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Remarks:

TREA has not reviewed. Processed IAW CIA
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 Executive Secretary
 7/16/82
 Date

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THE WHITE HOUSE
WASHINGTON

ATTACHMENTS

CABINET AFFAIRS STAFFING MEMORANDUM

82-5672

DATE: 7-15-82 NUMBER: 077387CA DUE BY: _____

SUBJECT: Cabinet Council on Economic Affairs

Monday, July 19, at 8:45 a.m. - Roosevelt Room

	ACTION	FYI		ACTION	FYI
ALL CABINET MEMBERS	<input type="checkbox"/>	<input type="checkbox"/>	Baker	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Clark	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Darman (<i>For WH Staffing</i>)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Harper	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Attorney General	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Jenkins	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Interior	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Wheeler	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Kudlow	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
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HUD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
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Counsellor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>	CCCT/Gunn	<input type="checkbox"/>	<input type="checkbox"/>
UN	<input type="checkbox"/>	<input type="checkbox"/>	CCEA/Porter	<input checked="" type="checkbox"/>	<input type="checkbox"/>
USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CCFA/Boggs	<input type="checkbox"/>	<input type="checkbox"/>
CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CCHR/Carleson	<input type="checkbox"/>	<input type="checkbox"/>
CEQ	<input type="checkbox"/>	<input type="checkbox"/>	CCLP/Uhlmann	<input type="checkbox"/>	<input type="checkbox"/>
OSTP	<input type="checkbox"/>	<input type="checkbox"/>	CCNRE/Boggs	<input type="checkbox"/>	<input type="checkbox"/>
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REMARKS: The Cabinet Council on Economic Affairs will meet on Monday, July 19, in the Roosevelt Room.

The agenda and papers are attached.

TREA has not reviewed.
Processed IAW CIA TREA
arrangement letter dtd 4/11/08.

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ATTACHMENTS

RETURN TO: Craig L. Fuller
Assistant to the President
for Cabinet Affairs

Becky Norton Dunlop
Director, Office of
Cabinet Affairs

THE WHITE HOUSE

WASHINGTON

July 15, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER *RBP*

SUBJECT: Agenda and Papers for the July 19 Meeting

The agenda and papers for the Monday, July 19 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The first agenda item is a report on the OECD Executive Committee Special Session. Assistant Secretary of State Hormats and Assistant Secretary of the Treasury Leland represented the U.S. and will report on the session. No paper will be circulated on this agenda item in advance of the meeting.

The second agenda item concerns Indian Borrowing from the Asian Development Bank. India is seeking a \$2.0 billion lending program from the Bank financed from the Third General Capital Increase now being negotiated by the Board of Directors. A paper, prepared by the Department of the Treasury, on this issue is attached.

The third agenda item is a report from the Working Group on LDC Financial Problems, chaired by Assistant Secretaries Leland and Hormats. The Working Group report includes a paper on U.S. Policy on Multilateral Development Bank Participation in Debt Rescheduling and a Status Report on Problem Countries currently experiencing financial difficulties.

Attachments

THE WHITE HOUSE
WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

July 19, 1982

8:45 a.m.

Roosevelt Room

AGENDA

1. Report on OECD Executive Committee Special Session (CM#275)
2. India Borrowing from the Asian Development Bank (CM#271)
3. Report of the Working Group on LDC Financial Problems (CM#179)



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

JUL 12 1982

MEMORANDUM FOR: THE CABINET COUNCIL ON ECONOMIC AFFAIRS

From: Thomas Leddy *TL*
Acting Assistant Secretary for
International Affairs

Subject: Indian Borrowing from the Asian Development
Bank (ADB)

India, currently a non-borrowing developing member country of the ADB, is seeking a \$2.0 billion lending program from the Bank. The lending program would be financed from the resources of the Third General Capital Increase now being negotiated by the Board of Directors. Prime Minister Indira Gandhi may raise this issue in her meeting with President Reagan in late July. Treasury believes we should continue present U.S. policy in opposition to a borrowing program for India in the ADB and that we should seek the President's concurrence in this position.

The attached paper covers the current status of India's request to borrow from the ADB. It outlines our concerns with the Indian request as well as providing the pros and cons of what we believe are the two available options: (1) confirmed opposition to Indian borrowing or (2) limiting the size of India's borrowing from the ADB.

Treasury recommends that we continue to oppose India's borrowing from the ADB and will seek the Council's endorsement of this position at the meeting on Friday, July 16.

