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PART A

CHANCELLOR'S PAPERS ON
THE INTERNATIONAL
INSTITUTIONS AND THE
COMMONWEALTH

Begins: 3/12/82
Ends: 8/12/83

DD: 25 years

5/9/95

PART A

cc: EST
Sir D Wass
Sir K Couzens
Mr Littler
Mr Lavelle
Mr Carey
Mr Bottrill
Mr Graham
Mr Atkinson

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

The Rt Hon Nigel Lawson MP
Secretary of State for Energy

3 December 1982

Dear Nigel

THE IMF's SCARCE CURRENCY CLAUSE

In your letter of 19 November 1982 to Arthur Cockfield, discussing the problems caused by Japan's trading performance and stressing the need for international, rather than unilateral, action if Japan is to modify its macro-economic policies, you asked whether I thought there would be any merit in using Article VII of the IMF as a means of bringing pressure to bear on Japan to modify her macro-economic stance.

As you know I share your view that voluntary restraint agreements and similar measures constitute no more than short term, and rather ineffective, treatment for the symptoms of the trade problem: they do little to resolve the fundamental problem over Japan's macro-economic policies. I have frequently drawn attention to the need for the Japanese authorities to take measures that will open up the Japanese market more rapidly both to imports and to investment; which will help the yen to appreciate; and which will prevent the emergence of large current account surpluses which jeopardise the free trading system.

I have strong doubts, however, about the possibility of using Article VII, the scarce currency clause, to put pressure on Japan, not simply because it is untested, but more especially because I question whether it would in fact achieve the desired objective.

Article VII deals with two forms of scarcity. One is the general scarcity of a member's currency outside the Fund and the other is an actual or threatened scarcity of the Fund's holdings of a currency. If the Fund finds that a scarcity of the first kind is developing, it can issue a report setting out the cause and make recommendations designed to bring it to an end. It is not necessary to find that the Fund's holdings of the currency have been depleted: nor is it necessary to find that the scarcity is attributable to the policies of a surplus member country: it can be produced by the extravagant policies of deficit countries. The Fund's recommendations have no binding force; and there are no sanctions if they are not followed.

As for the second kind of scarcity, the Fund may, by making a formal declaration of scarcity, authorise any member to discriminate against the issuer of the scarce currency by limiting exchange transactions in that currency.

/There is little

There is little prospect of the Fund finding the yen scarce under either category. There is certainly no scarcity of yen within the Fund and no prospect of one. A more serious weakness in the idea is that even if the yen could be shown to be scarce, and the Japanese authorities were to respond by increasing the supply of yen, this could cause the yen to depreciate further still - quite the opposite of what we have in mind. Nor do I think that at this moment it would be apt to show willingness to favour sanctions of a protectionist kind. In general there is no guarantee and quite a few doubts as to whether any move on these lines would produce the desired change in Japan's macro-economic policies.

The short point is that the scarce currency clause was designed for the very different monetary conditions existing immediately after the Second World War. It was adopted mainly in response to UK fears that the US dollar would be in short supply because of US policies. The possibility of declaring the US dollar scarce was discussed in 1947 but the Fund decided against doing so. In practice, therefore, the clause has been a dead letter for 35 years and it is hard to imagine circumstances in which it could be revived.

All that said, let me add that I entirely agree that we should continue to bring pressure to bear on the Japanese authorities through the IMF. In principle there can be direct contact between individual countries and the Managing Director - as happened recently in the case of the excessively large Swedish devaluation - but the Japanese authorities take care to avoid any measures which might lead to a direct confrontation. More realistically it is possible for the IMF to exert some influence when the Fund Staff prepare special reports which cover subjects relevant to Japanese experience. However the Article IV consultations provide the best opportunity for exerting international pressure and we intend to continue pursuing our arguments in this context. An Article IV consultation is being conducted with Japan at the moment.

I am sending a copy of this letter to Arthur Cockfield.

GEOFFREY HOWE

CONFIDENTIAL

cc Chief Secretary
Financial Secretary
Eco[illegible]ic Secretary
Sir [illegible] Wass
Mr Burns
Mr Ridley
Mr Littler
Mr Middleton
Mr Monck
Mr Lavelle
Mr Bottrill
Mr Peretz

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

The Rt Hon Gordon Richardson MBE
Bank of England
Threadneedle St
London EC2

4 January 1983

Dear Gordon

INTERNATIONAL FINANCIAL SCENE

Thank you for your full and helpful letter on this subject of 3 December.

2. As you would expect, I find it easy to agree with almost all the argument in your letter. For example, I agree with what you say about the inter-relation of IMF and bank lending, and about the development of assessment of sovereign risks by the clearing banks. I agree too that the BIS may be an appropriate vehicle for short-term bridging liquidity in appropriate cases where it is necessary to avoid a wider threat to confidence; but that the central bank role should be confined to cases where there is either good collateral or a plausible bridge to an IMF or other official facility (or both).

3. I wonder, however, if I can take a little further the idea of a statement or declaration from Central Bank Governors, which could help to buttress an agreement on a resources package for the IMF. I believe - and see it as a theme of my Chairmanship of the IMF Interim Committee - that the problems we face require readiness for action by each of the IMF, creditor governments and other institutions, the private world banking community, and the authorities of debtor countries. Confidence by each that the others are playing their parts will be a most valuable contribution. It is with this in mind that I am attracted by the idea of a statement. I quite see, of course, the difficulty of making any such pronouncement in vacuo, as you put it. But might it not be appropriate, and indeed natural, for Governors to issue a statement of welcome and approval for an IMF agreement, if one were forged in the Interim Committee in the second week of February, - and to do so, perhaps, at their next Basle meeting? A number of the matters discussed in your letter could find a place in a Statement of that kind and the opportunity might be taken to add one or two other components.

4. Far be it for me to try to draft such a gubernatorial pronouncement; but the following points might serve to identify some of the possible raw material:-

(i) the Governors might welcome the IMF agreement as helpful to the international banking system and to confidence;

(ii) in that connection they could recall their own statement of 10 September 1974 about the working of the international banking system. That statement referred to the problem of the lender of last resort in the Euro-markets and recognised that it would not be practical to lay down in advance detailed rules and procedures for the provision of temporary liquidity. But it added that the Governors were satisfied that means were available for that purpose and would be used if and when necessary;

(iii) the Governors could then note that in one or two recent cases, and as a strictly transitional measure, the BIS has been able to take action helpful to the Euro-markets and to the international financial system by providing short-term liquidity for countries facing debt problems. To do this the BIS has needed the support and cooperation of central banks and governments, and its help has had to be predicated on longer-term programmes of assistance by the IMF. Thus the principal help to the Euro-markets by central banks has recently taken the form of liquidity support to countries rather than to banks;

(iv) the Governors might also welcome the increased cooperation between the IMF and the commercial banks in organising programmes of support linked to firm policies of adjustment for countries with debt problems. Policies which are genuinely directed to restoring the creditworthiness of these countries merit such support;

(v) there might conceivably also be a reference to the work of the Cooke Committee described in paragraph 15 of your letter; and perhaps also to the desirability of legislation to give effect to consolidation of accounts (paragraph 16 of your letter).

