S E C R E T

IMF Negotiations: Some Problems and Parameters

1. This memorandum flows from an earlier one on the nature of and possible responses to IMF's "Arithmetic" paper (1 + 9 = 2; 5 - 3 = 4 variety!) prepared for the BOT at the request of the Gavana.

2. It is obviously critical to secure an agreement with the IMF:

   a. a substantial series of drawings over three years is the only way to reduce the accumulated commercial and debt service arrears significantly this side of 1990. These arrears threaten further supplier credits and aid flows and raise the cost of imports substantially (probably by 20-30% on 'open book' and other non-confirmed credit and now that we have 'defaulted' on confirmed letters of credit probably by an average of 5 - 10% on these). The annual present cost on imports may well be Sh.300 million, the present loss of aid/credits Sh.250 million and the risk of esculation high;

   b. without an IMF Agreement we cannot hope to get a World Bank SAP credit (Structural Adjustment Programme) for industrial, agricultural, transport operating inputs and spares;

   c. similarly without either an IMF agreement or (less certain to work out for us) a clear case of our being reasonable (ie. a Tanzanian "last offer" we can publish with explanation to demonstrate our reasonableness and IMF's unreasonableness) we cannot achieve either more bilateral aid or (even more critical) a shift in makeup of a substantial share of present grants/loans from project to import support (ie. from building new capital stock we cannot operate to raising production from and maintenance/rehabilitation of what we have;

   d. unless we can get more FOREX useable for operating inputs/spares, the present loss of over $1,000 million a year including over 50% of industrial output at 60% capacity utilisation (we could physically manage 70%) and 10-20% on exports as well as some domestic market agriculture (not grown because unmoveable or 'lost' through bad transport,storage) and services will not merely continue but get worse. It is already a loss of perhaps 20% of our potential national output. My guess is that we need $250 million a year for 3 years to restore that loss:

i) $75 million reallocation of aid use (requiring donor cooperation);

ii) $50 million gain on better allocation of our own FOREX;

iii) $25 million (year 1) to $75 million increased exports (rises as rehabilitation proceeds);

iv) $100 million (year 1) to $50 million (year 3) increased aid (falls as (iii) rises).

(These calculations are orders of magnitude not precise numbers. They exclude financing of critical export increasing or bottleneck breaking projects such as Kilamco and Mtera. If anything they are optimistic - so much maintenance has been deferred and now 'converted' by time into rehabilitation or reconstruction that cost could be up to 33-40% higher.);

e. without an IMF agreement (i) and (iv) are impossible and the building of (iii) is also unattainable;

f. time is not on our side. As in late 1979 I must say we have only a few months left. (We raised our margin in 1980, lost some ground in 1981 and have lost more in 1982. While the November position was on the surface slightly better than April, the underlying FOREX constraints and crisis were worse as was real purchasing power of wage - salary - small self employed groups.) Because it will take time to turn an IMF Agreement into bilateral aid increases/ makeup shifts (let alone into a Bank SAP credit) and more time to get the credits turned into goods arriving,I believe March 1983 is the latest possible date for an agreement if we are to avoid a series of economic breakdowns making late 1983 as much worse than late 1982, as late 1982 was than late 1977. The latest 'safe' date is January 1983.

3. But we cannot agree to the IMF's present proposals:

a. they are technically unsound;

b. they require a complete abandonment of all CCM's principles;

c. if 'successful' they would immiserize the urban population;

d. in practice given a, b and c there would be some type of collapse on both social and political (as well as economic) fronts.

Therefore, agreement on present terms would be just as fatal (probably just as quickly) as no agreement. What is on offer is not even 'to sell our birthright for a mess of pottage' because the supposed pottage is a mix of sand, seawater and arsenic.