Attachment

Indian Borrowing from the Asian Development Bank

India is technically eligible to borrow from the Asian Development Bank (ADB). However, at the time the ADB was established in 1966, its resource base was so small (approximately \$700 million in usable resources) that the Bank's focus was toward small and medium sized borrowers. It was decided that India with its huge resource requirement would be better served through the World Bank Group (IBRD, IDA, IFC). By borrowing from the ADB, India is attempting to lessen (1) the effect of China's entry into the World Bank Group (which reduces India's share of total borrowing) and (2) the impact of a smaller overall IDA program.

Because of the nature of India's agreement not to borrow, it can request the establishment of a lending program without any formal Board of Directors action. The issue arises only in the context of on-going General Capital Increase (GCI) negotiations regarding the size of the capital increase and possible country distribution of these resources. ADB Management, which would prefer that India not borrow, has no legal or technical basis on which to deny India's request. India's borrowing from the ADB could be prevented only if a sufficient number of countries informed Management of their opposition. From our soundings at the Board of Directors at the ADB, it does not appear that we would receive developed country support. The borrowing member countries who would be directly affected by the entry of a large new borrower would prefer India not borrow. It is doubtful, however, that they would align themselves publicly against a fellow Third World Country.

India first expressed its desire to borrow both from the ADB and the Asian Development Fund (the ADF provides concessional resources) in January 1981. After initial rejection of its request by Bank Management, the Indian Government sent a letter to the Bank saying it would seek to borrow ordinary capital resources for the period of the new capital increase starting in 1983, but would not seek ADF resources until 1986.

The United States supported Management's position that India should not receive any ADB resources but our position was weakened because we had not decided, at that time, whether we were going to participate in any replenishment. The last formal exchange on this issue occurred in September 1981 when ex-ADB President Yoshida informed the Indian Government that the traditional ordinary capital borrowers, such as Philippines, Korea, Indonesia and Thailand, had first claim to ADB resources. He implied that India could have a portion of GCI resources over that which would permit a fifteen percent growth in lending to the traditional borrowers. This apparent softening of Management's position resulted from its perception of a lack of continued member country opposition to India's request.

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U.S. Concerns

We are concerned about India's request for five reasons:

1. The character of the ADB, as an institution that serves small and medium sized borrowers, would be fundamentally altered.
2. A lending program for India would be an incentive for China to join the ADB, with the possibility that eventually almost half of the ADB's resources would be channeled to these two countries.
3. Congress strongly opposes an expansion of MDB lending to India. It is possible that the establishment of a lending program to India could cause defeat, delay or reduction in GCI authorizing legislation scheduled for next year.
4. If successful in gaining access to ADB resources, India will intensify its lobbying for access to concessional Asian Development Fund resources.
5. India already is the largest recipient of MDB resources, and is likely to continue to be so in the future, despite its under-utilized access to commercial credit.

Options

India expects to borrow from the ADB regardless of the size of the GCI. From India's viewpoint, the larger the GCI the greater the amount of resources that will be available to them.

The United States Government has to decide whether it wishes to oppose or to limit Indian borrowing from the ADB (by controlling the size of the GCI). The pros and cons of each follows:

1) Oppose any Indian borrowing from ADB.

pro -- This approach is most attractive to the Hill. Substantial negative Congressional reaction is expected for any ADB lending to India.

-- The Bank would retain its regional character and would continue to serve small and medium sized borrowers.

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- It is less likely India will attempt to borrow from ADF in 1986.
- China would be less interested in joining the ADB.
- con -- It may not be possible to rally sufficient support for our position from other countries to prevent India's borrowing from the ADB.
- Opposition to India's borrowing will worsen already strained bilateral relations.

2) Limit India's borrowing in the ADB by agreeing to a GCI that allows a maximum growth in lending of fifteen percent during the proposed GCI period.

pro

- Management will have to make very hard choices as to which countries receive less resources in order to accommodate India.
- It avoids a direct bilateral confrontation with India while at the same time sharply curtailing India's ability to borrow.
- A GCI that permits fifteen percent growth in lending is consistent with our position on the growth in lending in the Inter-American Development Bank GCI.
- con -- Negative Congressional reaction might lead to defeat, delay or reduction in size of ADB GCI (and possibly ADF) authorizing legislation now scheduled for submission to Congress in early 1983.
- It becomes easier for India to borrow on concessional resources in 1986.
- China may become interested in joining the ADB as a borrower.