5. I have spelt this out in some detail, not, as I have said, in the expectation that an ultimate statement would follow this outline at all closely, but in order to explain why I feel that the material for a substantive Statement is in fact available, even if it would contain little that was very new. It would to a large extent be descriptive of the evolution of support and supervision in the Euromarkets since 1974/5 - and would be none the worse for that. It would also direct attention to matters which are at theheart of the concerns of central banks and

genuinely complementary to the IMF package, but which would notappear central in a purely IMF context. If the idea appeals to you at all, then I am sure you could transform my ballon d'essai into something of more appropriate style.

6. If, as I say, such a statement were made immediately after a successful Interim Committee meeting on IMF replenishment, and were related to that success, it would certainly be made in a suitable context - and another might not arise for some time. Perhaps there is also some chance that if made in the second half of February or early March, the statement could mark, without any indication of complacency, the surmounting of the worst of the international debt "crisis" which caught the world's attention when the Mexican problem broke in August/September.

7. I was very interested to read what you said in paragraph 16 of your letter about legislation on consolidation in Germany. I would be inclined to draw the conclusion, on the facts you describe, that some German banks do represent a source of potential weakness in the international banking system. Their exposure to thedebtproblems of Eastern Europe has in some cases added to this. In the longer perspective this ought surely to be remedied. But it may be that the right timing is for the Germans to begin the process of legislation, application and transition in 1983. Otherwise, given the time lags, such legislation could well begin to bite in, or on the eve of, the next down-turn - if, in today's circumstances, one can venture to think in such conventional terms. There would have to be transitional provisions which could I suppose, in their most extreme form, apply the existing German capital ratios to consolidated lending only from a forward date. Perhaps the optimum would be to try to get the confidence effects in the near future and the restrictive effects on lending (and dividends) during any upswing that may develop? Perhaps the question whether we should try to press the Germans to plan legislation on this subject might be further discussed between the Bank and the Treasury?

8. I have been reflecting in particular on what you said in the last paragraph of your letter. I think we both see these international problems of over-indebtedness as part of the general problem of transition to lower rates of inflation in the world. That transition inevitably raised similar domestic problems of corporate and personal indebtedness. We are moving from a world in which inflation could be relied on to erode indebtedness rapidly, and where interest rates were often negative, to one in which debt is eroded more slowly and interest rates are positive. I agree with you that our approach to these debt problems has to be piecemeal and adapted to the circumstances of the individual case. There can be no question, internationally as well as domestically, of a quasi-automatic system of debt relief. As I tried to illustrate with my Kronburg references to an

"international entitlement programme", that would create all the wrong incentives and retard adjustment. I think it is also an essential ingredient of our approach to these debt problems that recourse to public expenditure, and charges on public funds more generally, have to be kept to a minimum. I see no seriousinternational support for going beyond the present basic approach of restoring creditworthiness through IMF action, coupled with appropriate debt settlements.

9. Of course, you are right to say that a resumption of growth in the OECD countries would ease these debt problems, provided that it was not associated with the expectation, or the reality, of a recrudescence of inflation. But, as we have both so often stressed, if that proviso were not met, we could not count on a sustained reduction in interest rates. That is why I continue to attach importance to the future path of the US budget deficit, as I know you do. As I see it, what we are trying to do goes well beyond securing an early resumption of growth, though we certainly need that. We have to break out of the whole 1970s experience of high inflation, massive oil price increases, gross imbalances, currency instability, sharply declining profit margins, growing budget deficits, distorted cost patterns, irregular growth and rising unemployment.

10. I believe that a number of OECD countries, including the UK, have made some progress in this direction. But the way in which the process should work is perhaps not widely enough understood, internationally as well as nationally. Even in the mind of someone as wise as Shultz I detect at least some disposition to seek relief in the wrong direction - perhaps because (and one can hardly blame him) even he is daunted by the scale of the US budgetary problem. Do you think there is anything more that either of us can do, in the context of the other matters discussed in this letter, to foster confidence in the process of non-inflationary recovery?

GEOFFREY HOWE

FROM: MISS M O'MARA
DATE: 16 May 1983

MR GROVES - FINANCE DIVISION

cc: Mr Beastall
Mr Basi

COMMONWEALTH FINANCE MINISTERS MEETINGS: CONFERENCE OFFICER

I have seen a copy of Mr Basi's minute of 16 May.

2. The view in the Chancellor's office is that a Conference Officer certainly is necessary for the CFM meeting. However, we do not think that an appointment from the British High Commission would be suitable and believe that Miss Goldsmith is much to be preferred. She both knows what is required and does it well.

MOM

MISS M O'MARA

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

EXCHEQUER
15 JUL 1983

15/7

Mr Littler.
Mr Unwin
Mr Lavelle
Mrs Hedley-Miller.

July 8, 1983

Sir:

This is to inform you that, in accordance with the votes carried out under the provisions of Section 13 of the By-Laws, the Resolutions submitted to the Board of Governors on June 2, 1983 concerning (1) Direct Remuneration of Executive Directors and their Alternates and (2) Home Leave Allowance for Executive Directors and their Alternates have been adopted.

Very truly yours,

Joseph W. Lang, Jr.

Joseph W. Lang, Jr.
Acting Secretary

Mr. Robert Leigh-Pemberton
Governor
Bank of England
London, EC2R 8AH, England

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

Mr Kirtler.
Mr Lamin
Mr Lavelle
Mrs Hadley-Miller.

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London, EC2R 8AH, England

EMBARGOED FOR AUTOMATIC RELEASE
Until 11:00 a.m. in Switzerland
5:00 a.m. EST
Friday, July 8, 1983

CHEQUE
25 JUL 1983

Mr Little
Mr Clawis
Mr Lavelle
Mr Bottrill
Mrs Hedley-Miller

Address by J. de Larosière,
Managing Director of the International Monetary Fund
before the
Economic and Social Council of the United Nations
Geneva, July 8, 1983

In the year that has elapsed since we last met, we have seen an easing of inflationary pressures in a number of industrial countries and signs that an economic recovery is becoming more firmly established, particularly in the United States. This welcome and long-awaited turn of events must now be consolidated and extended to the rest of the world economy. Beyond that, the crucial challenge for policy is to ensure that the recovery is a lasting one. This is essential not only to get growth and development going again on a sustainable basis but also to ease the strains on the international financial system and stem the rising tide of protectionism. From these perspectives, I propose, in my remarks today, to examine certain of the key aspects of policy bearing on the medium-term outlook for investment and growth both in the industrial countries and the non-oil developing countries as well as some of the avenues for strengthening international cooperation.

