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Prime Minister

AT 29/7

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

26 July 1985

A Turnbull Esq
10 Downing Street
LONDON
SW1

Dear Andrew,

INTERNATIONAL FINANCIAL SCENE

I enclose the latest assessment of developments on the international financial scene which has been discussed in the Treasury's International Debt Group.

In its survey of external economic developments, the Bank's paper notes the continuation of the more favourable outlook noted last month on interest rates and the US dollar. This is offset by uncertainties about economic developments in the US and sluggish commodity prices, including oil, where OPEC have just agreed small price cuts. The extent to which individual debtor countries are affected by these factors varies considerably: most notably in relation to oil. Their positions vary widely and require continuing improvisation in the approach taken by creditor governments.

Uncertainties continue on the political front too. There has been little sign of life from the Cartagena Group since the spring, but it could be fanned into life, either by action in a single country (eg Peru), or by an external stimulus such as the forthcoming Havana conference which is likely to promote a confrontational approach to the debt problem.

On individual countries, it is worth drawing attention to Peru. Last month we reported that the new regime seemed intent on an early break with the IMF and a more radical approach to debt problems, with the risk of a knock-on effect elsewhere. Latest reports suggest a more cautious approach and we have agreed with other main creditors, including the US, to encourage more moderate policies. Further indications of their intentions may become available after Garcia's inauguration at the end of this month.

Poland finally signed, on 15 July, the 1982-84 Paris Club agreement negotiated at the end of last year without promises of new credits. Signature was accompanied by an informal exchange of letters recognising the higher probability of the need for further debt relief towards the end of this year. Thus the Poles have been kept in play for the time being, but the long term financial outlook remains very poor.

In Latin America, Argentina has introduced a shock package, including a new currency and price and wage controls. This is designed to cut inflation and to supplement the measures contained in their June letter of intent to the Fund. The measures have been well received but in the absence of detail on the "follow-through" action to cut the public sector deficit, it is too early to judge the chances of success.

Brazilian negotiations with the Fund are proceeding very slowly. Some measures to reduce the public sector deficit have been taken but more are required. The commercial banks will need to decide whether to roll over on 31 August inter-bank and trade facilities worth some $16 billion. The ease or difficulty with which this can be done is likely to depend on the signals which the Fund can give on progress in the negotiations.

The next report on the International Financial Scene will come forward in late September, as background to the Commonwealth and Fund meetings. Before then the Treasury and Bank will be doing some analytical work on the economic prospects of the main debtor countries. The outcome of this will be taken into account in our September report.

I am copying this letter to Len Appleyard (FCO), John Mogg (DTI) and John Bartlett (BOE).

Yours ever
Rachel

RACHEL LOMAX

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INTERNATIONAL FINANCIAL SCENE

The most interesting developments recently have been the agreement of a new Argentine Letter of Intent and the introduction by Argentina of major new measures to reduce quickly and sharply the country's rate of inflation. A number of creditor countries were persuaded on the basis of these developments to give Argentina bridging finance to enable the country to reduce its arrears, thus avoiding the downgrading of the country's loans by the US regulators. The IMF Board will meet (probably around mid-August, although no date has yet been scheduled) to consider whether the adjustment measures taken by the Argentine authorities are sufficient to warrant the re-instatement of their Standby programme which has been in abeyance since last December. Meanwhile, discussions have resumed between Brazil and the Fund to agree a new Letter of Intent. Whilst these developments are certainly welcome, Argentina and Brazil have disappointed expectations a number of times over the past couple of years (and indeed there are reportedly still serious differences between Brazil and the Fund), so it would be premature to claim that a turning point has been reached. Nevertheless, if these two major debtors are able to agree, and adhere to, convincing Fund programmes over the next few months, this could do much to offset the immediate factors that generated gloom over the debt situation in the early part of the year. Conversely, if these debtors fail to agree (perhaps, for instance, as a repercussion from a major row that might develop between Peru and her creditors), this will make the overall debt outlook distinctly more threatening.

Meanwhile, recent external economic developments for most debtors have been broadly favourable. Eurodollar interest rates have stabilised, and the three month rate - now below 8% - is more than four percentage points lower than it was this time last year. Moreover, although growth in the US is apparently slowing down -

GDP in the second quarter grew at a rate of only 1.7% - the US trade deficit (which is more immediately important for the debtors) continues to widen, and is now officially expected to be $30 bn larger this year than last, and further import growth is also expected in the other major industrial countries. The continued weakness of the oil price at the moment benefits the majority of debtors; and the recent depreciation of the dollar helps those debtors whose debt is largely denominated in that currency.

Nevertheless, a number of uncertainties persist. The US current account deficit is clearly unsustainable, and correction will involve some combination of domestic deflation and/or further depreciation and/or increased protection. The great worry is that protection may play a major part in the corrective process. At the same time, whilst it is generally accepted that the US economy will not achieve the growth rates it experienced over the last couple of years, there is no sign that other industrialised countries are willing to take deliberate steps to take up much of the slack. Debtors are likely therefore to experience problems maintaining the volume growth of their exports. With commodity prices still remarkably sluggish for this stage of the economic cycle (non-oil commodity prices slipped back a further 2.4% in SDR terms in the five weeks to the beginning of July, and are now roughly back down to their level of early 1983), primary producers in particular are likely, if world trade slows, to find difficulties in maintaining the prices of their exports. On both counts therefore export values are likely to come under pressure.

The most important of these commodity markets, both for producers and consumers, is that for oil. The real price of oil has, on some measures, fallen by 7% this year. As noted above, falling oil prices should benefit the bulk of debtors. However, for a number of debtors, such as Nigeria, Venezuela, Mexico and Ecuador, oil revenue accounts for the majority of export earnings (for the first two of these countries over 90% of the total), so any fall in the oil price will have serious implications for them. Recent cuts in the price of Mexican and Soviet crude, and - even more importantly - the continued inability of OPEC to reach full agreement, make the prospects of sizeable further price cuts more real. Especially if price cuts are substantial, the relatively limited benefit the importers gain may well be over-shadowed by the serious impact on the exporters. Venezuela may have some cushion against price cuts, but could find its position very difficult if the cuts are sizeable; most of the other oil exporters are facing major problems, even at present price levels.