4. Therefore we must have a 'counterprogramme' of our own which has a real chance of being sold to IMF and if IMF remains fanatical can be sold to bilateral community as proving we are reasonable, IMF not reasonable. To date we have not done so.

   a. SAP is not really adequate (per my September memo) - especially in relation to short term crisis;

   b. over May-September we do not appear to have arrived at a coherent articulated position based on Hazina - BOT - Mipango consensus convincing and acceptable to highest levels;

   c. in October the Party Congress made serious negotiation/consultation by our side with its principals impossible. But also we had no clear initial proposals of our own - which we should have had after May and September talks with Woodhead and Co. (plus presumably 'upper reaches' of Fund in Toronto).

   I am not concerned with casting blame (as an adviser I am part of the process which is failing to produce a clear Tanzania position, let alone an agreement!). What is needed is to get our act together now in a way which we can realistically bargain from and win an acceptable solution (Inshallah! I mean that seriously not blasphemously.)

5. The balance of this memo is organised:

   a. IMF Proposals - Problems of Principle;

   b. - Problems of 'Arithmetic';

   c. - Problems of Technical Formulation;

   d. Possible Tanzania Proposals

   e. A Note on "Paris Club" (debt rescheduling) idea.

6. FOREX (reallocation, targets for 1982) will be covered in a separate, subsequent memo. An earlier version has been prepared for Hazina/BOT and a narrower, more detailed one on Manufacturing for Ministry of Industries. This is both to limit length of this memo, because FOREX allocation/procurement issues are far from identical with IMF ones, because IMF drawings alone <u>cannot solve</u> FOREX problem, only make it potentially more soluble,and because 1983 FOREX targets/rough allocations must be begun - and probably set in operation - <u>before</u> we can realistically hope to know outcome of IMF negotiations.

7. <u>Problems of Principle</u>

   a. <u>Level of exchange rate</u>. TSh.25 = $1 is <u>absurd</u> (as interestingly the World Bank agrees even if "off the record" - can we get them to say it "on the record" or at least let IMF know we know Bank disagrees with them). Its impacts on inflation, income distribution, degree of profiteering, corruption would be appalling and there is <u>no</u> reason to believe it would reduce the Government or the Crop Authority deficits <u>because</u> of the mega inflation it would trigger. (<u>Note</u> - devaluation itself is <u>not</u> a matter of principle but of dialogue on timing, extent.);

   b. <u>level of interest rate</u> may or may not be a matter of principle - ie. marginal changes are negotiable (albeit they are also useless in addition to not being very harmful) <u>but</u> a doubling of rates would be inflationary <u>and</u> would <u>increase</u> Government and Crop Authority deficits;

   c. <u>grower price increases</u> cannot be of order IMF seeks 25-50% in <u>real terms</u> because to achieve this would require <u>40-50% cut</u> in purchasing power of minimum wage earners and small self-employed as well as of salary earners;

   d. <u>wages</u> cannot be held to a 15% increase in 1983 <u>even without</u> a major devaluation; a 30% real fall in 1982 cannot be followed by another major fall in 1983 without disaster in immiserisation, social and stability terms. (IMF is in fact proposing 15% wage increase in a package that would result in 100-150% inflation.);

   e. <u>food subsidies</u> cannot be eliminated at a stroke of a pen - 200% increase (to Sh.7.50) in scale price as IMF proposes (actually more like Sh.10.00 on realistic projections of package) combined with 15% minimum wage increase is a recipe for massive malnutrition. (Reducing - at least in real terms - the subsidy, seeking to phase out over several years, restructuring from sembe to cassava/millet are not matters of principle - we should want to do them IMF or no IMF.);

f. price control abolition in a context of hyperinflation and no increase in availability of goods (the IMF package) is lunacy. It will raise parallel marketeering/profiteering (and thus evasion of tax) drastically while also making it "respectable".

This is, I admit, a somewhat daunting list of areas of basic divergence.