Recommendation

That we oppose India's borrowing from the ADB. If the Council endorses our proposal, we recommend (1) that we seek the President's concurrence for this position and (2) that we begin to try to organize opposition to the Indian request. Japanese support will be essential. If, however, they are unwilling to support our position, we may have to fall back to Option 2, limiting the size of India's borrowing from the ADB



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

JUL 14 1982

MEMORANDUM FOR: THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: Marc E. Leland
Assistant Secretary for
International Affairs

Subject: U.S. Policy On MDB Participation in Debt Rescheduling

Issue

Given the growth of multilateral development bank (MDB) debt exposure, situations could arise where debt service owed to the MDBs by a country seeking debt relief from its external creditors represents a significant portion of the total debt service falling due. For this reason, the CCEA Working Group on LDC Financial Problems examined the question:

Should the United States seek to reverse the traditional practice of excluding the MDBs from both official and private multilateral debt rescheduling operations?

Background

Principal and interest payments by 98 countries to multilateral organizations (including the MDBs) increased from \$1.55 billion in 1975 to \$4.42 billion in 1980 and, based on debt owed as of the 1980, will reach \$8.8 billion in 1985. (Over two-thirds of the 1980 total is attributable to the World Bank.) Despite this increase, debt service to multilateral organizations as a percentage of total debt service on public or publicly guaranteed debt declined from 10.4 percent in 1975 to 8.2 percent in 1980. But, for a large number of countries the multilateral component is more important than aggregate data would suggest. This is the case particularly in low income countries -- although in many of these the level of multilateral exposure is still relatively small. There are also high concentrations in Central America.

With one exception, debts owed to international organizations, including the MDBs, have been exempted from participation in multilateral debt renegotiations. A firm MDB policy on arrearages has also minimized loan repayment problems under

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the threat to delay both loan disbursements and consideration of new loans if there are serious payment delinquencies. The fact that MDBs have been, in effect, treated as "preferred" creditors has not been controversial among creditor governments, in part because the financing arrangements supporting MDB operations are already based on an equitable cost-sharing basis and the exclusion of the MDBs from participation in debt operations has not been perceived as conveying any particular advantage among the major creditor countries. Furthermore, MDB loans have had longer maturities and lower interest rates than bilateral loans. The non-participation of the MDBs has also been considered to be in the mutual interest of creditors and debtors since it: (1) facilitated MDB efforts to maintain programmed lending operations in the affected debtor country --- concurrent with debtor country efforts to implement improved policies; (2) avoided damaging the creditworthiness of the MDBs in private capital markets; and (3) made it easier for MDB donor governments to secure necessary public and legislative support for MDB contributions and subscriptions.

Discussion

Arguments which have been raised for reversing U.S. policy and favoring the inclusion of the MDBs in multilateral debt renegotiations are that such inclusion would:

- (a) be a logical extension of the "non-discrimination" and "comparable treatment" concepts which we apply to other creditor governments and private banks, respectively;
- (b) avoid a situation in which creditor governments were in effect "bailing out" the MDBs, and
- (c) instill more market discipline into MDB operations by encouraging more selectivity into the country allocation of lending.

-- The pattern of MDB loan approvals in 1971-81 to four recent recipients of multilateral debt relief shows mixed results on the question of whether there was any precipitous increase in MDB lending in the years prior to debt renegotiation.

The principal arguments for maintaining U.S. policy and continuing to exclude the MDBs from multilateral debt renegotiations are that exclusion:

- (a) does not convey any particular disadvantage among creditors, who are also the major MDB shareholders;

-- other creditors have not expressed any significant dissatisfaction with current practice and a U.S. initiative to revise it would likely be highly contentious.

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(b) avoids an adverse impact on MDB creditworthiness among bondholders, although admittedly it is debatable to what extent MDB participation in debt renegotiation would affect MDB ability to borrow in capital markets.

-- The World Bank Treasurer considers the Bank's excellent repayment record and the fact that it does not participate in multilateral debt reschedulings to be one of the two or three most important factors in marketing World Bank securities. Recent Treasury contacts with MDB underwriters in New York confirmed this fact; with one underwriter going so far as to say that World Bank participation in a multilateral debt renegotiation would immediately reduce its triple-A rating to a single-A rating, with consequent negative implications on the Bank's access to and cost of market financing.

(c) avoids the serious risk that MDB rescheduling would increase Congressional criticism of the Administration's decision not to seek appropriations for U.S. callable capital subscriptions to the MDBs;

-- the fact that MDBs have a good repayment record is perceived by MDB supporters on the Hill as a solid indicator of the banks' overall attractiveness as institutions to "put U.S. money."

