DETERIORATION IN TURKEY'S TERMS OF TRADE. INFLATION, MEANWHILE, HAS FALLEN STEADILY FROM OVER 100 PERCENT IN 1980 TO 37 PERCENT IN 1981, AND ABOUT 30 PERCENT IN 1982 AND 1983. (NOTE: AN ARTICLE ON TURKEY IN THE FINANCIAL TIMES ON NOVEMBER 4 ALSO FOCUSED ON ITS SUCCESSFUL ADJUSTMENT EFFORT THUS FAR.)

7. MEXICO ALSO ILLUSTRATES THE EFFECTS OF AN EXCHANGE RATE ADJUSTMENT IN AN OIL-BASED ECONOMY. IMPORTS SURGED IN 1979-82 WHILE THERE WAS A SHARP INCREASE IN DOMESTIC INFLATION THAT ERODED INTERNATIONAL COMPETITIVENESS AND WEAKENED THE BALANCE OF PAYMENTS. OIL ACCOUNTS FOR TWO-THIRDS OF MEXICO'S EXPORTS AND THE SOFTENING OF INTERNATIONAL OIL MARKETS THAT STARTED IN 1981 FURTHER WEAKENED THE BALANCE OF PAYMENTS AND THE GOVERNMENT'S FINANCIAL POSITION.

-- MEXICO'S ADJUSTMENT PROGRAM COMBINED A STRENGTHENED FISCAL POSITION WITH DECELERATION IN MONETARY GROWTH. THIS WAS COUPLED WITH A MODERATE WAGE POLICY AND INTEREST RATE CHANGES AND EXCHANGE RATE ADJUSTMENTS THAT RESULTED IN A REAL EFFECTIVE DEPRECIATION OF OVER 35 PERCENT IN 1982 AND 1983.

-- THE BALANCE OF PAYMENTS CURRENT ACCOUNT WAS REVERSED FROM A DEFICIT OF MORE THAN DOLS 5 BILLION IN 1982 TO A DOLS 4 BILLION SURPLUS IN 1984. MORE IMPORTANTLY, NON-OIL EXPORTS INCREASED BY 26 PERCENT IN 1984 AND REAL GDP GREW BY 3.5 PERCENT. ALL EXPORTS SHOWED A 7.5 PERCENT INCREASE IN VOLUME IN 1984. MEANWHILE, DOMESTIC INFLATION DECLINED SHARPLY FROM NEARLY 100 PERCENT IN 1982 TO LESS THAN 60 PERCENT IN 1984. UNFORTUNATELY, INFLATION HAS REMAINED AT THIS LEVEL, REFLECTING IN PART LARGE ADJUSTMENTS IN CONTROLLED PRICES. ADDITIONAL CONTRIBUTING FACTORS WERE A SLOWER PACE OF IMPORT LIBERALIZATION THAN HAD BEEN ENVISIONED AND A LOOSENING OF DEMAND MANAGEMENT POLICIES TOWARD THE END OF 1984. ONE CONSEQUENCE WAS THAT THERATE OF GROWTH OF NON-OIL EXPORTS SLOWED IN THE SECOND HALF OF 1984, AS MEXICO AGAIN ALLOWED THE PESO TO APPRECIATE IN REAL TERMS.

8. THE SITUATION IN BRAZIL PRESENTS AN INTERESTING CONTRAST. BRAZIL'S EXPORT-LED GROWTH OF THE 1960S AND 1970S WAS FINANCED MAINLY FROM ABROAD, WHICH LEFT IT EXTREMELY VULNERABLE TO CHANGES IN CONDITIONS IN INTERNATIONAL CAPITAL MARKETS. BRAZILIANS HAVE REALIZED SINCE THAT GROWTH MUST ALSO BE BASED ON INCREASING EFFICIENCY AND THE GENERATION OF DOMESTIC SAVINGS SINCE THEY CANNOT RELY ON FOREIGN RESOURCES TO THE EXTENT THEY HAD IN THE PAST.