1. <u>Medium-term outlook and policy issues for the industrial countries</u>

For the industrial countries as a group, there are now better prospects than for some time past of achieving a transition to sustainable noninflationary growth. Prospects for 1983 are for a further decline in inflation, a resumption of growth, and a leveling off in unemployment. Real output is projected to be about 1 1/2 per cent higher than in 1982. An increase in momentum in the course of the year is expected to continue into 1984, leading to an average annual growth rate of close to 3 per cent during the period 1984-86.

The recovery in prospect in the industrial world is, by past experience, a relatively moderate and gradual one. Also, the average rate of growth through the mid-1980s would be lower than that achieved in the late 1970s (4 per cent) or in the decade prior to 1972 (4.7 per cent) and would imply only a modest decline in unemployment from the current very high levels. Basically, there are two reasons for this: first, given the need to complete the process of disinflation so as to firm up the basis for sustainable growth, there is no scope for relaxing financial policies. Second, the rate of increase of productive potential in the industrial countries is estimated to be significantly less than in the 1960s and 1970s partly because of the lower rate of capital formation in recent years and partly because of structural changes reducing productivity growth.

a. Financial policies

Though a number of major industrial countries have made striking progress in bringing down inflation, concern about inflation is far from over. In a large number of industrial countries, high inflation still persists. Even in those countries where price pressures have eased, inflationary expectations remain deeply entrenched. This reflects both the erosion of confidence that follows a long period of rapid price increases as well as skepticism as to the credibility of anti-inflation policies given the continued existence of large fiscal deficits.

For the seven major industrial countries, central government borrowing accounted for 57 per cent of net private savings in 1982: this contrasts with a ratio of 48 per cent at the time of the 1975 recession. Deficits of this magnitude as well as the uncertain budgetary outlook in a number of countries, particularly in the United States, are keeping inflationary expectations alive. This, in turn, is causing interest rates to remain at very high levels--particularly for longer-term maturities--in spite of the weakness of economic activity and the decline in inflation. An indication of the intensity of inflationary expectations is given by the unusually wide differential between long-term interest rates and the current rate of inflation. In the United States, for example, in the first half of 1983, long-term interest rates were about 8 1/2 percentage points above the rate of inflation (measured by the increase in the GNP deflator); during the decade up to 1973, that differential was only 2 1/2 percentage points. The elimination of structural budget deficits is, thus, of crucial importance for the sustainability of the world economic recovery; this is a point that cannot be overemphasized.

Monetary policy, in general, remains under control. Although monetary growth has accelerated in some of the major industrial countries since the second half of 1982, this appears to reflect, in certain cases, a variety of financial innovations, which have temporarily increased the difficulty of gauging monetary growth, rather than any basic shift in the stance of monetary policy. Nevertheless, it is instructive to keep in mind that higher rates of monetary growth have not been accompanied by any marked fall in interest rates. On the contrary, interest rates have been firm for quite some time. This suggests that an attempt to force the pace of recovery by means of a deliberate shift to active monetary expansion would almost certainly be counterproductive; because of the consequences for inflationary expectations, interest rates would be more likely to rise than fall.

b. Structural policies

A second reason for expecting the pace of the recovery to be moderate is to be found in the sluggishness of investment and productivity growth in the industrial countries.

The sustained weakness of fixed investment is a particular source of concern. For 1983, much of the impetus to renewed growth is expected to come from consumer demand and a cyclical rebuilding of stocks. Gross fixed investment for the industrial countries as a group is expected to fall in 1983 for the fourth successive year. There are several reasons for this:

- first, the low rates of capacity utilization that have resulted from the prolonged recession together with uncertainty as to the prospects for noninflationary recovery as reflected in the unusually low backlog of orders in capital goods industries.

- second, persistence of high interest rates, in real as well as nominal terms, associated with lingering inflationary expectations and the inappropriate monetary-fiscal policy mix.

- third, the low and declining profitability of manufacturing industry, which is partly the result of the recession but also stems from the very rapid real wage growth during the first half of the 1970s, particularly in a number of European countries, the effects of which have not yet been reversed.

- finally, the fiscal and monetary systems of many industrial countries have been biased against saving and, hence, investment. Although steps have been taken by some countries to deal with these distortions--for example, through cuts in high marginal income tax rates and deregulation of the financial system--some of the basic problems still remain.

Lower investment goes some way toward explaining the decline in productivity growth in the industrial countries in recent years. Other influences undermining productivity have included government action to prop up declining industries and various measures that impede labor and capital mobility as well as restrictive work rules. Figures for the 14 largest industrial countries show productivity growth declining to 3 per cent annually over the period 1973-82, compared with over 5 1/2 per cent in the preceding decade.

An increase in the productive potential of the industrial countries will depend upon effective policy action to deal with rigidities. Above all, a strengthened resolve to tackle structural budget deficits will be needed to avert the widely recognized danger of crowding out private investment from financial markets as the recovery gathers strength. In spite of the current depressed state of investment demand this may not be as far off as might be assumed. Though capacity utilization rates appear to be lower than at the start of recent previous recoveries, there are indications that, as a result of technological advances and the second wave of energy price increases, much of existing capital equipment is outmoded or obsolescent; there may, therefore, be a considerable pent-up demand for replacement and modernization.

Substantial efforts are also needed in European countries to re-establish real wage rates at levels consistent with an adequate rate of return on capacity-expanding investment. For example, in France, Germany and

Italy, the share of gross profits in total incomes of the manufacturing sector fell from about 40 per cent to less than 35 per cent during the 1970s. The net profit position of enterprises in the major European countries reached historically low levels in the early 1980s. Greater restraint in real wage growth would facilitate a strengthening of the financial position of enterprises, thereby providing greater incentive to invest as well as some of the finance for it. Higher investment would boost productivity, which together with greater wage restraint, would be the surest way of achieving a more rapid reduction of structural unemployment and of providing a secure basis for higher real incomes in the future.