Further concern derives from the increasing difficulty experienced by a number of countries in filling all their financing gaps. Additional IMF resources are no longer available to several countries, and indeed some of them should soon start making net repayments to the Fund. Banks remain anxious to minimise the commitment of new money, and generally insist as a condition of agreeing a MYRA that no further new money will be provided. The filling of financing gaps in the future may therefore require flexibility and innovation: in the case of Chile, for instance, banks refused to fill the identified financing gap themselves, but Chile managed to fill it by obtaining an additional IBRD B-loan, and by seeking official debt relief from its four major creditors*

Economic performance amongst debtor countries has recently been mixed. The Brazilian trade surplus has revived, and the $11.7 bn target for the year looks attainable. Exports from Korea too have revived, after a sluggish beginning to the year. Mexico's exports on the other hand - both oil and non-oil - remain somewhat depressed, prompting calls for further measures to improve the country's competitiveness. On the internal side, there seems to have been some modest improvement in the performance of a number of debtor countries. In addition, both Argentina and Brazil have introduced significant adjustment measures; Chile too has introduced new measures in line with IMF recommendations. In all of these, however, it is too early to say what impact the measures will have on performance.

Meanwhile, the incoming Garcia Government in Peru has continued to threaten a more radical approach to that country's debt problems, involving a limit on interest-service payments, and no relationship with the Fund. At present there is little sign of

* now extended to a wider group of creditors (including the UK).

this attitude spreading amongst the Cartagena Group (or indeed of quite how seriously it is held within Peru itself), but clearly any action the Peruvians might take, and the response this is perceived to generate from the creditors and the international community, may well have serious knock-on consequences for the debt situation elsewhere. For the moment the Cartagena Group is considering how to take its proposals forward in the light of the replies it has received to its message to the Bonn Summit. Most of these replies re-iterated governments' endorsement of the present ad hoc strategy, but in a separate and tendentious message Cheysson (EC) expressed firm support for the objectives of the Cartagena Group. Meanwhile, the political temperature has been raised somewhat by a Cuban invitation to the Latin American debtors to attend a conference in Havana at the end of the month on easing the debt burden (by confrontational methods).

A significant capital market development has been the $1 bn syndicated loan negotiated for Colombia. Although Colombia is the only major Latin American borrower not to have rescheduled maturing debt, the deal incorporates IMF monitoring of the economy and is thus yet another package (after those for Mexico, Venezuela, and Ecuador) which sets up a long-term role for the Fund. Elsewhere, there have been a number of new loans for countries in Eastern Europe.

More details on the major debtors are given below.

(i) Latin America

In mid-June, the authorities in Argentina introduced a package of far-reaching measures designed to cut inflation drastically and rapidly. A new currency (the austral) was introduced and fixed to the US dollar, wages and prices were frozen, after a sharp rise in public sector tariffs, and interest rates on deposits were cut from 30% per month to 4% per month. With prices having risen by over 1,100% in the year to end-June, the decision to supplement the restrictive demand policies of the revised IMF programme (enshrined in a new Letter of Intent presented on 11 June) with more fundamental reforms, indicates a welcome commitment by the

Argentine authorities to tackling their domestic economic problems. It is, however, too early to assess the impact of these reforms and their chance of success. A better impression may emerge by the time of the meeting of the IMF Board (scheduled for early in August), at which the Argentines' request for reinstatement of the SDR 1.4 bn SBA (agreed last December) will be discussed. The revised programme envisages a reduction in the public sector deficit from 11.3% of GDP in 1984 to 2.6% of GDP in the first quarter of 1986, and settlement of all external arrears by March 1986. It is still uncertain whether the recent reforms will prove compatible with the IMF programme, but it is clear that the Argentines have finally recognised that they have to come to grips with their problems, so that for the moment at least, they are likely to be given the benefit of the doubt. As an example of this, the US, BIS and a number of Latin American countries made a $460 mn bridging loan to Argentina in June to enable the country to reduce interest arrears on public sector debt (making interest current to end-February). Additionally, these developments persuaded the US banking regulators not to downgrade Argentine loans - although they have urged the banks to treat these loans conservatively in their accounts - and should help the banks' Working Committee in its attempts to relaunch the Argentine debt package (rescheduling of $14.5 bn of 1982-1985 maturities and provision of $4.2 bn of new money) this month.

In Brazil, negotiations with the IMF are continuing, but progress has been slow. The existing EFF has been abandoned and the aim is to replace it with a Standby arrangement; the new programme is unlikely to be put to the IMF Board before the end of August. Meanwhile, Finance Minister Dornelles has introduced a number of measures since the end of April aimed at reducing the public sector deficit. Further measures to reduce the deficit are, however, required, and there are reports of continued disagreements between Dornelles and Planning Minister Sayyad over how - and indeed whether - such measures should be implemented. For their part, the banks have agreed a rollover (to end-August) of the interbank and trade facilities which expired at end-May. The banks and the Brazilian authorities are still aiming to complete a MYRA, provided Brazil can reach agreement with the

IMF. Parallel action by governments (although on a smaller scale) will also be necessary: preliminary discussions have been held with the Paris Club Secretariat.

In Mexico, now that the MYRA is in place, worries are emerging that the strong external performance of the previous two years is not being sustained. The prospects for oil are worsening and Mexico has announced cuts in the price of its oil. Non-traditional exports are depressed. In response to this situation, the Mexican authorities recently permitted commercial banks to operate in the 'parallel' market for the peso, and then allowed the, previously unofficial, parallel rate to replace the official free market rate; these changes effected a partial devaluation within the official dual exchange rate system. Official results from the Congressional and State elections earlier this month indicate that the ruling PRI party has gained widespread victories, but the opposition is denouncing the elections as fraud. It is reported that, now the elections are over, the government will be introducing further cuts in public expenditure.