(d) recognizes that MDB finance plays a somewhat different development role with a longer term economic perspective than either private sector finance or that portion of bilateral finance geared to export promotion; and

(e) reflects the case that can be made that the continuation of planned lending by the MDBs during a debt crisis situation already constitutes an important component of the multilateral effort to facilitate the debtor's recovery.

-- Net transfers from multilateral organizations generally do not appear to have been adversely affected to any major extent by debt crisis situations and have tended to remain high -- and in some recent cases, actually recorded significant increases. Since debt renegotiations are conditioned on the debtor country's commitment to an IMF program, these MDB net transfers should be taking place in an economic environment improved from that which occasioned the debt crises.

This pattern of MDB net transfers contrasts markedly with that of private creditors (suppliers credits/ financial markets) where declines or negative net transfers frequently were recorded during a debt crisis. While this is not surprising given the

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nature of and the commercial criteria underlying the private debt, it does illustrate the disproportionate burden that would be placed on the MDBs vis-a-vis private creditors if the MDBs were also required to participate more directly in debt renegotiations at the same time they were maintaining normal MDB lending and loan implementation in a debt crisis situation.

MDB Co-Financing Arrangements

We have also examined the implications of MDB exclusion from rescheduling for MDB co-financing arrangements with commercial banks and other private lenders.

The objectives of U.S. emphasis on co-financing are threefold:

- a. To maximize the impact of the technical assistance, project skills and market-oriented policy advice of the MDBs.
- b. To reduce the MDBs' demands on the Federal budget and U.S. capital markets.
- c. To facilitate LDC access to international capital markets.

To the extent that increased MDB private sector co-financing is consistent with these objectives, we welcome and encourage such activity. On the other hand, we would object to co-financing programs that become competitive with private sector financial institutions, or that encourage the MDBs to participate in low risk, high financial rate of return projects where their presence is not needed.

There has been significant growth over the past several years in both total MDB co-financing and the private co-financing component. Private sector participation in co-financed World Bank operations totaled \$1.8 billion in both FY 80 and FY 81, and in FY 82 the level rose to over \$3.2 billion. (The IDB has recorded a cumulative total of \$532 million in private co-financing; the cumulative total in the ADB is \$125 million.) The benefits to commercial banks of participating through co-financing with the MDBs include: MDB familiarity with LDC conditions and procedures, controlled exposure, low cost access to MDB project expertise, and the use of the MDBs as project appraiser and loan administrator.

Although private co-financing has increased, it still constitutes a relatively small component of the operations of both the MDBs and the commercial banks. In FY 82, only 16 of the World Bank's 150 operations involved commercial co-financing, and commercial co-financed loans represented only about 1.5 percent of outstanding commercial bank loans to IBRD borrowing member countries as of 12/31/81.

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Given current commercial bank concern about lending to developing countries, the MDBs recognize that co-financing will have to be made more attractive if the expansion of private co-financing is to continue. In this context, there have been suggestions that the "cross-default" clause be made mandatory, also that new co-financing instruments and techniques be devised.

The World Bank has now specifically proposed an experimental "A/B" loan package in which a portion of the loan ("B loan") is designed to commercial specifications (variable rates) with both World Bank and commercial bank participation. This substantially increases the risk that the Bank will be under pressure to participate in both loan accelerations and reschedulings. Indications are that the Bank will strenuously reject these pressures, but it admits that it will be breaking new ground and that it cannot be foreseen how the parties involved might view a "B loan" in the actual circumstances of a debt rescheduling.

Under the "cross-default" provisions currently included in World Bank co-financing arrangements, the Bank, at its option, may decide to accelerate the repayment on the corresponding Bank loan outstanding if the co-lenders have taken legal action to accelerate their loan. The option is, however, entirely at the Bank's discretion and, has not been exercised to date. To our knowledge, there have not been any instances where the private sector component of an MDB co-financed loan has been rescheduled.

The United States would have serious problems if World Bank efforts to increase the attractiveness of co-financing arrangements sought to transfer the Bank's preferred creditor status (in rescheduling operations) to the private component of co-financed loans. However, any new co-financing procedures are far more likely to make a component of MDB lending liable to rescheduling than they are to attempt to exempt the corresponding component of commercial bank lending.