2. Medium-term aspects of adjustment and growth in developing countries

The setback in the growth performance of the non-oil developing countries over the past few years is attributable both to adverse external developments as well as lagging domestic adjustment. These events have culminated for a number of developing countries in the emergence of acute external indebtedness and financing problems. The potential disruptive impact of those crises has been averted through swift and decisive action by all parties--debtor and creditor governments and financial institutions--acting in close concert. But so far we have only been buying time--the time needed to launch in-depth solutions that will enable countries to grow out of their financial problems. A successful resolution of the problems of indebtedness and a resumption of lasting growth throughout the developing world will depend upon the implementation of forceful and comprehensive adjustment programs in these countries supported by adequate financing flows and a sustained recovery in the industrial world.

a. Adjustment programs

The scope for economic recovery in the developing world will depend to a very large extent upon the firmness with which the authorities implement policies aimed at reducing the severe external and internal imbalances that confront many of these countries. Though the external current account deficit of the non-oil developing countries as a group has declined significantly since 1981, much of that improvement represents a response to extreme financial pressures rather than a comfortable balance between payments and receipts. In 1982, for example, net inflows of capital to these countries actually fell by some \$35 billion, chiefly because of a cutback in commercial bank lending, while export receipts fell by some \$14 billion; as a result, imports were reduced by \$42 billion, or by 8 per cent in real terms. Nevertheless, domestic demand management has still not adjusted far enough to external constraints. Indeed, inflation remains virulent throughout the developing world: the average rate of increase in consumer prices will exceed 30 per cent in 1983 for the fourth year in a row. Such high rates of inflation have produced severe economic distortions.

In these circumstances, demand management has to play a central role in the adjustment strategy. Fiscal policy is of particular importance in developing countries where the budget deficit often exceeds 10 per cent of GDP. Such large deficits cannot easily be financed without excessive monetary growth and must, therefore, be considerably reduced. It is also important to ensure that demand management policies are supported by adequate pricing policies and other measures aimed at strengthening the productive base of the economy. To this end, timely adjustments in key administered prices, including the exchange rate and interest rates, are of major importance.

There is a widely held view that a revamping of policies along these lines involves a sacrifice of growth. The facts do not bear this out: empirical studies that have recently been published by the Fund show conclusively that those developing countries that have followed prudent financial policies and a flexible exchange rate policy, aimed at maintaining external competitiveness, have achieved not only a better current account performance in recent years but higher growth rates as well.

b. <u>External financing flows</u>

Smooth adjustment in the developing countries requires the necessary financial underpinnings. Adjustment and financing, after a certain point, are self-reinforcing: improved policies in debtor countries will attract new financing, which, in turn, facilitates the adjustment process. But there is a critical intervening period when new financial commitments must be made on the strength of policy intentions and programs. A number of countries that have recently entered into arrangements with the Fund are still at this early stage of adjustment and, for several of them, Fund financing is not sufficient to bridge their external financing gaps. In these cases, agreements have been reached with commercial banks to provide additional financing in tandem with the Fund. The confidence of other lenders--official entities and the commercial banks--in the quality and efficacy of Fund adjustment programs has been the primary factor behind their willingness to expand their lending at an uncertain, yet critical, moment. Thus, the policy of the Fund in maintaining the quality of its conditionality--in the face of criticism from some quarters--not only helps countries to achieve adjustment but also helps to attract the financial support needed to facilitate the process.

Looking ahead, continued financing by the commercial banks on reasonable terms will be necessary to support the adjustment now under way in many developing countries. The prospective growth in bank lending --projected at an annual rate of around 7 per cent in 1983 and 1984--will, nevertheless, be well below the unsustainable rates recorded over most of the past decade, and it is unlikely that official flows will rise very significantly. Given their large needs for external resources, the developing countries would be well advised to place greater emphasis on policies designed to attract foreign direct investment as part of their development strategy. Direct investment has the advantage that it is tied to productive capital formation and forms part of a package that includes the transfer of technology and skills. More rapid growth of direct investment, especially in the non-oil developing countries, could well prove a potentially powerful instrument for carrying out the structural adjustments that these countries require, as well as for alleviating the serious problems of unemployment they face.

c. Impact of the recovery in industrial countries

For many developing countries, the needed adjustments in current conditions constitute a heavy burden. They can no longer rely on high inflation and negative real interest rates--as they could in the 1970s--to erode the real burden of their external debt and debt service. They are now crucially dependent upon a recovery in the industrial world to support their own efforts to tackle their indebtedness problems. And indeed, their adjustment programs have been formulated on the assumption of a strengthening of markets in the industrial world and a consequent expansion of world trade.

Stronger growth and lower interest rates in the industrial countries would have a powerful impact on the external payments position of the developing countries. For example, on the basis of historical relationships, an increase of 1 percentage point in the average annual rate of economic growth of industrial countries over the period 1984-86 could lead to an increase of about 3 1/2 percentage points in the average annual rate of growth of the value of exports of non-oil developing countries. By 1986, this would imply additional export receipts of close to $35 billion per annum. Similarly, a reduction of 1 percentage point in market interest rates would, after a year or so, reduce the annual flow of interest payments of non-oil developing countries by roughly $4 billion. These yardsticks give an idea of the overwhelming importance of a healthy and durable recovery in the industrial countries for the working of the entire international financial system.

d. Outlook for growth in developing countries

The outlook for growth in the developing countries is greatly enhanced by the strengthening of adjustment efforts now under way in many of these countries as well as the emerging recovery in the industrial countries. A further consideration, which gives reason to expect growth to pick up in the developing countries--and one that tends to be overlooked--is that investment in these countries has remained relatively strong.

World Bank data show, for example, that gross domestic investment in the middle-income developing countries during the 1970s rose at a faster rate (7.8 per cent) than either private consumption (5.2 per cent) or public consumption (7.1 per cent); the same picture is true for the low-income countries as well. Further evidence is given by a recent Fund study, covering the 20 non-oil developing countries with the largest debt service payments in 1982. This shows that the increased indebtedness of these countries over the past decade or so has been primarily reflected in an increase in investment outlays rather than in spending for consumption. The median investment ratio for these countries rose from about

19 per cent of GNP in 1968-72 to 22 per cent in 1974-77 and further to nearly 24 per cent in 1978-81.

Of course, higher investment alone does not assure borrowing countries of immunity from debt service problems: some countries with high investment propensities have encountered debt service difficulties because of inappropriate domestic financial policies, poor investment choices, ill-advised financing, adverse external conditions and so on. But the finding that expanded borrowing and indebtedness is reflected in investment outlays rather than in consumption offers greater assurance that debt problems could be expected to ease progressively, provided that appropriate policies are pursued.