Elsewhere in Latin America, a number of countries have made progress towards resolving their immediate debt problems. In Chile, negotiations with the banks' Advisory Committee have been concluded, with a preliminary agreement covering $1.085 bn of new money in 1985 and 1986 and rescheduling of $5.99 bn of maturities falling due between 1985 and 1987. Of the new money, $300 mn represents IBRD B-loan cofinancing, with the IBRD guaranteeing half of the amount. The package is now in the process of being put to creditor banks, who will need to be assured about Chile's prospects of negotiating the rescheduling of $170 mn of official debt; the Chileans have reportedly been assured by the Chairman of the Paris Club (without proper authority) that this rescheduling will not affect Chile's access to further official cover.. Agreement has also been reached between Colombia and the banks' Consultative Committee on a $1 bn new money deal, involving IMF/World Bank monitoring of the Colombian economy. The "roadshow" took place early in July, the Colombians then aiming (optimistically) to get the package in place by 15 July, when the

IMF Board met to discuss Colombia's last Article IV report. In Ecuador, the moratorium on commercial bank debt has been extended to the end of September to allow the remaining thirty banks to commit to the $200 mn of new money for 1985 and to the 1985-1987 MYRA. It is now hoped that the package will be signed in August. The "roadshow" marketing Venezuela's $21.2 bn MYRA, for 1985-89 maturities, took place in June, and there is every chance that the agreement will be signed in September.

However, no progress has been made with Peru. The spokesmen of President-elect Alan Garcia, who is scheduled to assume office on 28 July, have indicated that the banks can expect no more than token interest payments in the coming months during which period the new team intends to put together a new debt scheme, possibly involving the setting of upper limits on debt service payments and a refusal to allow any IMF involvement in the Peruvian economy. The US banking regulators have decided not to downgrade loans to Peru to the "value impaired" category at this stage, but have kept them in the "sub-standard" category until they have a clear indication of the debt policies of the new administration.

(ii) Far East

Within Asia these is little new to report on the Philippines. It seems, on the basis of limited economic data for 1985, that the authorities have managed to regain control of monetary growth. Inflation is coming down to under 30% (a.r.) in June (from 64% last October) and the trade deficit continues to narrow. South Korea's request for a 20-month SDR 280 mn Standby arrangement was approved by the IMF Board on 12 July. However, it is not yet known how successful the efforts by G5 countries were to persuade the Koreans not to draw funds down unless the country's balance of payments were to weaken markedly. Whilst Korean economic performance has improved over the past few months, a cloud remains over part of the financial sector: from 1 July the Bank of Korea is to provide special soft loans to a number of domestic banks. As regards Indonesia, the Inter-Governmental Group, IGGI, met on 4-5 June when $2.4 bn was pledged in official assistance for FY 1985/86 (the same level as FY 1984/85).

(iii) Eastern Europe

At a meeting of the Paris Club on 15 July, Poland signed the 1982-84 Agreement, but there was an informal exchange of letters recognising the high probability that the Poles will need to return to Paris toward the end of the year to seek further debt relief. Further progress has been made in discussion between the Poles and ECGD on the terms of the bilateral agreement implementing Paris Club rescheduling for 1982-4, but there remain difficulties over the interest rate. It is hoped to sign the 1985 Paris Club Agreement in September provided that the Poles have made the downpayments required under the 1982-84 Agreement by that time. The Yugoslavs and the banks met in Washington on 9 July to discuss monitoring arrangements, and are expected to meet again later this month in an effort to resolve the continuing impasse on pricing in connection with the rescheduling of 1985-88 maturities. Romania, currently faced with liquidity problems, met the four agent banks involved in its earlier reschedulings in London on 26 June and 10 July to discuss its request for a $150 mn five-year syndicated loan; the banks were reasonably sympathetic. Meanwhile, Hungary has warned that its export performance so far this year has been weaker than anticipated, and that its targetted hard-currency current-account surplus of $400 mn is unlikely to be acheived.

(iv) Southern Europe

There are encouraging reports from Portugal of a significant improvement in inflation and of a favourable trade performance in the first four months of the year. Following the collapse of the coalition government, however, a period of political uncertainty lies ahead. The president is to call a general election, probably for early October.

(v) Africa

Morocco has requested both a follow-on Standby arrangement with the IMF and a purchase under the Compensatory Financing Facility to meet excess cereal import costs. The Board was due to consider the request on 12 July, but the discussion has now been put back to August. Nevertheless, final agreement on commercial bank rescheduling of 1983-4 debt is expected shortly and an agreement covering 1985-6 maturities may soon follow. A mission from Warburgs went to Washington on behalf of Nigeria in mid-July following indications that the authorities might now be willing to accept the conditions for a Fund programme, including a substantial devaluation. Depending upon the outcome, a Paris Club taskforce would be ready to go to Lagos if that would help to clinch a deal. A further $539 mn of promissory notes has been issued to a large number of uninsured creditors, the previous two issues having been confined to debts owed to multinational companies. A final, much bigger, issue is expected in August. Progress on reconciling insured creditors' claims with importers' submissions remains slow.

The outlook for South Africa is paradoxical. On the one hand, a sharp deterioration in the South African government's international political standing and behaviour is leading inexorably to the imposition, as a warning shot across its bows, of selective economic measures, notably by the United States. On the other hand an improvement in the current account of the balance of payments, after firm fiscal and monetary adjustment, has made possible significant repayments of short-term debt, which forms the bulk of its external debt. The international measures now being formulated seem unlikely to have much practical economic effect, but more severe sanctions could follow if South Africa fails to undertake further internal political reform. An IMF mission is currently in Sudan to discuss with the authorities the adjustment measures necessary to attract further donor support; provided arrears to the Fund are cleared, a later mission could negotiate a new Standby arrangement.