8. Problems of Arithmetic

a. The IMF (apparently on basis of World Bank on agriculture) wants 25% (domestic food) and 50% (export) grower price increases. It also wants reduced Crop Authority and Government Deficits and an end to food subsidies. If one assumes that prices of food crops with no fixed prices and parallel marketed crops with prices fairly near official levels (eg. all peasant rice) rose similarly - a plausible assumption - then real wages, salaries, incomes of small scale self-employed must fall by 50%. (Detailed numerical presentation is in earlier memo to Gavana/PST if desired.) This is patently unacceptable. IMF simply did not do the calculation.

b. The IMF estimate of inflation after $1 = TSh.25 of 40% is absurd. The 1981 Exchange Rate study is out of date on overvaluation but its estimate of how devaluation would affect inflation remains the the best there is. (I did not do that bit. IMF Research Department privately agrees with it.) On that basis 165% increase in Sh. value of $ would lead to an increase in inflation over 12 months of 100-125% added on to a base level of 30% = 130 to 155%. Because hyperinflation of that order causes total loss of confidence in money it is very hard to haul down so 100-150% a year inflation for a decade would be likely. (IMF claim that most goods are sold on parallel market is untrue. Further much of COL basket is actually bought. Finally with no increase in goods available I see no reason to expect end of profiteering. Making unreasonably high offset for prices being higher/rising faster than COL lowest plausible range is 100-125%. Note, to get the 50% cut in real wages/salaries/urban small scale self-employed incomes the IMF proposals require with their 15% wage increase would require 130% inflation because 115% - new nominal wage - divided by 230 - new price index - equals 50 - new reduced real wage. This 130% figure is within the range of my estimates and quite unlike IMF's 40%.);

c. the IMF's claim that enterprise sector would not need more overdraft is also rubbish. The imported element in inventories would rise 165% in cost for same volume very quickly. The local goods and the receivables would rise with inflation rate - say 130% - over a year for same volume of real business. This might average, say, 140%. There would be no increase in the initial one third (a rough average) of inventory financed by net worth. Therefore, at first calculation overdraft would need to rise about 200% (ie. 100-33 = 67 to 240-33 = 207). True, cash flow (profits plus depreciation less replacement of fixed assets) from operations would rise but that at best would reduce required additional overdraft to 140% (ie. restore one third net worth element in total). A nil increase would cause a sharp fall in real output if enforced;

d. food subsidy eradication would not require 200% increase to Sh. 7.50 but 300% to Sh.10.00 odd. (IMF has simply not got grain price nor other cost increases right even on 40% domestic inflation, 25% increase in real grower price, 150% increase in transport cost - largely import cost - basis. Details in earlier memo to Gavana/PST.);

e. Given likely inflation (and assuming the Government paid the doubled interest rates on new borrowing - which IMF 'forgot' in their budget 'arithmetic'!) it is very doubtful that the Budget deficit would fall even in real terms and would certainly rise in T Shilling terms. Nor would the real deficits of Crop Authorities fall given the high fuel/transport components in their cost structures and the 155% (food) and 180% (export) crop nominal ground price increases (to give 25% and 50% real). Shilling deficits would grow.

f. Evidently 'my' arithmetic model:

i) 130% inflation;

ii) 25-50% real increase farmer cash incomes;

iii) 50% real decrease wage/salary/small self-employed incomes plus

iv) loss from real output fall forced by constant nominal overdraft;

v) 15% nominal wage increase;

vi) basically unchanged real and 115 - 125% higher T Shilling Government/Crop Authority deficits

would not happen. The point is that on correct arithmetic it is what IMF proposals require/imply. To attempt it would lead to quite major collapses, breakdowns, profiteering etc. which render projection of actual outcome unreal. (It would not be Zaire or Uganda unless there was a coup but it would have a much closer resemblance to them or to Mathare Valley than to Tanzania today.)