-- THE ADJUSTMENT PROGRAM ADOPTED BY BRAZIL IN 1983 INCLUDED A CUMULATIVE DEPRECIATION OF THE CRUZEIRO AGAINST THE DOLLAR OF OVER 600 PERCENT, ALTHOUGH THIS HAS BEEN LESS THAN 30 PERCENT IN REAL TERMS. THIS HAS STRENGTHENED ITS BALANCE OF PAYMENTS POSITION SUBSTANTIALLY. 1984 EXPORT GROWTH WAS STRONG, INCLUDING AN INCREASE OF ONETHIRD IN MANUFACTURED EXPORTS.

-- PROGRESS ON THE EXTERNAL POSITION HAS NOT BEEN MATCHED

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DOMESTICALLY. BUDGET POLICIES HAVE NOT BEEN SUFFICIENTLY RESTRICTIVE AND WHEN COUPLED WITH AN ACCOMMODATIVE MONETARY POLICY AND INDEXATION OF WAGES, BRAZIL HAS BEEN UNSUCCESSFUL IN CUTTING DOMESTIC INFLATION. A REDUCTION IN THE CLAIM THAT THE FISCAL DEFICIT MAKES ON PRIVATE SAVINGS IS VITAL TO PROVIDE DOMESTIC SUPPORT TO WHAT OTHERWISE HAS BEEN AN IMPRESSIVE EFFORT IN BRAZIL'S EXTERNAL POSITION. THIS WILL ALLOW PRIVATE SAVINGS TO BE REDIRECTED TOWARD PRODUCTIVE EFFORTS. END TALKING POINTS. SHULTZ

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WASHINGTON POST
OCT. 29, 1985

VIII (C)

Banks Balk At Loans to 3rd World

Seek U.S. Assurances Of Reduced Risk for New Commitments

By James L. Rowe Jr.
Washington Post Staff Writer

Many major commercial banks yesterday balked at providing an additional $20 billion in new loans to developing nations without government assurances that will lessen the risks of any new loans to those countries, government and banking sources said.

But U.S. government officials and executives of multilateral institutions such as the International Monetary Fund and the World Bank said they wanted a commitment of new lending before considering any steps that might make it less risky for the banks, these sources said.

About 60 banks from around the world met with representatives of the U.S. Treasury, the World Bank, the IMF and the Inter-American Development Bank yesterday to discuss proposals to ease the world debt crisis that were put forth three weeks ago by U.S. Treasury Secretary James A. Baker III.

Baker urged that major multinational banks increase their lending to debtor nations—most of them in Latin America—by $20 billion over the next three years and that the multinational institutions boost lending by $9 billion. The Baker proposals also call on the debtor nations themselves to take steps to reform their economies: reducing the size of the often-inefficient state sector and putting more emphasis upon so-called market forces.

The Baker plan is a recognition by the U.S. government that Latin American debtor nations cannot tolerate many more years of the austerity measures they have been following in order to pay the interest on their debts—which today total about $360 billion.

Yesterday's meeting was held under the auspices of the Institute of International Finance, a group of major banks that was formed in the aftermath of the Latin American debt crisis, which began in August 1982 when Mexico announced it had run out of money.

Sources at the meeting said that the banks themselves were divided on the Baker proposal, with officials such as Citibank Vice Chairman Hans Angermueller more supportive of the Baker plan than many other banks' representatives.

But many banks said they could not commit themselves to increasing their lending to Latin America because they already have too many loans to the region and cannot justify increasing their exposure unless governments are willing to share in the risk.

"It's no longer a banking problem," said one U.S. banker in attendance. "You're not talking about bailing out the banks, you're talking about bailing out the countries." Commercial banks have lent Latin American countries about $230 billion to $240 billion.

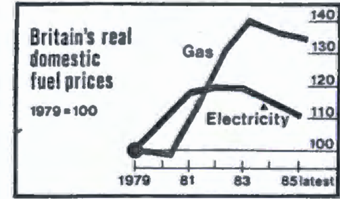
David Mulford, the assistant secretary of the Treasury for international affairs, told the bankers that it is in their best interest to increase their lending to the region so that the countries can resume economic growth.