(vi) Other

Israel has announced a further series of emergency measures in an attempt to halt the continued deterioration in its economic situation. It is hoped that the measures will encourage the US to agree to the release of the $750 mn emergency economic aid approved earlier in the year. There is some concern about Turkey's trade performance; in the first four months of the year the trade deficit widened to $1 bn ($0.6 bn in the same period in 1984), although the May figure showed a considerable improvement. The OECD in its annual report was critical of current policies and warned of the vulnerability of the balance of payments position.

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INDEBTEDNESS AND BRITISH EXPOSURE $ billion

	Total external debt	British-owned banks' exposure[1]	ECGD amounts at risk	
	End-Dec 1984	End-Dec 1984	End-Mar 1985 [2]	End-Mar 1985 [3]
Latin America				
Argentina	48	2.5	0.1	0.2
Brazil	100	6.6	0.7	1.7
Chile	19	1.3	-	0.1
Colombia	12	0.6	-	0.2
Ecuador	7	0.5	-	0.1
Mexico	96	6.2	0.5	1.2
Peru	14	0.3	0.1	0.1
Venezuela	39	2.2	-	-
Far East				
Indonesia	35	0.8	0.7	1.6
Philippines	26	1.3	0.2	0.2
South Korea	43	2.4 (0.5)	0.4	0.8
Eastern Europe (convertible currency)				
East Germany	13	0.6	0.1	0.1
Hungary	8.5	0.5	-	0.1
Poland	27	0.5	1.1	1.2
Romania	7.5	0.3	0.2	0.4
Yugoslavia	19	0.9	0.7	1.0
Southern Europe				
Greece	16	1.3	0.2	0.4
Portugal	15	1.2	0.2	0.3
Spain	41**	2.5 (1.1)	0.1	0.1
Africa				
Morocco	12	0.1	0.1	0.2
Nigeria	18	1.3	1.7	3.2
South Africa	25	5.0 (1.1)	0.7	2.7
Sudan	9	-	0.1	0.1
Other				
Israel	30	0.5	0.1	0.2
Turkey	20	0.3	0.2	0.3

[1] This column now shows exposure defined as consolidated external claims, adjusted for certain inward and outward risk transfers in respect of guaranteed loans, plus any net claims on local residents in local currency.

[2] Defined as unrescheduled principal disbursed, plus political claims paid and claims under examination.

[3] Defined as guaranteed principal and contractual interest, plus political claims paid and claims under examination.

** End-June 1984

Amounts in brackets represent total unused commitments adjusted for certain inward and outward risk transfers in respect of guaranteed loans.undisbursed commitments where these exceed $1/2 bn.

INDEBTEDNESS ccPG

AFRICA: THE CHALLENGE OF ADVERSITY

INTRODUCTION

A quarter of a century ago Harold Macmillan, as he then was, made one of the most memorable speeches of his career to the South African Parliament in Cape Town. One passage has been particularly remembered. ''The wind of change is blowing through this continent and, whether we like it or not, this growth of national consciousness is a political fact. We must all accept it as a fact, and our national policies must take account of it''. It is the wind of change that has largely shaped the Africa of today. I should like to talk about its problems and the implications for us in Britain.

Macmillan was speaking of a continent with which Britain has strong historical links. Much of Africa was once under direct British rule, and still more under British influence. Our intense interest in Africa is therefore understandable but it is not just a reflection of our colonial past. Our interest grows out of deeply held principles - a commitment to peace with freedom and justice and prosperity throughout Africa.

Of course it is Africans who will shape Africa. But we are bound to look at it in the light of the questions: what has Britain contributed to Africa? What can we do now to help - to help ourselves, as well as Africa - on the path to peace and prosperity?

Our contribution to Africa has been diverse. Not everything has survived and indeed not everything deserved to do so. But to our credit we did attempt to implant there many of those institutions which we cherish most highly within our own society: parliamentary democracy; peace, law and order and justice; a non-political Civil Service; education. It was inevitable that institutions nurtured in our own very different conditions should be subject to change and adaptation to African circumstances; but much still remains, a foundation of common heritage which binds us together and on which we can build.

In 1960 Macmillan saw the great issue of the second half of the 20th century as 'whether the uncommitted peoples of Asia and Africa will swing to the East or to the West?' It has now become clear that communism has not provided the answer to Africa's needs. According to definitions of official development assistance endorsed by the United Nations, Soviet economic aid to Africa over the five years to 1983 has only been 27% of that given by Britain alone. In the famine areas the Soviet response to humanitarian needs has been tardy and limited. India has already given ten times more aid to Ethiopia in the past six months than the Soviet Union. Instead the Soviet Union has concentrated in the main on exporting guns and revolution, when the real need is for aid and sensible economic management. Certainly those African countries which have adopted the Soviet model have found their economic problems only exacerbated.

Africans reject the suggestion that they can be bought by either East or West. They wish to remain free to develop in their own way. However, the problems facing them are immense. Since the early 1970s the energy crisis has seriously affected those countries which do not have their own oil supplies, many of them among the poorest. The world recession has undercut export markets. Rising population, environmental degradation and falling production have moved the target of rising living standards further and further out of reach. Africans are themselves the first to recognise that mismanagement, faulty economic policies and corruption have also played their part. Several countries have had to contend with political instability and in some cases civil war.

The West is determined to assist Africa. We can only do this if we remain involved positively and practically and if we ensure that our help is applied in the most effective manner. But most of all, the future of Africa has to rest on the efforts of Africans themselves. The seriousness with which they are facing up to their own future has been demonstrated by the summit meeting of the Organisation of African Unity which has just met in Addis Ababa. What are Africans making of their future? What are we in Britain doing to help? Which way should we now go? In trying to answer these questions I should like to address 3 major problems which now face Africa: the drought and the ensuing famine which have been brought home to us in their full tragedy; the economic crisis, including the heavy burden of debt; and the political situation in Southern Africa.