9. Problems - Technical

a. Getting the arrears base right. IMF sets reduction target on known level at some point before Letter of Intent. By time of disbursement they have risen for trend and overhand reasons. This was initial cause of 1980 Programme breakdown;

b. Government bank borrowing level and timing (basic cause of 1980 Programme termination) is very hard to estimate. Because revenue base deteriorates until we get more FOREX (and improve allocation) the initial Estimates deficit will be exceeded and quarterly pattern will be different (higher in 3rd and 4th quarters than normal);

c. Total bank credit limit must - in addition to government element - include an element for business overdraft increase needed to operate at same level of real output and achieve a modest real increase in output (there is no purpose in signing a letter of intent requiring that we do not raise output!) which present IMF proposals notably fail to do. Here too timing will be abnormal because of devaluation impact and lagged restoration of import (and thus inventory) pipeline;

d. future foreign exchange receipt projections must be realistic. We must not again include a SAP credit which is not signed, nor put in optimistic increases in bilateral assistance, nor agree to far too optimistic projections of export (high) and import (low) prices - all of which we did in 1980. One way to close gaps on paper is to fudge estimates this way but in operation this simply leads to a breakdown of the agreement (as in 1980).

10. Proposals for a Tanzanian Programme

Given the previous three paragraphs the reader may well think I have proved there is no chance of agreement. But given the paper's opening paragraphs it is also necessary to have the best go we can with our minds concentrated on getting a negotiable package without destroying Tanzania.

a. Exchange Rate

i) 10% devaluation at once. This would add credibility to our claim;we can and will have small devaluations regularly to reduce overvaluation while avoiding shock and inflationary impact of jumbo devaluations;

ii) willingness to devalue 10-15% more on presentation of Programme to IMF Board (ie. agree per cent and do it day before it goes to Board not an uncertain length of time before). This would take T Sh. to 12 to 12.5 to $ (from 8.6 odd in February) which is demonstrably a significant adjustment. (I consider this too much. I would advise the 10% now IMF or no IMF but not another before more FOREX could lead to more goods, ie. 6 months after effective date. But I don't believe we can get that and advise conceeding another 10-15% if necessary to get agreement.) It is a position the World Bank, the present US Ambassador, at least many businessmen and - I think - the Nordic Governments would see as reasonable if combined with;

iii) a <u>commitment</u> to:

- 10% devaluation 5 to 7 months after effective date (Sh.13.3 to 14 to $);
- 10% devaluation 11 to 13 months after effective date (Sh.14.8 to 15.6 to $);
- review position 12 months after effective date and indicate intended policy (whether and if so probable magnitude, timing of future exchange rate changes).

(Earlier memo to Gavana and my September memo make case in more detail. I have slightly revised timing and components but proposed result in March 1984 odd is the same.)

b. <u>Interest Rates</u>

i)	Raise Overdraft Rate	1%
ii)	Government Security Rates	½ to 1%
iii)	Savings/Term Deposit Rate	½ to 1% (and POSB rate)
iv)	Long Term Loan Rates	2 to 3%.

(iv. is higher because rates of 10-14% for fixed assets are <u>not</u> high given any reasonable calculation of 1983-88 inflation rates. And this increase does not have massive inflationary impact overdraft as government borrowing increases would have.)
These changes would not do much good or harm (except iv. which I would advise IMF or no IMF). They would seem worth proposing to make a saleable package.

c. <u>Grower Prices</u> increases for 1983 should <u>not</u> be changed. We cannot get FOREX in time to raise real goods available nor will March price increases raise June-August harvests. All that would rise would be inflation. We should state intent to raise grower prices in general by rate of inflation or slightly above for 1984. (We could conceed a nominal - 10% - 1983 increase on effective date but this will only cause inflation so should be conceeded only to avoid collapse of negotiations.)

d. Wages requires a flat statement that 1983 wage increases (given that there were none in 1982) will be 2/3 to 4/5 of 1982/83 inflation rate for minimum wage tapering down to say ½ for salaries and that for 1984 target would be increases of same ratio to 1983/84 inflation. (This will work only if the Programme - SAP - etc. do result in decline of inflation from late 1983.)