One banker at the meeting said each side wanted the other to "show their cards first." Many banks wanted assurances that the industrial governments would guarantee increased bank loans, while the U.S. government officials and those from the multilateral institutions wanted bank commitments before they were willing to talk about any risk-reducing actions for the banks.

Initially, Baker wanted to include World Bank guarantees for some new private bank loans to developing countries, mainly in Latin America, but he had to kill that part of the proposal after it met with resistance from European finance ministers and executives of the World Bank itself. Baker made his proposal at the annual meeting of the IMF and the World Bank in Seoul.

One banker in attendance said that the meeting progressed about as far as could be expected under the circumstances. "There are a number of issues that have got to be ironed out, and they cannot be done in big sessions like today's," he said.

Industry is no tax collector



Britain's state energy suppliers need to be profitable and private—not secret tax collectors for the government

Britain's chancellor of the exchequer, Mr Nigel Lawson, risks confusing expedient with principle in his treatment of nationalised industries: particularly those, like gas and electricity supply, the nature of whose business, in a small country, makes them natural monopolies. In the annual skirmishing before Lord Whitelaw's "Star Chamber", Mr Lawson's Treasury is thought to be demanding an extra £300m-400m ($420m-560m) from Britain's reluctant energy industries. Victory looks politically seductive—a blip on inflation is a small price for paying off the cost of beating the miners' strike, and for tax cuts to come.

The proposal is a bad one. Little is served by milking money, which either should not be spent or should be raised by taxation, from profit-making state corporations. That just milks the taxpayer, offering the cream to fat management, laxly run business, and greedy trade unions. The principle should be something quite other. It should be to increase the incentive for these important suppliers of public goods to do so cheaply and well.

This can be done by selling off those industries which will find buyers easily in the private sector—including (as planned) the British Gas Corporation and (why not?) the electricity supply industry; and by making sure that, once in the private sector, such monopoly powers as they continue to enjoy are effectively regulated, and they are exposed to as much competition as possible. There is little point using the gas corporation and its like as surrogate tax collectors, on the pretext of fattening them for market. Like any indirect tax on sales, higher gas prices are regressive: they hit the poorer harder than the richer. If the chancellor is in favour of raising more indirect tax, he should do so openly, not in this covert way.

Britain's state-owned energy suppliers are already asked to make handsome profits for the Treasury's coffers. Through its "negative external financing limit" (forgive the classic Whitehall jargon), BGC is supposed to contribute £352m in the present financial year—and that is on top of taxes and a levy on its sales which are set to raise another £2.9 billion in the three years to 1987-88. Likewise the electricity supply industry of England and Wales: its negative EFL this year is just over £1.1 billion.

The Treasury once pleaded for legislation to make its relationship with the nationalised industries honest by giving it greater powers at the expense of the industries' chairmen and their sponsoring departments. That idea was rejected. So let the Treasury now accept defeat and allow the industries it cannot sell the commercial freedom that the government endlessly promises them, but never delivers. And flog the rest.

Baker's half-baked cake

Too small for the debtors—and too nice for the banks?

The American treasury secretary, Mr James Baker, has taken a new job: leader of the world economy. Praise be—but do not assume that America will always lead the world in safer and wiser directions. An early issue for scepticism is international debt, where some big strategic decisions will be made in the next few weeks.

The urgency is prompted by what Mr Baker did and did not say at the annual meetings of the International Monetary Fund and World Bank. Over the next three years, he wants commercial banks to lend $20 billion in new money to the biggest third-world debtors. The World Bank and regional development banks would chip in a further $9 billion, on top of the $18 billion that they would probably lend to these countries anyway. Mr Baker seemed to be making up his plan as he went along, an impression confirmed by the way he later mused about giving official blessing to a "superbank" to handle all private lending to the big debtors.