World Bank consideration of procedures which would make the Bank portion of co-financed loans liable to rescheduling would have to weigh seriously the impact of such a move on the Bank's overall credit standing in private markets. At the present time, the Bank appears opposed to the idea of making the cross default clause mandatory or to instituting what in effect would be "cross-rescheduling" provisions. Even if the Bank were to agree to specific transactions where it would more effectively "share the risks of lending" with its commercial co-financing partners, in A/B loans or other schemes, it would undoubtedly ensure that the remainder of its loan portfolio would remain exempt from rescheduling.

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In summary, current co-financing instruments and techniques in no way conflict with U.S. debt rescheduling policy. However, new Bank proposals will be monitored closely as they evolve with a view to identifying situations where possible refinements or clarifications in U.S. debt rescheduling policy may be necessary or where the USG would want to oppose such proposals.

Recommendation

The Working Group concludes that no U.S. policy initiative is needed at this time on the issue of MDB debt rescheduling and supports the general practice of excluding the MDBs from multi-lateral debt reschedulings. At the same time, the Working Group recognizes that individual country situations could arise where the United States would be justified -- after a "case by case" analysis of MDB operations in a given country -- in encouraging individual debtor countries to seek relief in some form from the MDBs. In addition, MDB proposals on co-financing need to be followed closely as they evolve.

The Working Group recommends that the Cabinet Council endorse this position.

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DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

JUL 14 1982

ASSISTANT SECRETARY

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: Marc E. Beland
 Assistant Secretary, International Affairs

SUBJECT: Status Report on Problem Countries

The Federal Reserve, State and Treasury are following closely the financial difficulties currently being experienced by a dozen-odd countries in which the United States has a special interest. Recent developments in Mexico, Argentina, Sudan and Zaire are of particular significance.

MEXICO

The Mexican economic situation remains precarious. While the trade account is somewhat stronger and capital flight may be abating, capital inflows are not sufficient to meet short-term foreign exchange needs. The recent \$2.5 billion "jumbo" loan was poorly received by the market. Banks are very reluctant to increase their exposure. The GOM will not be able to float a large syndicated loan for at least several months, if not longer. The GOM will be forced to rely on rollovers of maturing credits and "club deals" that bring in \$50 to \$100 million at a time. July and August will be particularly difficult months. (C)

Adding to existing problems, on September 1 President Lopez Portillo will deliver the annual State of the Union Address (his last). Traditionally Bank of Mexico reserves are announced. The President will want to announce a figure as large as the \$3.9 billion announced for the end of May -- which he is very unlikely to be able to do. A complicating factor is that pressure on the peso usually picks up on the anniversary of previous devaluations, i.e., August 31. (C)

Establishment of confidence in the willingness of the GOM to implement strong corrective measures remains the key to overcoming the continuing financial crisis. Only private capital markets can provide the amount of financing the Mexicans require. Now that the election is over, the GOM must announce convincing implementing measures, e.g., more price increases for public sector goods and services, further budget cuts, interest rates high enough to remain positive in real terms and an accelerated depreciation of the peso. The international banking community already expects considerable tightening up in the stabilization program. If this does not occur, the foreign financing situation could deteriorate rapidly. (C)

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 Declassify Review for
 Declassification on 7-14-88

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The Treasury and Federal Reserve swaps, even under circumstances appropriate to their use, are necessarily short-term and limited in amount. President Lopez Portillo, who will remain in office until December 1, remains opposed to recourse to the IMF. However, borrowing from the Fund may become unavoidable both for confidence and direct financing reasons. (C)

ARGENTINA

The new Argentine government of President Bignone appears to be taking a mid-course between the austerity measures of his immediate predecessors and the statist approach of Argentina's traditional political parties, including the Peronists. The new Minister of Economy, Jose Maria Dagnino Pastore, announced a series of major economic policy changes during the first week of July; capped by a 22% devaluation of the peso and a return to a dual exchange rate system. A "commercial" rate will be pegged daily for trade transactions. A "financial" rate for tourists, debt service and other payments will reflect "the free play of market forces." The "financial" rate moved quickly to a discount of 35% from the official rate on July 6. The government has also eliminated the requirement that all external payments be approved by the Central Bank. This requirement had caused chronic delays in private debt service since the measure was adopted on April 30. Foreign exchange purchases for non-debt related payments -- including imports -- continue to be tightly controlled. (LOU)