e. Food Subsidies propose to keep sembe subsidy constant in nominal terms (real reduction) and raise consumer price as necessary to achieve that. Also indicate intent:

i) to continue phasing real (and if possible nominal subsidy) down;

ii) shift subsidy from sembe alone to sembe - millet - cassava (not increasing total amount) so price of latter two to consumers is below that of sembe. (We should do this IMF or no IMF.)

f. Price Controls are now limited to a small number of items. To reduce to one 'type' per product category would either require: (a) enforcing physically production of that 'type' or (b) letting producer shift to different type ending price controls. We should state:

i) we have cut down to minimum and will not go further at this time;

ii) we do and will continue to allow cost increases (including those reasonably estimated for coming year) to be included in controlled prices;

iii) if we get FOREX to increase capacity utilisation unit costs will fall from spreading overheads with dramatic positive result on profitability.

11. I advise that all of these proposals (except a. - ii and note to c. on 10% increase) should be considered and if agreed (and with modifications, additions, deletions) written up as a package we present to IMF at start of next negotiations making plain:

a. this has been analysed, discussed, approved;
b. it represents a drastic austerity programme;
c. only marginal further steps can be considered.

Tactically I am not sure next negotiations should be in Dar. A round in Washington led by Ag.MF might be better (if he had a clear negotiating mandate) because Woodward would have to consult his principals at once and in practice allow some direct contact with Zulu/Larossiere. Wherever the negotiations are the earlier the better - realistically (if we are to have a firm negotiating mandate) January 15 or 20.

12. Technical Requirements

These are not matters of principle or policy. But they are vital if the programme is to be workable in practice. If they are once again blurred (as in 1980) we will once again trip the trigger clauses (and the gun in question if pointed at our heads!).

A. Arrears Base/Reduction

i. have December 31, 1982 arrears total for January negotiations;
ii. have Letter of Intent show estimated level of arrears as of proposed date of IMF Board decision - that is "i" plus additional arrears accrued, estimated overhang;
iii. agree to reduction targets (triggers)on basis of using ½ of IMF drawings for that purpose;
iv. do commit ourselves to wiping out government debt service arrears ($30 million) within 6 months of effective date and to prevent their recurrence.

B. Government Deficit

i. For 1982/83 a pessimistic (but not apocalyptic!) estimate, ie above Budgeted figure;
ii. initially December 31, 1982 base but insist increases allowed (triggers) apply to actual Government Bank borrowing as of Effective Date;
iii. pay all the domestic bills we can (ie reduce overhang and bring Treasury subsidy and transfer payments forward) before date of presentation to IMF Board to maximise actual base per "ii" and reduce deficit for rest of 1982/83. (Do not tell IMF this is to be done.).
iv. produce a conservative (not apocalyptic) 1983/84 government borrowing requirement and stick to it. Do not fudge it by 'agreeing' to unattainable expenditure cut, aid increase or tax

boost targets. (Presumably some of cuts/boosts Hazina is now considering will be approved - at least in principle - in time to be stated roughly in terms of intent and seriousness). Make clear that Budget 1983/84 target Bank Borrowing will be lower than trigger clause levels;

v. insist for 1983/84 that the quarterly maximum borrowing be:
   a. end of first quarter 50%
   b. end of second quarter 75%
   c. end of third quarter 80%
   d. end of fourth quarter 100%

because first normally cash flow is highly negative first half year, near balance third quarter, in deficit fourth and second in 1983/84 recovery in manufacturing and therefore government revenue will bunch in second half of the year.