[illegible]

Baker has encouraged debtors and bankers to make their own bids. Debtors say that $20 billion from the banks over three years is not enough. In a sense they are right. But they should get cash only for good reasons—because they are prospering, offering profitable projects—not because bankers have had their arms twisted or want to keep interest paid up on their existing loans. The World Bank reckons that the developing world's 12 biggest exporters of manufactures—among them several of the major debtors—would need $18 billion a year in new bank loans in 1985-90 if they grew by a fast $6\frac{1}{2}$% a year. Even if they grew by only $3\frac{3}{4}$%, they would need $9 billion a year from the banks—more than Mr Baker is proposing.

Bankers have complaints of their own. Some have lent so little to Latin America that they would prefer to cut their losses and be shot of the place. Others feel that, if governments are going to bully them, they

[illegible]

[illegible] Perhaps they could ease the accounting rules that inhibit lending to poor countries, and even guarantee new loans. A clever lawyer could think of umpteen ways to bring banks and governments closer together.

Stick with moral hazard

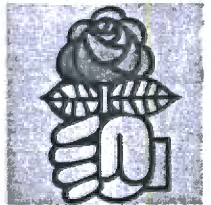
The idea of guaranteeing bank loans is superficially appealing. It seems to confirm what most people know already: that international debt is not confined to the legal relations between bankers and borrowers, an issue they can settle in the same way that banks foreclose on a company's credit or a housebuyer can stretch out his mortgage if he falls ill. International debt is supremely political. It has dragged in the rich world's governments and central banks, who have provided emergency loans to debtors. Rich-country governments have much to lose from a collapse of export markets in Latin America or a retreat to Peronist xenophobia. Worse, President Reagan would be sorely tried if two or three banks as big as Continental Illinois looked like going bust one Monday afternoon; ditto for Mrs Thatcher with any of the British clearing banks. Since governments are as involved as banks, why not make them underwriters?

That thinking is muddled and dangerous. It ignores what central bankers call "moral hazard"—that lenders [illegible] more trouble to judge creditworthiness or pick good projects if they know they could lose their all. Moral hazard is far harder to apply to bankers than to makers of soapsuds or software. For that reason, what little there is in banking should be preserved.

That does not mean that rich-country governments have nothing to do. If they think Latin America needs more foreign exchange, they should take the lead in providing it. They can lend more through their export-credit agencies. Through the IMF they could set up a facility to compensate the biggest debtors if the interest rates on their debt rise above a certain ceiling. Governments could also provide more aid, which has fallen from 0.38% of their GNPs in 1982 to 0.36% last year. Most of all, they could reduce the trade barriers that cramp developing countries' exports.

All these things are worth doing, and the right job for governments. If they were also used to persuade poor countries to adopt new policies—competitive exchange rates, an open door for foreign investment, tighter controls on public spending and borrowing—the resulting boom would have bankers scrambling to lend more as well. But the distinction between political initiative and commercial banking needs to be kept. If it is not, it will weaken the link between risk and reward—which is what has driven economic progress for 300 years.

Mitterrand can keep his grip



Even if France's Socialists lose their hold on parliament

France's battered Socialist party is showing an instinct for survival that ought to worry French conservatives. Too many of them are behaving as if next spring's parliamentary election had already been fought and won. They smugly assume that, once the Socialists have dwindled to a shrunken minority in the National Assembly, President Mitterrand will have either to resign or to confine himself to the Elysée as a titular head of state. Yet Mr Mitterrand has always been at his most dangerous when apparently cornered.

If today's opinion polls are anything to go by, the Socialists are indeed likely to lose the large and lopsided majority in parliament they have enjoyed since 1981. But that is only the beginning, not the end, of the argument. Mr Mitterrand, who created the modern French Socialist Party, will still have two years of his presidential term to run. Defeat at the polls will not necessarily destroy his party. Much depends on the size of the Socialists' loss; after the election, they could still be the largest party in parliament. Some conservatives complacently thought the demoralised Socialists would break up into irreconcilable factions at last weekend's conference in Toulouse. They showed instead a hardy and unexpected unity (see page 53). For the conservatives, on the other hand, disunity is still the rule.