DROUGHT AND FAMINE

As we all know a band of countries across sub-Saharan Africa are gravely affected by the drought which has held them in an increasingly tight grip for the past two years. This is a major international disaster, on an immense scale. Public attention in Britain has focussed on the famine in Ethiopia and the Sudan but at least three other countries - Chad, Mali and Niger - are also very seriously affected. As many as a dozen other countries in Africa also suffer from heavy reliance upon imports of food, for which they cannot always pay.

In the countries most seriously affected the number of people at risk totals about 20 million, including an estimated 8 million each in Ethiopia and the Sudan. The scale of the human suffering is cruel and devastating. In Britain and across the western world the television pictures - of pitiable conditions, of long lines of our fellow human beings waiting patiently for food and water, of the young and old struggling to keep alive - have had a dramatic impact.

The response to this crisis by the west - by members of the public, by voluntary agencies, by governments - and by international organisations has been very substantial and very swift. In Britain, the public have contributed with great generosity; well over £60 million has been freely given and that does not include the sum raised by the recent Live Aid concerts estimated at over £40 million. Most of this money is channelled through the highly effective voluntary agencies. The Government works in close partnership with them and places a large slice of our assistance through them. We will do all we can to help the agencies ensure that money donated will be used in the best way.

UK role

But what of the British government's response? While we have had to work within the limits of our own need to control public expenditure, we have provided very substantial resources towards dealing with the famine - both for short term relief and longer term needs. In the last financial year, to the end of March 1985, we spent £95 million on famine related operations in Africa. This year we expect to spend at least £70 million bilaterally and multilaterally.

It is not however just the quantity of our response which is significant but also its quality and effectiveness. I think we may also rightly claim to have done much to accelerate the European Community's response. The Community and its Member States, Britain included, are playing a major part in relief efforts in Africa. Generally shipments of grain and other supplies are now sufficient and concerted efforts are being made to distribute it as quickly and effectively as possible to those in need. Through the RAF Hercules in Ethiopia, where the RAF and army team have been doing such a marvellous job there since last November, and the more recent Save the Children Fund air charter in the Sudan, we are making a valuable contribution to the airlifting of supplies. But given the scale of the operations, greater attention must be paid to the effective distribution of supplies by surface routes. In Ethiopia, we have urged the Government to honour its pledge that food aid should reach all those in need throughout the country. We have been pressing the authorities to provide more trucks of their own to increase the off take from the ports and will continue to do so. For our part, we are providing trailers and contributing to the United Nations truck hire fund and we have of course just announced that we will continue the RAF operation until the end of December.

In the Sudan, where the distances to the West are so much greater, we are providing about 100 trucks and the funds to hire 50 more. We are also helping to rehabilitate the railway which should be the main life line. Such emergency assistance will be needed well into 1986 and we will play our part in providing it, through concerted international effort.

AID FOR DEVELOPMENT

The UK can also be justly proud of its major contribution to Africa's long term development.

- Over the last ten years our bilateral aid to Africa has totalled £1984m - nearly £2 billion - of which £1877m went to sub-Saharan countries.
- In 1984 alone we provided £266m of which £248m went to sub-Saharan countries, including £234m for long term development.
- We also make a substantial contribution through multilateral channels notably the European Development Fund through which the Lome Convention is implemented. Our shares of the Sixth EDF will be about £740m.
- We also strongly support the World Bank's recovery programme as a means towards solving Africa's long term problems.

This massive transfer of resources, which comes in the end from taxes paid by all our citizens, must be matched by the pursuit of appropriate economic policies on the part of recipients. It is sad that in countries suffering from drought and famine, internal strife and unsound policies can sometimes divert money, transport and fuel from developmental and humanitarian needs. It is also vital that aid should not distort traditional patterns of life; people must be enabled to go back to their land with assistance to plant their crops as soon as the conditions are right.

Agriculture is of course central. Too many African countries have become increasingly reliant on food imports over the past decade, absorbing scarce foreign exchange and depressing smallholder food production and incomes. Good land use is one priority; and we are helping to tackle environmental degradation by supporting forestry and soil and water conservation schemes in the dry areas of Kenya, Sudan and Ghana. Other problems have arisen with the introduction of cash crops where this has led to people losing their land for subsistence crops. But the main problem is not that cash crops have replaced food crops but that agricultural production has gone down in recent years. There is in Africa the capacity, the potential and the fertility to produce enough to eat and to export.

The Green Revolution has brought astonishing advances in many developing countries. In China grain production has risen by 30% (100 million tons) between 1979 and 1984. India has emerged from the terrible cycle of famine, and this year will be a net exporter of wheat. With perseverance the goal of food self sufficiency can be won. We believe that one of the key ingredients of success in agriculture must be better incentives for farmers to produce more, as the Chinese example has shown. That is what the World Bank, the IMF and other organisations all stress at present. This means not just higher prices but getting the basic infrastructure right: better research and extension services, more credit and improved distribution, marketing and storage arrangements. Parastatal marketing monopolies, with their high overhead cost and erratic service to farmers should face the discipline of competition in supplying farm inputs and in marketing produce. This may require some countries to change their policies and there will need to be some plain speaking between donors and recipients. In addition many countries will have to tackle the dauntingly high rate of population growth. The World Bank projections show that the population of the six countries worst affected by the drought is set to rise fourfold within the lifetime of many born today. Increases on this scale in these and other African countries will speed up desertification, vastly increase the number of poor needing to be fed in the towns, and so raise the risk of further famines.

I find it heartening that there is a growing consensus in Africa for the reforms that are needed. There have been a number of success stories here, and many in bilateral aid projects.