The Fund's most recent projections envisage a steady improvement in the external position of the the non-oil developing countries over the next few years and an increase in their real growth rates. The aggregate current account deficit for the group could settle in the neighborhood of 14 per cent of their exports of goods and services--down from about 22 per cent in 1980-81, and close to the average for the years immediately preceding the second wave of oil price increases. This improvement in current account positions would lead to a gradual alleviation of external debt service burdens. If such conditions materialize, the financing needs of the non-oil developing countries should prove to be manageable over the medium term. Consistent with the strengthening of their external position and the projected recovery in industrial countries, real GDP growth in the non-oil developing countries could be expected to pick up to 2 1/2 per cent in 1983 (from 1 1/2 per cent last year) and further to 4 1/2 per cent annually in 1984-86.

3. Strengthening international cooperation

Developments in recent years have put added strains on international economic relations and have endangered the cooperative process. The international repercussions of the recession in the industrial world, the steep increase in oil prices since 1973, the upsurge in interest rates on world capital markets, and the wide fluctuations in exchange rates for major currencies have been among the shocks to the world economy. The spread of protectionist measures has threatened to fragment the world economy. Yet, this experience has also underlined the economic interdependence of nations and the fact that stronger growth in the world economy will depend upon closer international cooperation.

It is, of course, true that political pressures of domestic self-interest are often strong, and there is a limit--though far from uniform--to which countries are willing to forgo national interest or sovereignty, as these are frequently perceived, for the sake of international considerations. Nevertheless, the process of integration of the world economy has gone much too far for countries to turn their backs on their economic partners or even to weaken their commitment to international cooperation. Yielding to nationalistic pressures would not only jeopardize the recovery but would put the world economy at risk of lapsing into a deflationary spiral. The United Nations and its specialized agencies provide the crucial framework for sustaining the cooperative process and reinforcing it in the interests of all countries.

Let me conclude by singling out three aspects of international cooperation that are of particular importance at this time:

First, the open trading system must be preserved and strengthened. Over the past few years, recession has fanned the flames of protectionism. Specific trade restrictions adopted by industrial countries have proliferated, particularly since 1980, and now limit or distort a sizeable proportion of world trade. It is also disturbing that many developing countries have reacted to their external financing difficulties by imposing various kinds of import controls and restrictions. Now, the prospect of recovery not only opens the way for a strengthening of markets and world trade but also enhances the atmosphere for trade liberalization. In this connection, it is essential that the call by the leaders of the seven major industrial countries at Williamsburg for a halt to protectionism and a dismantling of trade barriers as the recovery proceeds be followed up and translated into action.

A second aspect of cooperation concerns the need to expand official development assistance. ODA constitutes a key element of external financing for developing countries. And it has a central role in the promotion of orderly adjustment, which is sometimes forgotten. For some developing countries, the adjustment burden is hardly manageable in the absence of higher flows of concessional assistance, more especially now that commercial flows are being scaled down. Countries that are implementing forceful adjustment policies both need and deserve the support of larger flows of financial assistance. At the same time, assistance channeled to such countries also promises to prove a sound investment. That is why the efforts by the World Bank and other multilateral development organizations to muster increased development assistance are so important. Besides the volume of aid, greater attention also needs to be paid to its quality and terms so as to ensure that, in each case, aid meets the needs of the recipient country.

Finally, a word on cooperation within the framework of the Fund. The recent upheavals in the world economy have underlined the need for strengthening the Fund's surveillance over members' economic and financial policies as well as the importance of maintaining the Fund's financial strength and its liquidity. We have already taken steps to reinforce our policies for surveillance--particularly in the areas of trade policy and external debt management. Also, we have been working closely with the major industrial countries, on the basis of the initiatives launched at the Versailles summit more than a year ago, in an effort to pave the way for a closer convergence of their economic and financial policies. Owing to their nature, these consultations must be conducted in a confidential way. However, I can say that they have yielded positive results and it is encouraging that, at Williamsburg, the major industrial countries expressed their intention to reinforce their cooperation on a multilateral basis through the Fund.

Given the uncertainties of the current situation and the large prospective demands on the Fund in the years to come, it is essential to preserve the financial strength of the institution by maintaining the integrity of its assets and a strong liquidity position. As you are aware, the financial resources of the Fund will be increased under the recently approved general increase in quotas and the enlarged and expanded General Arrangements to Borrow. Legislative action is needed in a number of countries before these new resources become available to the Fund. With the Fund's commitments under existing programs now close to SDR 25 billion and more requests for assistance under consideration and in prospect, the Fund's liquidity position is under considerable strain. It is, therefore, of overriding importance that members expedite the procedures for ratifying the quota increase so that the exercise can be completed before the beginning of 1984.

Mr Adair Ridley,
Hall

to be distributed from
1st on 2.3 me.

c.

Not a key consideration, but:-

if Wicks speaks as in para 20, a lot of black + brown men will be sad — ~~so~~ they will interpret it as a retreat from G.H.'s position (see para 4 below) — and they will get at you in Trinidad.

2. ~~If~~ the developed world is now coming out against an allocation, (and I'm not sure that it will: the French certainly won't) need we get out in front? Para 2~~0~~ is therefore v. important.

do adopt BAHill's new tack,
[ad how to outwiz A. Walters
if we stick to GH's old one?]

CONFIDENTIAL

FROM: A R H BOTTRILL
DATE: 26 JULY 1983

1. MR LAVELLE ✓ 26/7
2. CHANCELLOR

cc Mr Littler
Sir T Burns
Mr Peretz
Mrs Diggle

C: for discussion at our 4 am meeting?

MP

SDR ALLOCATION

The IMF Executive Board is to discuss on 1 August the question of an SDR allocation for next year. This follows the request from Finance Ministers at February's Interim Committee meeting that Executive Directors should review the issue before the next Interim Committee meeting in September to determine whether there was broad support for an allocation.

2. The last allocation of SDR 4 billion was in 1981, bringing the total to SDR 21 billion since the SDR was introduced in 1970. No allocations were made in 1982 or 1983 largely as a result of opposition by major countries, including the US, Germany and ourselves, who argued that there was no global shortage of liquidity and that an SDR allocation would give the wrong message when countries were striving to reduce inflation.

3. G5 Ministers discussed the matter again in the margins of the April Development Committee meeting. There was concern that world liquidity had contracted in the past year but also recognition of the need for continued prudence as long as inflationary expectations persisted. No-one had made up their minds about an allocation but the US Treasury Secretary, Mr Regan, said that he expected pressure at UNCTAD for an SDR allocation and would be prepared to contemplate a modest allocation largely on political grounds but providing there were also reasonable liquidity arguments in favour.

4. The former Chancellor publicly welcomed the Interim Committee decision to review the SDR issue and this has been interpreted as a more open-minded UK position compared to our previous opposition.

under-statement. G.H. saw an SDR issue as the likely 83/4 Interim Cttee sop for LDCs — just as the Quota increase was the 82/3 sop. ~~[illegible]~~ He urged the Interim Cttee to agree to a review, and he implied v. strongly that he would ensure that it produced an allocation.