Conservatives such as Mr Raymond Barre are arguing that a right-wing majority in the National Assembly would be wrong to "cohabit" with Mr Mitterrand. Having lost the confidence of the voters, says this point of view, the president should resign, making way for the election of a conservative president. The argument rests more on politics than on the constitution, which though open to interpretation on the division of labour between president and parliament would clearly not oblige Mr Mitterrand to resign. But by clinging to power, say the opponents of cohabitation, Mr Mitterrand would weaken the presidency and undemocratically cheat the voters of effective government.

Of the conservatives, Mr Barre would benefit most from an early presidential election. This is not the best reason for thinking he is wrong. His argument would be more compelling if the choice were between discredited Socialists and a united conservative party. Yet the French right is split into four: the warring centre-right followers of Mr Barre and of Mr Valéry Giscard d'Estaing, two men at loggerheads; the more melodramatic neo-Gaullists under Mr Jacques Chirac; and the far right under Mr Jean-Marie Le Pen. Both Mr Chirac and Mr Giscard d'Estaing would be willing to be President Mitterrand's prime minister. And if those combinations sound implausible, there are other centre-right politicians who could lead a caretaker "national" coalition. There are bound to be sharp disagreements. The debate over the scale of privatisation will be

full advantage of tax losses [illegible] cals firm, which could be as much as [illegible] billion and have to be used up before the end of 1987, the carmaker needs 95[illegible] of AEG's shares. To get that, Daimler will have to start buying shares in the market or increase its bid.

International debt

Is the superbank a flier?

Bankers were puzzled by the vagueness of America's debt initiative at the annual meeting of the IMF and World Bank in Seoul last week. They are even more puzzled by the specific proposal for a new "superbank" aired later in Washington by America's treasury secretary, Mr James Baker.

The superbank, inspired by the chairman of the Federal Reserve Board, Mr Paul Volcker, could play a part in encouraging banks to increase their lending to deserving third-world debtors by $20 billion over three years. It would aim to streamline the way that banks negotiate new loans to third-world debtors and reschedule old ones. Though details are unclear, the idea is that creditors would put new money into a new institution, perhaps in exchange for a proportionate number of votes. Run by executives from a couple of the biggest creditor banks, the organisation would work with the World Bank and the IMF to decide on economic criteria for developing-country debtors.

The institution would replace the existing bank syndications, which require creditors to put up new money in proportion to outstanding loans and need the approval of all to any new deal. The syndications are under pressure. Rolling over Brazil's short-term credits in August was delayed by a handful of small Spanish banks; the first tranche of Mexico's multiyear rescheduling was delayed by American regional banks.

More details may emerge at a meeting in Washington on October 28th of the Institute for International Finance, the creditors' club whose members include most of the big bank lenders. Some 20 American banks and 30 European and Asian banks are expected to attend, along with the IMF, the World Bank and the American Treasury.

American banks—which account for over one-third of the total bank debt of rescheduling third-world countries—have mixed views on the superbank. Some of the bigger lenders are willing to lend more to get more back, and would welcome a semi-official lending body. Non-American banks are much less keen to hand over decisions to an institution over which they will have little control.

Some bankers argue that it is illogical to urge them to lend more while supervisors continue to apply the regulatory brakes more firmly. (Last week, America's regulators decided to make banks give more information on loans to foreign countries.) Supervisors point out that banks are making enough profits these days to increase their capital and cover more third-world lending. In the end, neither side is likely to fuss too hard: the new money envisaged by the Americans in Seoul is peanuts to the banks expected to provide it.

A fate better than debt

WASHINGTON, DC

Some bright ideas from Washington's Institute for International Economics* (IIE) on how to increase the flow of money from rich countries to poor ones. Debtor countries need an extra $20 billion a year, says the IIE, which reckons that its proposals could bring in half of that without increasing the debtors' dependence on their banks.