C. Total Bank lending must be calculated:

i. Initially December 31, 1982 base but actual base to be level on effective date;

ii. Amount to business must include allowance for increase in overdraft necessary to do business at same real level plus for 1983/84 a 5% recovery in level of activity. This needs to be computed with care. I'd guess March 1983 - June 1983 - a) seasonal upswing 15%, b) same real volume 20-25%, c) 5% recovery 5% = 25-30%.

iii. seasonal element must be included in quarterly totals:
   a. end of first quarter (July-September) - 40%
      (seasonal crop marketing)
   b. end of second quarter (Oct-December) - 60%
   c. end of third quarter (Jan-March) - 70%
   d. end of fourth quarter (April-June) - 100%

(The total bank credit results from adding B-V and C-iii).

D. Foreign Exchange Receipts/Expenditure

i. 1982/83 should include pessimistic view export earnings (try to get hard estimates on main items) plus moderate realistic cash flow from committed and in force aid and no more. Do not include large net service income as that depends on Zambia actually paying. (Concede IMF drawings less arrears reduction if necessary but try to keep it as contingency;

ii. 1983/84 is 'rather' hard to do. Exports as for 1982/83. Aid must be conservative view (don't now agree to include SAP) on both amount and how much shifted from project to payments support.

iii. 1982/83 imports should assume levels allowing halt to decline in output and pipeline building to allow 83/84 recovery. Here must allow full devaluation impact (IMF will see you do on exports/aid!);

iv. 1983/84 is almost impossible to do as it really depends on how much new aid and how much useable in payments support.

v. Short Term Borrowing ceiling can be low - say $25 million - on Under 5 Year net borrowing but on 5-10 Year must not be so low as to prevent Kilamco which requires £500 million odd 10 to 11 year borrowing. (IMF favourably disposed to Kilamco.).

13. These technical issues must be fought as hard as those of Para 11 or Programme will be unworkable. Again a clear preagreed (here basically BOT-Hazina-Mipango) position is needed on paper as negotiating position to begin next round. Again:

i. indicate this is reasoned analysis;

ii. represents austerity;

iii. must have some margin for error as all the projections (especially 1983/84) cannot be certain;

iv. very little room for amending figures now. Could agree to review in August 1983 after better picture on 1983-84 aid levels and makeup and March-June 1982 results.

14. Programme Amount/Timing/Use

We should seek:

i. $400 million over 3 years (or as fallback $250 million over 15 months);

ii. Phasing by quarter:

	3 year		15 month	
March '83	75		75	
June '83	50		50	
September '83	40		50	
December '83	35	(200)	40	
March '84	35		35	(250)
June '84	35			
September '84	30			
December '84	25	(325)		
March '85	20			
June '85	20			
September '85	20			
December '85	15	(400)		

iii. Agree to use ½ of each drawing for arrears reduction. If - as I believe - Government debt service arrears are about $30 million we can clear that with ½ of first drawing. Basically arrears (on 3 year Programme) would be:

Feb.	28	1983	(Commercial	320	
			(Government	30	350
May	31	1983	Commercial		312½
August	31	1983	Commercial		287½
November	31	1983	Commercial		267½
November	31	1984	Commercial		200
December	2	1985	Commercial		150

(This is too slow but to have any leeway in use of IMF FOREX we can do no better out of that source. Only an export increase - or a windfall price gain - can allow significantly more rapid reduction.).

N.B. - Interest on IMF drawings must be included in FOREX use projections! (All calculations here are in $ to avoid confusion from changing - and uncertain - exchange rate.).

15. Debt rescheduling via "Paris Club" taks has been discussed (as well as, I believe, seeking merchant bank advice on the subject).

16. I very much doubt the desirability either of taking such action or of allowing rumours that we intend to do so to build up. (They are now common gossip on the business and diplomatic circuits.).

a. there are very limited gains;

b. there are substantial costs and delays;

c. the mere knowledge (or rumour) that we are considering has costs.