CONFIDENTIAL

19/28/26

5. We have no up-to-date information on G5 colleagues' thinking. The US position will be crucial, but the Administration may not want to take a clear decision while the IMF quota legislation is still before Congress. Congress is seeking to add an amendment to the Quota Bill to make US approval of an SDR allocation subject to Congressional approval. The French may be expected to be sympathetic to an SDR allocation, the Germans sceptical and the Japanese equivocal. The LDCs will be in favour of an allocation, if possible skewed in their favour.

6. The Fund's approach to the SDR is covered by Articles VIII and XXII. The former says that the SDR allocations shall be determined by 'the long-term global need' to supplement existing reserve assets. The latter obliges Members to collaborate to make the SDR 'the principal reserve asset' of the international monetary system.

7. Arguments about SDR allocations have typically centred on measurements of global liquidity. Some countries - notably the LDCs - have also tried to introduce arguments about the distribution of reserves. The current debate promises to follow this familiar pattern.

8. The level of official non-gold reserves in the world as a whole has been broadly flat at around SDR 340 billion since the end of 1981 following average annual growth of 15 per cent in the two previous years. This is broadly true for all major groups of countries, although oil producers' reserves have been declining somewhat from their earlier peaks and industrial countries' reserves have shown a modest rise recently.

9. The Fund Staff in a paper for next week's Board meeting suggest that the slowdown in industrial countries' reserve growth can be explained by the slower rise in demand but that for non-oil developing countries supply factors - notably the slowdown in net new bank lending - are to blame. Oil producers are perhaps best considered separately.

10. The Fund's analysis is largely in terms of the ratio of reserves to imports. See Table 1. In the case of industrial countries, reserves at end-1982 were equivalent to about 17 per cent of imports, close to the post-1973 average. Non-oil LDCs' reserves had fallen to 21 per cent of imports, rather below the post-1973 average. Oil producers' reserves had fallen back from their peaks, but still represented 55 per cent of imports, well above the average for other groups.

Why?

Table 1: Non-gold reserves relative to imports (per cent)

	1970-72 average	1973-82 average	End-1982
Industrial countries	22.8	16.8	17.1
Oil producers	56.2	71.6	55.0
Non-oil producers	24.1	23.0	20.8
Total:	24.4	21.9	21.7

11. The ratio of reserves to imports is not a perfect measure. It has probably been affected by structural changes such as the general move by industrial countries to floating exchange rates as well as the increase in the importance of the Euromarkets and in swap arrangements, eg in the EMS, as alternative sources of finance. Nevertheless, it provides perhaps a broadly sensible starting point, and it suggests that there is no strong case for arguing that there is a global shortage of liquidity.

12. Over the period ahead, say to end-1985, it is reasonable to expect the demand for reserves to rise. In the case of industrial countries, this will reflect a growing transactions demand as their imports recover. In the case of non-oil LDCs, they will be seeking probably both to restore their reserves to a more normal relationship to imports as well as to provide for financing an increase in trade. They may also consider their current debt-financing difficulties an additional precautionary reason for increasing their reserves. Oil producers may be ready to see a further modest fall in their reserves.

13. The Fund's own analysis is woefully lacking in any assessment of the scale of global demand for reserves or how it is likely to be met. On the above assumptions, we might broadly guess that the demand for reserves might rise by about SDR 100 bn between the end of 1982 and the end of 1985 - an annual average of about 9 per cent.

14. Under the multi-currency reserve system, the creation of reserves to match this demand will depend heavily on the monetary policies of the major reserve currency countries - particularly the G5 whose currencies make up the SDR and most of world foreign exchange reserves. In the past year, monetary conditions in this group have eased with narrow money growth of 10 per cent well above the rise in nominal GDP at around 6 per cent. Over the year ahead we are assuming average monetary growth of around 8-9 per cent - more closely in line with nominal GDP. This should allow for a steady growth in international funds available for credit-worthy borrowers.

15. The prospect for the US balance of payments and the dollar will be particularly important. The cumulative current deficit is likely to exceed $100 billion over the 3 years 1983-85. The extent to which this gives other countries an opportunity to add to their reserves through intervention, however, depends on the extent of offsetting capital movements. The current relatively accommodating stance of US monetary policy suggests that capital flows into the dollar may not be so strong as in the recent past. Increased awareness of the scale of the current deficit may also undermine confidence in the dollar encouraging capital outflows.

16. Any judgement must be tentative - and a renewed tightening of US monetary policy could reinforce the dollar - but on balance it seems likely that a large US current deficit coupled with a weak dollar will give other countries an opportunity to add to their dollar reserves through intervention. It is worth remembering perhaps that in 1977 and 1978 when the US had a cumulative current deficit of $30 billion, the accompanying relaxed monetary policies of the Carter Administration helped lead to an increase of $60 billion in the countries' dollar reserves.

I've heard that before.

17. The prospect of a dollar 'glut' in the next 2 years is perhaps not one that we can view with total equanimity. It reinforces the case for fiscal prudence by the US to ease the Fed's task in securing monetary control. It also emphasises the need for a consistent set of policies among G5 countries so that the responsibility for providing international liquidity is shared and exchange rate volatility reduced.

18. It would perhaps be sensible to ask the Managing Director and the IMF Staff to consider some of these issues in an examination of the multi-currency reserve system. This would fit well with his multilateral surveillance exercise with the G5, provide some groundwork for any study of international monetary reform and put the debate about SDR allocations into its proper monetary context.

19. Even if the global case for an SDR allocation is not proved at present, LDCs are likely to argue for at least a selective increase in their favour. There have been other more ambitious suggestions that there should be a general SDR allocation but that industrial countries should 'voluntarily' relend theirs either directly or alongside IMF programmes to the LDCs. These are in general open to two objections. They either make the stability of the SDR depend on the capacity of the weakest economies, or they rely on industrial countries being ready to underpin the creation of international liquidity through the SDR which they are reluctant to do by providing their own currencies. Neither looks attractive. We prefer to concentrate on providing conditional finance through quotas and the GAB.

20. At this stage, we are proposing to instruct our IMF Executive Director to:

When?

(i) Question the case for an SDR allocation on grounds of global liquidity needs.

(ii) Urge the IMF Staff to conduct a more thorough appraisal of the prospects for reserve creation through the multi-currency reserve system in the period ahead.

(ii) Oppose suggestions for a skewed SDR allocation in favour of LDCs.