Success stories: reform

Ghana, for example, is heading this year for a substantial grain surplus, after desperately needing grain two years ago. Good rains helped, but also bold decisions on devaluation and higher agricultural prices. As I saw earlier this year, by taking timely and effective action to phase food imports and mobilise transport and distribution Kenya has been able to avert the worst effects of the drought. Zimbabwe has made a strong recovery after last year's harvest failure and has offered some of its current surplus to Ethiopia. Malawi, despite being among the least-developed, not only feeds itself but has surplus maize for export. These welcome developments give grounds for hope in the many other countries affected by drought and famine.

Success stories: Aid

Let me give a few examples of major British aid projects.

- A new road around the eastern side of Mount Kenya, the Thuchi-Nkubu road, was opened in March to complete the opening-up of the zone of cash crop production on the slopes of the mountain.
- The road between Songea and Makambako will be completed in November enabling a vast area of good agricultural potential in Southern Tanzania to have easier access to ports and markets.

For both these road projects we are of course thinking seriously about longer term maintenance arrangements and we shall look to fitting them into a coherent plan.

- In agriculture, we have been engaged for five years on an Integrated Rural Development Project in northern Zambia. A team of young Britons has worked with the local councils to strengthen rural development capability. The councils and the people themselves have built roads, bridges, wells, health centres and depots. The result has been a dramatic increase in maize production and the standard of living.
- In Zimbabwe we have given extensive support to the government's programme to resettle small farmers on land which commercial farmers left idle after the country became independent.

Life was very hard for the new farmers at first, but this year's rains have brought ample rewards for their efforts and those of the Zimbabwean agricultural and credit services who have been striving to help the farmers increase their production.

- Manpower aid is of prime importance in our African aid programme. Often we supply manpower in association with capital aid projects, including those I have mentioned. But most of our contribution is in seconded staff, experienced officers in the service of African governments whose salaries we supplement, or sometimes pay outright, and the growing band of zealous young - and not so young - people from VSO and the other volunteer agencies. The essence of our approach to developing the quality of management and administration in Africa is to improve the capacity of indigenous resources, using expatriates only where needed.

We have three main objectives in this:

- to concentrate on helping institutions and organisations which are critical to economic growth and development;
- to provide our manpower aid in packages, covering both personnel and training;
- and, having limited resources, to cooperate fully with the World Bank and other donors.

Another effective British contribution to economic development comes through the work of the Commonwealth Development Corporation which has played a significant role in Africa. At the end of last year, CDC's total commitments in Africa stood at £408m. £188m of this was committed to projects in the renewable natural resources field. 16 of the 31 projects to which CDC made commitments last year were in Africa. CDC makes a valuable contribution to food production in Africa. It pioneered the concept of a nucleus estate and outgrower schemes, which enabled farmers to produce cash crops for export , whilst still growing food for local consumption. In 1984 the CDC also promoted two substantial projects in Zambia and Zimbabwe aimed exclusively at providing food locally.

Another success has been the contribution of our military training teams in Zimbabwe and Uganda. The underlying purpose of this assistance, wherever we offer it, is to maintain or restore conditions of political stability without which economic development cannot take place. When I was in Harare earlier this year I heard nothing but praise for the British army personnel who have helped their counterparts to build the Zimbabwe National Army. Our military team in Jinja in Uganda is working to forge a well trained and disciplined cadre of officers and NCOs. Many of you who have read the recent appalling Amnesty International Report on Human Rights abuses and torture in Uganda will ask why we bother. I really do believe, however, that it is better to try and obtain concrete improvements in the security and human rights situations in Uganda, slow though these may be in coming, than to cut and run. Even so the allegations in the Report are shocking.

Malcolm Rifkind made plain to the Uganda High Commissioner on 25 June and thus to President Obote that there must be an improvement in human rights in Uganda, if we are to sustain our present assistance to that country. That is why we are glad that President Obote has invited Amnesty International to send a delegation to Uganda to investigate the alleged abuses described in Amnesty's Report.

DEBT

Debt remains one of the most serious and pervasive problems facing African countries. Latin American debt problems often get more publicity because they are in money terms much greater: at about $100bn total sub-Saharan African debt is about the same as Brazil's or Mexico's. But this masks the magnitude of the problem facing individual sub-Saharan African countries whose average GNP per capita is less than a third of Brazil's and Mexico's, and whose debts are often long term and if anything more intractable. Whereas most Latin American debt is owed to commercial banks, with the exception of Nigeria most sub-Saharan African debt is to official creditors either for export credits or aid loans and to multilateral organisations. With few exceptions the potential export earnings of African countries are less than those in Latin America. Therefore although the same broad principles apply, we have to consider case by case the circumstances and needs of individual African debtors.

Strategy on Debt

There are no easy solutions to the debt problem, but there is a strategy.

- First, it is vital to establish the right international economic environment, and this is mainly the duty of the developed countries. Essentially it means sustaining recovery in the world economy, and maintaining the open trading system; this will give debtor countries the chance to export and grow, and British firms the challenge of competing in expanding markets. The new GATT round will be an important opportunity to roll back trade barriers. High interest rates must be reduced, and we have been encouraged by recent falls in US rates. But it is essential that the US Government takes positive measures to reduce its budget deficit to ensure further reductions in interest rates.
- Second, action by the debtors themselves. African countries will only be able to make the best of opportunities offered by world economic growth if their own economies are sound. Structural imbalances which have grown up over years cannot be put right overnight. Measures to cut bureaucracy, reduce budget deficits, devalue currencies, and increase producer prices can have painful side effects, but without them many countries will not have the chance to restore economic growth and credit worthiness.

And these, together with the adoption of appropriate promotion and protection agreements are a pre-requisite for attracting further inward investment. The longer reforms are delayed the more painful they become.

It is encouraging that some countries have lately been persuaded of the merits of fostering a competitive environment for business with less tariff protection, fewer state monopolies and more incentives for investment. State enterprises, for long a drain on budgets and on bank liquidity are being selectively privatised or revitalised along commercial lines.