One neglected source is international investment in equities. Returns on developing-country stock markets can be high: the average for 11 emerging markets (including those in Brazil, Argentina, Chile and Mexico) was 25.5% a year in dollar terms between 1976 and 1983, compared with an average annual return of 13.5% for all American stock markets over the same period. Developing countries' stock markets also have the advantage that their returns tend to move out of step with those in rich countries, allowing investors to spread their risks.

Barriers to international flows of equity finance have been erected by both sides. Brazil and Mexico limit foreign investment to special funds or specific stocks, while Argentina insists on (unattractive) minimum holding periods for foreign investors. In America, most state and local pension funds are prohibited from investing in foreign securities. Some countries, like Britain, allow insurance companies to invest abroad but only on approved stock markets. The IIE (fancifully) reckons there is a case for government guidelines, especially in Japan, that would call on institutional investors to hold, say, 25% of their foreign portfolios in developing-country equities.

Commodity-linked bonds would be another way to reduce the debtors' overreliance on banks. It would be hard, though, for big debtors to take the lead and establish new markets. So the IIE suggests that Sweden or Finland might start the ball rolling by issuing pulp-linked bonds. Once a commodity-linked market was off the ground, developing countries could join in.

The institute thinks other experiments are worth trying too. It suggests, first, "quasi-equities"—a mixture of direct and portfolio investment that gives the buyer a share in the income, physical output or profit of an enterprise without a share in its ownership. Second, project finance that links borrowings to the returns from a particular project but, unlike quasi-equities, puts a cap on the rate of return. Third, indexed bonds jointly guaranteed by groups of borrowers. The IMF and the World Bank would need to play (though not necessarily pay) a part to get these schemes started.

*Financial Intermediation Beyond the Debt Crisis. By Donald Lessard and John Williamson. Institute for International Economics.

Wall Street brokers

Capitalism

NEW YORK

America's government-bond market has been one of the easiest places to make and lose money this year. Yo-yoing interest rates and therefore bond prices threw up fat profits in the first six months for those with keen judgment and the capital to back it. However, as average daily turnover on the market has grown (
around $80 billion, almost five times wh
it was in 1980), so has the amount
capital needed to play the game.

Little wonder that government-bo
dealers are queueing up to raise ext
cash. One way is to go public. Bea
Stearns, the tenth biggest firm on t
New York Stock Exchange and one of t
few still privately-owned, said recently
plans to raise between $176m and $20
later this year through a public offering
8m common shares (underwritten by
self). Bear, Stearns' holdings of gove
ment bonds at the end of July were wo
$8.6 billion, ten times the value of
equity portfolio. Revenues from deali
on its own account in fixed-interest se
rities more than doubled in the year to t
end of April 1985, to $123.4m fr
$61.2m a year earlier.

Another firm planning to raise ex
capital to increase its ability to deal in t
bond market is L. F. Rothschild, Unt
berg, Towbin, the American broker
house 50%-owned by Britain's wheel
dealer financial group J. Rothsch
Holdings. It hopes that it can more t
double its capital by raising a minimum
$100m, half of it through a private plac

Washington Post, October 9, 1985

Reaction Mixed to Debt Plan

Ministers in Seoul Skeptical of Baker Commitment on Loans

By Hobart Rowen
Washington Post Staff Writer

SEOUL, Oct. 8—Treasury Secretary James A. Baker's proposals for a shift in strategy for dealing with the Third World debt crisis received a mixed reaction from the international financial community today.

In his address to the joint annual meeting of the World Bank and the International Monetary Fund, Baker called for a program emphasizing economic growth in the Third World, fed by fresh cash from commercial banks and the multilateral development banks, including the World Bank.

As Baker departed for Washington immediately after his speech, officials said they welcomed any initiative in the face of a new and apparently more serious phase of the debt crisis.

"The international economic system has reached the point of no return," IMF Managing Director Jacques de Larosiere said in his annual address. "There is no alternative to closer cooperation and leadership. It is now up to the international community to act, and to act together."