Argentina's liquid foreign exchange reserves -- now estimated at \$600-\$800 million -- continue to erode. The Central Bank, however, claims to still have \$1.1 billion in bilateral trade swaps available within the region and \$1.5-\$2.0 billion in letters of exchange potentially available for discount on foreign financial markets. These are in addition to \$1.3 billion in gold reserves. Argentina could also use its nearly \$640 million of SDR holdings and reserve tranche in the IMF. (C)

U.S. banks (with the exception of some smaller, regional, institutions) continue to roll over maturing Argentine debts into new short-term obligations. Argentine sources claim that as much as 90% of maturing obligations are being rolled over; compared to only 75% during the peak of hostilities in May. The GOA is currently attempting to negotiate several club deals in the \$50-\$150 million range with U.S. banks and at least one new commercial bank credit line to an Argentine bank (for \$130 million) has been arranged. Hard currency liquidity is nonetheless very tight, in part because of Venezuela's failure to actually deposit \$1 billion in foreign exchange holdings in Argentine banks as promised in May. (C)

Argentine officials hope to restructure external debt in the months ahead through a consolidation of short-term public sector obligations into club loans led by major U.S. banks. While the GOA does not wish to seek an IMF standby due to internal political considerations, a technical assistance mission has gone to Argentina to evaluate the situation and suggest corrective economic measures.

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An IMF stand-by arrangement may still prove necessary to avoid an unacceptably low level of reserves and mounting commercial arrearages in the fourth quarter. (C)

SUDAN

In February, the IMF approved a one-year SDR 198 million standby in support of a stabilization program covering CY 1982. There was also a special pledging session in January (U.S. share = \$125 million) and a Paris Club debt rescheduling in March (U.S. share \$50 million). Since mid-May, the Government of Sudan has been out of compliance with the IMF standby because of failure to eliminate arrears relating to payments due under the 1979 Paris Club rescheduling. There is also an unresolved issue with the IMF concerning Sudan's exchange rate policy. Accordingly, the IMF has withheld release of SDR 35 million, which would have been available at the end of June. (LOU)

The Government of Sudan missed an interest payment of about \$23 million due to commercial banks and under a "London Club" debt-relief agreement concluded last December, it has informed the banks that it will be unable to meet the September payment as well. One of the leading U.S. banks is threatening to declare Sudan in default, although there is probably a large element of bluff in this threat. (C)

The extremely precarious external financial position of Sudan is not new. It was well understood at the time the IMF arrangement was approved that Sudan would have a serious cash flow problem throughout 1982. However, export earnings and aid disbursements appear to be substantially lower than projected at the beginning of the year, and the situation is now at a critical stage. (LOU)

A recent review of the "Horn of Africa" by the NSC has concluded, among other things, that the USG should strongly encourage continued Sudanese economic reform and austerity measures. Specifically, the review recommends that an interagency working group examine options for meeting Sudan's needs for financial assistance including debt relief. This examination could be undertaken within the CCEA's Working Group on LDC Financial Problems, with State taking the lead. (C)

ZAIRE

Zaire is experiencing serious foreign exchange shortages and accumulating arrears to private and official creditors as a result of economic mismanagement. Depressed world prices for copper and other commodities have contributed to Zaire's difficulties. To maintain the flow of donor aid since mid-1981, Mobutu has emphasized political relations (such as recognizing Israel) rather than economic reforms. (LOU)

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Significant FMS arrearages have held up FY 1981 and FY 1982 military assistance in the form of Federal Financing Bank loans at market-related interest rates (guaranteed by the Department of Defense). An interruption of our military assistance programs would presumably have an adverse impact on USG-GOZ political relations. (LOU)

Relations with the IMF are at an all time low. The 3-year, \$1 billion extended arrangement was cancelled last month, just one-year after it was approved, because the GOZ failed to meet its September 1981 performance targets and was unwilling to implement the policy reforms necessary to reestablish its eligibility for Fund credit. (LOU)

Debt relief arrangements are in limbo. The GOZ has failed to sign all but one of the bilateral agreements implementing the July 1981 Paris Club agreement that set debt-relief terms for 1981 and 1982. This situation threatens the effectiveness of the Paris Club approach to debt relief. Meanwhile, Zaire has paid only part of the interest due in April 1982 to commercial banks under a debt-relief agreement concluded in 1979. The banks have taken the position that nonpayment is unacceptable. (LOU)

From an economic/financial perspective, U.S. policy toward Zaire should emphasize the necessity for Zaire to implement the necessary economic adjustment measures and negotiate a new standby arrangement with the IMF. (C)

Classified by 13 (Templeman)
 Declassify Review for
Declassification on 7-14-88

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