IMF: Role in reform

Can outsiders help? Yes. Most countries need guidance on recovery programmes, and the IMF and IBRD are best placed to provide it. Some African leaders have been critical of the IMF; President Nyerere was when he spoke here recently. Of course the IMF does not always get it right: nobody does. Critics should bear in mind that the real purpose of IMF assistance is to provide the necessary Balance of Payments support while the country takes the steps required to achieve a viable external sector position. As such it is the best source of technical advice available. It does not make sense for the IMF so to dilute its advice that it will be ineffective. Nor do they provide blanket advice; they do take into account individual country problems. Conditions are not imposed they are negotiated.

Creditors' usual requirement that an IMF programme is in place is not purely for doctrinaire reasons: it helps to give assurance that the right policies are being pursued to ensure long term economic growth which must be in the best interests of creditors and debtors alike. Countries have to earn foreign exchange, but this does not have to mean cash crops displacing food crop production: a healthy cash crop sector is often accompanied by increased food production. Although some IMF programmes have not met all their targets, the reasons are diverse, and both external and internal. Notwithstanding such problems a number of countries particularly in West Africa have made good progress and got to grips with adjustment programmes. But it will be a long term task for most. The IDA has a major role to play in Africa, both as a provider of much needed finance on very concessional terms and of detailed guidance on economic management and public institutions. The new World Bank Special Facility for Africa is of particular importance in providing funds to help countries tackle their structural problems. We have agreed to provide £75m of our bilateral programmes in association with this; and have already announced our first intended commitment of £10m to Zambia.

Direct assistance with debt

This brings me on to the third strand, which is what direct assistance can be provided to help individual countries' debt problems. We do not believe simply writing off all debts is the answer, not least because without adjustment, developing country economies would be ill-equipped to use the extra resources. Like other creditors we believe in tackling the problem on a case by case basis: each country's problems are different.

UK Role

There is a need for rescheduling, some debt cancellations for the poorest, and for new money. We are helping in all of these areas:

- With other creditors, we reschedule official debts through the Paris Club. Since January 1980 there have been 32 Paris Club reschedulings of official debt for 14 African countries. The terms are generous, even going as far as rescheduling 100% of principal and interest. We have written off the aid debt of 13 African countries totalling about £262m.
- All new aid to countries with an annual per capita income of less than $790m is provided on grant terms.
- From our bilateral aid programme in 1984 we provided £266m to 47 countries in Africa including relief aid. This was 40% of all our bilateral aid.
- We have agreed to provide £401.5m to IDA7 and £740m to EDF VI. About 35% of IDA7 and 90% of EDF VI will go to sub-Saharan Africa. It is

worth recalling that in providing this aid there are substantial returns to British industry: in 1984 about 74% of our bilateral aid was spent on British goods and services.

If these are the main parts of the strategy they are by no means all. We are always ready to talk constructively about debt issues and look for new ways to handle the problem. Multiyear Rescheduling Arrangements, increased direct investment, and the Multilateral Investment Guarantee Agency are only three of the possible ways.

Is the strategy working? Precise measurement is difficult. It is of course impossible to say how countries would have performed without outside assistance. However such general evidence as is available from IMF/IBRD suggests that countries following IMF prescriptions have benefited. Average economic growth in 34 countries, including 16 in Africa, with IMF Standby Arrangements is expected to be about 4% this year. Their imports are expected to be 10% up in dollar terms. This trend is encouraging. Renewed economic growth in African countries is vital to British industry. Our exports to sub-Saharan Africa declined from £3.29bn in 1980 to £2.72bn in 1983, rising slightly to £2.93bn in 1984. Effective management of the debt problem is essential to re-establish growth in the African market.

SOUTHERN AFRICA

It is tragic that recent years should have brought such serious economic difficulties to Africa. As I have said, many governments are tackling them with resolve, especially where there is a firm basis of internal stability. But some serious political problems remain. Most of these are for Africans to solve with the support and encouragement of their friends. But the problems of Southern Africa stand apart. The raids by South African forces, including that into Botswana in June, and the mounting violence in South Africa itself, underline the urgent need for progress on these problems.

It is easy to forget in the face of such outrages that Southern Africa as a whole has seen major changes in the last ten years: the independence of Mozambique and Angola in 1975; the independence of Zimbabwe in 1980; and the Nkomati Accord in 1984. Britain has played a part and we do not intend to opt out. We have watched with great sympathy Mozambique's struggle to overcome threats to stability. We have increased our aid and recently we have agreed, in conjunction with the Government of Zimbabwe, to give military training to selected members of the Mozambican Army within Zimbabwe.

SOUTH AFRICA

Within South Africa there is much of real value which South Africa inherited from its links with Western Europe - a body of law, a legal system, a constitutionally based administration, and a significant role for the press. It is this which needs to be strengthened for the future. South Africa's developed economy could contribute much to the health of the region. Yet so much of what could be intrinsically good is shared on a basis of grotesque inequality.

Let there be no doubt about our abhorrence of apartheid and all the repressive measures used to enforce it. Apartheid is unacceptable, unworkable and indefensible. It is contrary to all British and Commonwealth values. It is given added repugnance by the existence side by side of two communities - a ruling minority and a majority deprived of power - between whom the inequalities, in terms of material possessions, education and expectations are vast. Most repugnant of all is the fact that these inequalities are built upon foundations of racial discrimination.

It is just because we condemn apartheid so strongly that our efforts to promote change in South Africa through continuing involvement in that country are not always understood.

I hope it will be clear from what I have said that our differences are about means rather than ends. We have been following closely the debate on selective economic sanctions in the United States and in other Western countries. Every new outrage in South Africa gives those who press for such measures further ammunition. Western governments certainly ask themselves seriously whether such measures offer the right approach, whether their existing policies have failed so badly that they should abandon them and, in effect, disengage in any constructive sense from the problems. Frankly I do not believe this would be right. We remain firmly opposed to economic sanctions of any kind.