21. We would expect him, however, to co-ordinate his approach with other G5 Directors, and if there is strong support for an SDR allocation we would wish to reconsider the position. We do not currently expect that to be the case.

A. Bottrill

A BOTTRILL

CONFIDENTIAL

FROM: J O KERR

DATE: 28 July 1983

cc Mr Littler
Sir T Burns
Mr Lavelle
Mr Peretz
Mrs Diggle
Mr Hall
Mr Ridley

MR BOTTRILL

SDR ALLOCATION

The Chancellor discussed your minute of 26 July at a meeting yesterday with Mr Littler and others. He made it clear that he shared your scepticism about the case for an SDR allocation on grounds of global liquidity. He was however concerned that we should not get out in front of our G5 partners in expressing such scepticism on the IMF board. He saw no reason why we, rather than the Germans and the Americans, should take any flak from the LDCs. He would therefore prefer that the proposed instructions to Mr Wicks should make it plain that speaking as in your paragraph 20 would be contingent on having first established - your paragraph 21 - that we would not, by doing so, put ourselves out in front of the rest of G5.

J O KERR

(Sorry - must have slipped off the tape).

Judith
Middleton is on leave!
But surely this isn't necessary any way:
Lady Howe always went.

MR WILLIAMS
(PS/MR MIDDLETON)

MR BONNEY

MISS LYONS

FROM: MISS J C SIMPSON
29 July 1983

[Grace ?]

cc

TRAVEL TO TRINIDAD AND USA

Mrs Lawson has been invited to accompany the Chancellor when he goes to Trinidad for the Commonwealth Finance Ministers' Conference, and to Washington for the IMF meeting (20-28 September inclusive for the two visits combined). Before seeking the Prime Minister's permission, as we are required to do, for authorising payment from official funds of Mrs Lawson's travel expenses, I should be grateful to know that Mr Middleton has no objection.

MISS J C SIMPSON
PRIVATE SECRETARY

John - Too late!
As you put this in the wrong way, I have already minuted PEM again. In fact, it wasn't ignored last year - Jill dealt with it. PEM's office put it to him yesterday - and we must
(a) ask the PM
(b) be able to tell her that the Treasury, in the person of its A/c officer, has not objection.
It is a formality, but the hoops have to be gone through.

FIRB's circular was news to me, and ignored in '81 and '82!

2. If Bonney or Lyons are making a fuss, I suggest
a) try telling them to shut up
b) get them to get Littler to confirm no HMT objection.

3. I also suggest you hold your horses till we find whether she wants to go to Grace. That too would be standard, and cd be cleared on the same procedure at [illegible]

J

EM

FROM: I BASI

DATE: 1 August 1983

cc PS/Chief Secretary
Sir T Burns
Mr Unwin
Mr Carey
Mr Lavelle
Mr Hall
Mr Bonney
Mrs Diggle
Miss Lyons

1. MR ~~BEASTALL~~ 1/8
2. MR LITTLER 2/8
3. PRINCIPAL PRIVATE SECRETARY

COMMONWEALTH FINANCE MINISTERS AND IMF/IBRD MEETINGS 1983

The Chancellor's approval is needed for the size and composition of the delegation to these meetings.

2. Commonwealth Finance Ministers (Port-of-Spain)

The normal list would be: the Chancellor (and Mrs Lawson), Mr Kerr, Mr Hall, Mr Littler, Mr Carey, Conference Officer, Personal Secretary, Communications Officer/Clerical Officer plus Sir W Ryrie (ODA), Mr Appleyard (FCO) and an official from the Bank of England (likely to be Mr Balfour).

3. In the case of the previous overseas venue, Nassau in 1981, the Bank of England were not represented (but had attended CFM regularly up until then). They are proposing to send a senior official to Port-of-Spain. The requirement for a Conference Officer has already been agreed (Miss M O'Mara's note of 16 May refers). A personal secretary (seconded from Embassy, Washington) and communications officer (seconded from High Commission in Ottawa) were considered necessary for Nassau. Similar arrangements may have to be made for Port-of-Spain if such services are genuinely needed (eg the communication officer could man telephones, provide clerical support and do "safe hand" runs). There is little chance of recruiting someone locally as staffing in the High Commission in Port-of-Spain is said to be rather restricted.

18/8

IMF/IBRD (Washington)

4. The delegation for Washington is likely to be the Chancellor (and Mrs Lawson), Mr Kerr, Mr Hall, Sir T Burns, Mr Lavelle, Mr Littler, plus Sir W Ryrie (ODA), Mr Appleyard (FCO) and senior officials from the Bank of England (probably the Governor, Mr Loehnis and Mr Gilchrist).

Questions for Decision

5. I should be grateful to know if the Chancellor agrees with the lists of delegation described above. In particular does he need the services of a personal secretary and a communications officer? If so, does he wish to take his own personal secretary or is he content for us to negotiate with the FCO to second someone from Washington (this would save on fares)? Is he also content that Bank of England should be represented at the CFM (they pay their own way)?

6. Miss Lyons has produced a note on the travel arrangements for Treasury members of the delegation (copy attached).

7. I also attach a delegate form prepared by the Commonwealth Secretariat which has to be completed by each member of the Treasury team going to Port-of-Spain; I should be grateful if completed forms could be sent to me by Monday 8 August for forwarding as necessary.

I Basi

I BASI
AEF1 Division
Rm 82/1
Ext 3700

ds

1. MR ~~BEASTALL~~ MB
2. MR ~~LITTLER~~
3. PPS

I agree GJB 2/8

FROM: R J BONNEY
DATE: 2 August 1983

cc PS/CST
Mr Unwin
Mr Carey or
Mr Gilhooly or

1. Mr Basi
2. Mr Smith
3. FMA

CFM 1983 : COMMONWEALTH FUND FOR TECHNICAL CO-OPERATION (CFTC)

Mr Littler's minute of 21 July asked whether we could find some "lollipop" for the Chancellor's CFM speech in Trinidad. The Commonwealth Secretary General made a point of praising the work of the CFTC when he saw the Chancellor on 20 July and Mr Kerr recalled that the previous Chancellor had scored an enormous success at the Nassau CFM in 1981 by offering a modest increase in the UK contribution to the CFTC.

Sir Geoffrey Howe's success at Nassau appears to have been based on his willingness to maintain the UK's traditional 30% share in an increasing CFTC budget (producing a contribution of £3.9m in 1981-82, some £700,000 more than the previous year) and our agreement to paying our contributions in the three years up to 1983-84 in single annual instalments as a means of building up the CFTC's operational reserve.