De Larosiere reported that export earnings of the developing nations are expected to shrink 2.5 percent this year after rising 8 percent in 1984, compounding their cash-flow problems.

What happens now to Baker's proposals is problematical. There will be no action taken at the IMF-World Bank annual meeting. But his ideas no doubt will be raised in private conversations with bankers and managers of the multinational lending agencies expected to provide new funding.

Discussions also could be held with officials of debtor countries being asked to modify their economic policies and welcome foreign investment.

But there was widespread skepticism that Baker had offered a meaningful solution to the debt problem.

States, like some other countries, wants to promote and expand the role of the World Bank," said H. Onno Ruding, chairman of the influential IMF Interim Committee. "But it is not clear how this is to be implemented without a general capital increase for the bank."

Baker said the bank has enough resources to expand its lending without a general capital increase, but didn't rule one out if demand for "quality" lending increases.

Ironically, the new focus on the World Bank came on the day that its president, A. W. Clausen, announced that he will retire next June when he completes a five-year term.

Bankers and other officials also were skeptical that the "commitment" Baker had said he would seek from commercial banks for $20 billion in fresh lending to some 15 middle-income countries over three years would materialize.

A senior administration official who remained in Seoul after Baker left said at a briefing tonight that the Treasury secretary had received "a favorable reaction" from American banks that had been given advance information on the program last week in Washington.

He said that the posture of European banks was less clear, but "it seems to me that these [American] banks have every reason to continue to lend. They are heavily lent now, and eventually they will have to face this situation. It seems to us they would rather have this three-legged approach. So the banks have every reason to be positive."

John McGillicuddy, chairman of Manufacturers Hanover Trust Co., called the Baker proposal the "first plan that is prospective rather than reactive to the problems," and said his bank, one the biggest lenders to Latin America, supports it and will "work with others in further developing the plan."

Nonetheless, many private commercial bankers who circulate at these annual meetings indicated they wondered whether Baker had not oversold the potential of a debt rescue operation making demands of a commercial banking system already overcommitted in the Third World.

A Latin American banker said the three major debtor countries in his area now have an annual interest burden of $25 billion, and need the foreign banks—mostly American—to refinance $10 billion of that amount. But if that money is provided on lenient terms, "that will cut into the profits of your banks," he noted.

Robert Hormats, a former government official and now a vice president of the investment banking firm of Goldman Sachs & Co., said, "Without the enormous buildup, Baker's proposals might have been viewed as a reasonable first step."

A Treasury official expressed regret that Baker had to withdraw a proposal to create a pool of $5.4 billion for sub-Saharan countries and other poor nations through a unified World Bank/IMF operation. He revealed that the United States had been prepared to make a contribution on its own to this pool, supplementing bank and IMF money.

In his speech to the annual meeting, Baker said, "I would like to see the banking community make a pledge to provide [$20 billion] in new lending and make it publicly, provided the debtor countries also make similar growth-oriented policy commitments as their part of the cooperative effort."

But neither Baker nor the senior Treasury official who briefed reporters later could say who would make these pledges on behalf of the bankers or debtors.

Ruding of the IMF interim panel, who is also finance minister of the Netherlands, said: "You can't summon the bankers, and say, 'Do this or that.' " He argued that the logic of Baker's case—that the debt crisis had worsened, calling for greater World Bank loans—"requires a commitment right now for a general capital increase."

Actually, Baker was more forthcoming on the possibility of U.S. approval of a general capital increase for the World Bank than he had been before coming to Seoul. Moreover, he hinted there could be support later for a similar increase for the Inter-American Development Bank.

PRESERVATION COPY

It was this new suggestion of greater cooperation with the multilateral development banks sprinkled through Baker's speech that encouraged representatives of the developing nations. They saw a new willingness by the U.S. administration not only to take a hand in managing the debt crisis, but also to expand the role of the international lending banks. At the start of the Reagan administration, the policy was the reverse.