- Sanctions against Rhodesia served to strengthen parts of the white business sector at the expense of blacks. The South African economy is much stronger and more diversified than was Rhodesia's. It would undoubtedly adapt to sanctions.

- The effects of economic measures would of course be felt most keenly by black South Africans. They would also affect the economies of South Africa's neighbours even if the latter did not formally participate in the sanctions policy.

- We oppose sanctions because we believe that economic growth in South Africa offers the most likely route for peaceful political change. We should be looking for ways of strengthening these internal economic forces, especially the growing economic power of the black community; the black trade union movement, and the facilities for training and education of blacks. The application of sanctions would mean an end to all these activities.

As Mrs Helen Suzman remarked recently in Luxembourg, sanctions would in fact "blunt the only weapon that blacks have ... . - the economic muscle that accompanies upward mobility on the ladder by virtue of greater skills and increased consumer power". Alan Paton, too, has argued very recently that his conscience would not allow him to support disinvestment, since in his view those who would pay most grievously for it would be the black workers of South Africa.

I believe that we have been right to draw attention to those reforms that were until recently beginning to emerge. We have emphasised that they were only a small beginning. The lot of some black South Africans had in some respects begun to improve. But the fundamental reforms which we all seek have still not been taken in hand. And tragically such changes as have taken place have been accompanied by repression in its ugliest form. The South African Government's call earlier this year for a dialogue with black South Africans has been flatly contradicted - and indeed frustrated - by the arrest of many of those whom black South Africans regard as leaders. And the State of Emergency declared over the weekend will add to the growing numbers who languish in detention without any legal recourse.

What must be done? The State of Emergency sharply underlines the urgent need to redress fundamental grievances. The South African Government should be in no doubt of our strong conviction that their society must evolve in a way which will provide a system of government which commands the support of the people of South Africa as a whole. It is not for us to prescribe cut-and-dried solutions. The most urgent priority is action, and action of a convincing and effective kind, to create a climate of confidence which will permit a real dialogue with the genuine leaders of the black community, whom blacks must be permitted to choose. The dialogue cannot avoid the fundamental question of the political aspiration of blacks. And the dialogue must be seriously meant and tenaciously pursued. This requires bold steps by the South African Government.

- the unconditional release of Nelson Mandela and other acknowledged political leaders;
- an end to forced removals;
- an end to detention without trial;
- an early end to the State of Emergency;
- the progressive abolition of discriminatory legislation such as the pass laws and the Group Areas Act;
- a commitment to some form of common citizenship for all South Africans.

I am sure that all those who are working for peaceful evolutionary change in South Africa know that an outcome must be found whereby white South Africans are guaranteed their rightful place, but not more than their rightful place, in any future South African political system.

British and other foreign companies in South Africa cannot expect to continue their activities there as though they were in a political vacuum. Many, indeed most, accept their responsibilities willingly. They play constructive and positive roles.

Apartheid is abhorrent in moral and social terms. Beyond that, the practical effects of apartheid hold back South Africa's economic growth potential, based on her vast natural resources, which could contribute much more to the welfare of all her peoples.

The private sector must continue challenging these conditions, which impede its own success as much as they are socially unjust. The EC Code of Conduct can play a very important part in that respect. For it is clear that the further economic development of South Africa will hasten the collapse of apartheid. The commitment to the ending of job reservation, and the acceptance of blacks as permanent residents in the urban areas are evidence of this. There is considerable scope for further initiative by British companies: community works, social welfare of their employees, equal opportunities. And the private sector must play a full part in the broader political life of South Africa, condemning repression and working for peaceful change.

NAMIBIA

I turn now to another issue which is of great concern to the British Government. The settlement of the Namibia problem is long overdue. Namibia needs a truly independent and representative government. This is not only in the best interests of Namibians themselves. Greater stability and an end to cross-border violence is clearly in Western interests too. The world cannot wait for ever while South Africa delays. The South African Government should be in no doubt of the responsibility it bears for its unlawful occupation of Namibia. Nor should it believe that the world will accept the unilateral establishment of an interim administration. Such measures have no status whatsoever under the UN settlement plan.

CROSS BORDER VIOLENCE

There must be an end, once and for all, to the sort of violence we saw recently in Gaborone. The UK is no stranger to terrorism and condemns without qualification violence by the ANC or anybody else who employes it in the course of seeking political change, inside, or outside, South Africa. But nothing can justify the actions which this regional superpower has been prepared to mount against its weaker neighbours. If there is to be any prospect of stability and economic recovery in the region, actions of this kind must cease.

I have explained what I consider needs to be done to solve these complex and deeply worrying problems:

- to secure the independence of Namibia in accordance with SCR 435;
- to press ahead with the changes that are needed to bring apartheid to an end;
- and to prevent a recurrence of the recent attack on Gaborone and the shootings at Uitenhage.

Our approach is shared by our Partners in the European Community. Foreign Ministers of the Ten yesterday issued an important statement about the situation in Southern Africa which reflects very closely the policies which I have just described.

The only course of action consistent with our values and our record is to do what we have done elsewhere - over the major problems of debt, drought and famine: to remain closely and continuously involved and to work for positive, peaceful change. I can assure you - and this is my main message to you today - that the British Government will remain energetically and actively involved in pressing for solutions to all these problems, and in particular in pressing for the establishment of genuine, multi-racial democracy in South Africa.

CONCLUSION

Neither we nor Africa can turn the clock back to 1960 and begin again. There have been successes as well as the tragedies. Africa still faces a hard, uphill grind. We in Britain will play our part. Through history, through human ties, through the Commonwealth and now also through the European Community, Britain is linked to Africa and its problems by common interests and shared aspirations. The ideas which Harold Macmillan so eloquently stated in 1960 must not be allowed to perish in the harsher world of today.