17. The gains are low because:

    a. the greatest debt problem is the arrears which cannot be "Paris Club" rescheduled. (If we could get states of companies to which they are owed to discuss a 2 + 8 year loan at 9% that might be worth doing. But I am doubtful this is achievable and it would not be "Paris Club"!)
    b. of our debt service proper over next few years up to half is World Bank. The WB never reschedules. (What we could try is to use heavy debt service to WB as an argument for balance of payment support SAP loans of comparable amount.).
    c. a substantial further portion is (on projections) to China. Chinese debt payments may well be rescheduleable but not via "Paris Club" - bilaterally (or trilaterally counting Zambia) with China.
    d. perhaps one fifth of the debt service, largely supplier credits is rescheduleable, ie perhaps $25-30 million a year saving for perhaps 2 years.

18. The costs of rescheduling include:

    a. interminable negotiations eating up top level BOT/Hazina time better deployed elsewhere;
    b. uncertainty/unwillingness to lend during negotiations;
    c. higher interest (on rescheduled principal, rescheduled interest - if rescheduling of interest allowed at all and arrears of principal/interest). Assuming we got a 2 year interest and principal grace period then the cost thereafter might average $15 million a year for 8 years - a total net cost of $60-70 million.

19. The knowledge/rumour is hurting us:

    a. nobody wants to loan now and be caught up in rescheduling;
    b. even though Kilamco is being set up with special escrow provisions to separate it from other supplier credit, the rumour that "Tanzania is going to Paris Club" is seriously embrangling negotiations.

20. I have no doubt a merchant banker might evaluate it differently.

    a. he would place greater value on the short term (1985 and 1986 giving a half year to decide and 18 months to negotiate) because he would not take a medium term macro view on where we would be after that.

b. he would place lower value on medium term (1987-94) higher cost and net cost because he would discount it for inflation. But we have no reason to suppose price of our exports will rise and if they don't inflation discounting is, for us, wrong;

c. managing our debt and negotiating its rescheduling is a risk free, profitable, growing business for merchant banks. I am far from alone in wondering openly whether it is useful to their clients.

21. On this issue, as it happens, I agree with the IMF (including Mr. Woodward). They have done same benefit and cost arithmetic as I have and came to same answer. (No, the IMF is not always wrong, so I don't take that as a repudiation of my conclusion!)

22. This memorandum is sent by me only to Hazina/Benki Kuu/Mipango/Ikulu/Waziri Mkuu. I do not advise much wider circulation of the full paper. If excerpts - eg from the Paras (7-8-9) analysing IMF proposals - are considered useful 'ammunition' I have no objection to their being so used.

P.S.

1. Kenya has overvalued to about 12.6 = $1 (from 10.9). It has raised interest rates to 16%. (Apparently it was dollar pegged as two 1981 devaluations of 22% had been offset since by 15% + revaluation - against the £ presumably.)

2. On the face of it this does not affect our case. In fact, we may be able to make use of it:

   a. Kenya economy is in some respects similar to ours and has been affected similarly;

   b. Current account deficit is same order of magnitude in export/import ratio (under 60%), current deficit to GDP (8-9%), recurrent budget deficit to GDP (same for us, slightly lower for Kenya) and probably GDP deflator/inflation index (Kenya's Cost of Living index may well have risen less but, as it was being "fiddled" even in early 1970s, what that means is open to doubt), shortages of mass market goods (including staple food) have been endemic there for four years too;

   c. therefore, relatively similar changes - ie moderate devaluation, regular review, marginal interest rate charges are appropriate.

3. The way to appear to be acting along same lines is:

   a. 10% devaluation to Sh 10.75 = $1 now before talks start;
   b. agree to 14% to Sh 12.5 = $1 on effective date of credit (or day before submission to Board);
   c. propose the interest rate changes as above (1-1½% in general) including 2-3%.on long term borrowing rate which does take that rate to 14-15% range.

4. If Tanzania proposes that package, IMF will (given how similar Kenya is) be hard put to continue T Sh 25 = $1 and 18-24% interest rates line of argument. As Kenya has two failed programmes that over 1980 one collapsed is also not a difference calling for more drastic action than in Kenya.

R

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9/XII/82

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