Observers here suggested that further rapport between the Reagan administration and the World Bank could develop once the White House settles on its choice to succeed Clausen as the bank's president.

Among those prominently mentioned as candidates are Federal Reserve Board Chairman Paul A. Volcker, former Citicorp chairman Walter Wriston, and Deputy Secretary of State John Whitehead.

Mr Danzansky

7502

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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

September 26, 1985

INFORMATION

MEMORANDUM FOR ROBERT C. McFARLANE

FROM: JOHN LENCZOWSKI JL

SUBJECT: A Suggestion for Southern Africa

South Africa may indeed find it is in its own self-interest to abolish apartheid under pressure of foreign economic sanctions and international opprobrium. But it may not: it has been quite successful in gaining self-sufficiency in many sectors.

In addition to our own policy of economic sanctions, which was not our initiative, and which gives the world the impression that we were shamed into it, we could take the lead with an alternative policy which I believe is more positive in spirit. This would be to compel South Africa to eliminate apartheid by forcing it to compete for foreign laborers by offering them a better deal, while creating a political environment designed to melt the spirit of fear and defiance which perpetuates the existing system.

As things stand, the South African economy does not have to compete for its foreign labor force. Its economy is prosperous while those of its neighbors are typical Third World basket cases, many of which are accompanied by political orders that are more repressive than South Africa's. Hence workers from those countries don't mind coming to South Africa given their alternatives. If, however, Mozambique, Zimbabwe and the others became democracies with political freedom and vibrant economies, those workers would be more inclined to stay home. Under these circumstances, South Africa would be forced to compete -- and the best way it could do so would be to offer all its workers full equality and an even more hospitable economic environment through such things as lower taxes, which would enable workers to keep a greater share of the fruits of their labors.

If the above-mentioned neighboring states ceased being Marxist or Socialist dictatorships, with strong sympathies for the communist ANC, the South Africans would no longer feel as threatened by externally-based subversion and would be much less inclined to view their black bretheren as a political threat to their civilization.

How could this come about? Well, we would first have to suggest it publicly as an ideal solution and a new element in U.S. policy. Then, we could request more money for the National Endowment for Democracy and encourage it to help "build the infrastructure of democracy" in these neighboring states. We might also consider supporting the anticommunist resistance movement in Angola.

On the economic front, we could try an innovative approach which would be much more appealing to these countries than the universally despised, austeritarian conditionality provisions of the IMF. Instead, we could give these countries an "offer they couldn't refuse." Specifically, having identified the principal barrier to production (especially the disincentives to work, save, invest, and take economic risks) in a given country--say, excessively high tax rates -- we could offer to pay the difference between anticipated revenues and those actually acquired, if the government lowered the rates to levels which offered people greater rewards for production. Although this would be somewhat of a gamble, it should be a good one, since tax rates throughout the Third World are outrageously high. In Tanzania, which is the worst example on the continent, one reaches the 95 percent tax bracket at an income of $2,500 per year, and it is not surprising that there is almost no productive activity going on in that country.

In the case of a front-line state, within the last few years a citizen of Zambia had to pay income taxes at a 70 percent rate at an income level of about $9,000 per year--a prohibitive rate which has encouraged leisure rather than production, brain drain rather than retention of productive individuals, and inefficient underground economic activity rather than efficient, above-ground, taxable production. If Zambia lowered its top rate to 40 percent and raised the income threshold at which one met that rate, the increased incentives might cause the same kind of revenue gain that we have enjoyed here in response to the President's tax cuts. To encourage Zambia to risk such a move, however, we could offer to compensate them for any revenue loss that might occur (but which probably won't). They would have nothing to lose by attempting this experiment but their socialist ideology, and the possibility that it might succeed would be a revolutionary coup not only for U.S. foreign policy but for the hopes of scores of developing countries.

If prosperity came to these countries, South Africa would have to bid high to keep its workers from returning home.

cc: Phil Ringdahl, Helen Soos, Walt Raymond, Stephen Danzansky, Dave Wigg, Don Fortier