The CFTC's management board (on which ODA represent the UK) met earlier this year to discuss expenditure plans for the three years 1983-84 to 1985-86. The UK representative argued against the Secretariat's proposal which included an element of 5% per annum real growth in addition to an allowance for inflation. However, he received no real support and the Secretariat's target figures were approved. ODA are now recommending that their Minister should approve a 30% contribution based on the approved target figures, despite the Government's

policy of seeking to reduce multilateral aid commitments wherever possible. The resulting UK contribution of £5.7m, £6.6m and £7.6m in the three years is rather higher than the present provision but the increased cost would be absorbed within the overall aid programme.

Given the line taken by ODA's representative at the CFTC management board meeting in May, we believe that the Chancellor would win some credit at the CFM simply by confirming that the UK is after all willing to provide its traditional 30% share of the increased CFTC budget. The increase in our contribution in sterling is of similar order to the one which Sir Geoffrey Howe was able to announce in Nassau. Many Commonwealth countries (particularly the smaller ones) make a point of announcing increases in their CFTC contributions at the CFM. There is no reason why the Chancellor should not announce the proposed UK contribution in his speech and at the same time take credit from the fact that and that under the traditional formula our CFTC contribution rises proportionately with increases agreed by other countries.

We would not advise the Chancellor to go further than this. It would be difficult for Treasury Ministers to be seen to be encouraging ODA to increase expenditure, at a time when the Chief Secretary is having to resist Sir Geoffrey Howe's very considerable additional bids both for aid and for other FCO expenditure in this year's PES.

R J Bonney

R J BONNEY

FROM: J G LITTLER
DATE: 21 JULY 1983

MR ~~BEASTALL~~

COMMONWEALTH FINANCE MINISTERS

As you know, the Chancellor saw the Commonwealth Secretary-General yesterday. Towards the end of the meeting, the Secretary-General mentioned the Commonwealth Fund for technical co-operation, and left Mr Kerr with the impression that he was looking for the UK to give renewed support.

2. This led Mr Kerr to raise with me this morning the question whether we might be able to find some "lollipop" for the September meeting in Trinidad. He said that we had contrived to do this previously in the Bahamas meeting which the previous Chancellor attended, with enormous success, and at trivial cost. This being the present Chancellor's first attendance, it would be nice to make a score of a similar kind.

3. Could you please reflect - have a word with the ODA at this stage as appropriate - in any case have a word with me about it when you have reflected and we can consider whether there is anything available, or anything which could be invented.

(J G LITTLER)

L855

SPACE

FROM: J O KERR
2 August 1983

MR BEASTALL 3/8

c c Mr Littler

DELEGATION FOR THE CFM AND IMF/IBRD MEETINGS

Please see the attached submission.

2. I foresee no problems with the Chancellor over the proposed Treasury team. But I am puzzled by the suggestion that an FCO representative should accompany us in both Port-of-Spain and Washington. Although there were some FCO staff lurking in the background at Lancaster House last year, I cannot recall that we took any to Nassau two years ago. And we certainly have had no FCO chaperone at any of the IMF/IBRD meetings I have attended. Are we sure that we want to set a precedent? Good though Mr Appleyard is, not all his successors might be as helpful. And I am not clear what precisely he would do.

3. The submission also suggests that the Chancellor should decide whether he needs the services in Port-of-Spain of a "communications officer". Neither he nor I would have the faintest idea how to answer this question. The communications officer in Nassau was imported because the communications staff in Nassau were unable to cope with the flow of telegrams which the delegation would generate. I do not know what communications staff there is in Port-of-Spain. Could you settle this one with the FCO Conference Officer?

4. If we are all agreed that we need an FCO chaperone - and that we want to revive the tradition of having someone from the Bank at the CFM - the note to the Chancellor had better, I suggest, explain why. For he is likely to ask. And perhaps the unanswerable question about the communications officer could be suppressed and settled separately with the FCO?

JOK

J O KERR

FROM: J G LITTLER
DATE: 4 AUGUST 1983

MR KERR

cc PS/CST
Mr Unwin
Mr Carey
Mr Beastall
Mr Gilhooly

Mr Basi
Mr Smith
FMA

CFM 1983: CFTC

The attached minute from Mr Bonney of 2 August responds to the point you raised with me, looking forward to the Trinidad meeting.

2. I have asked Mr Beastall to look again, and have a word with the ODA, to see whether there is anything that they are doing or proposing to do, which we could exploit and which, even if known already to the experts, might nevertheless be in some degree publicly exploited at Trinidad. I have to endorse their advice that the Treasury cannot at this juncture afford to press the ODA to look for something new - as you know, the tone of Treasury/ODA relations at the moment is dominated by our resistence to their demands for extra resources.

3. The attached minute gives some basis for a good showing on the CFTC, with little doubt that the line we can take will be modestly welcome. We shall make of it what we can. There will also of course be the report of the Commonwealth Study Group. Not having yet seen it, but heard a little of its outline, I guess that we would be able to give a reasonably positive reception to that, which will also be helpful.

(J G LITTLER)

From: MISS E A CLARKE
Date: 4 August 1983

MISS J C SIMPSON

cc Mr Bonney
Miss Lyons
Mr Williams o/r

TRAVEL TO TRINIDAD AND WASHINGTON: SEPTEMBER 1983

Your minute of 1 August.

2. Mr Middleton has given his permission for Mrs Lawson's travel expenses to be paid from public funds if it is the case as you say, that Lady Howe's were last year.

E A Clarke

MISS E A CLARKE
Assistant Private Secretary

FROM: J O KERR

DATE: 5 August 1983

MR LITTLER

cc PS/Chief Secretary
Mr Unwin
Mr Carey
Mr Beastall
Mr Bonney

CFM 1983: CFTC ETC

The Chancellor has read with interest your minute of 4 August, and Mr Bonney's of 2 August. He very much agrees with you, and Mr Bonney, that it would be wrong to press the ODA to do something new for the Commonwealth, which would incur new expenditure; and he notes that we can take a trick at the CFM simply by confirming that we are after all willing to provide our traditional 30 per cent share of the increased CFTC budget. He agrees that we should announce the proposed contribution in his CFM speech.

2. The Chancellor however agrees with you that it would be very useful if Mr Beastall could indeed establish whether there is anything which ODA are already engaged on, or have already decided to do, of a "Commonwealth" nature but not necessarily particular to the CFTC, which we could also announce - or "re-announce" - at Trinidad. If we can come up with something which would be costless, in addition to announcing our CFTC contribution, so much the better.

J O KERR

I agree with all the declining – including 80th *s. Re MC Don't accept dinner yet, in case [illegible] follow-up turns up. PC.

FROM : P T SHERIDAN

DATE : 5 August 1983

MISS SIMPSON C.

cc Mr Bottrill
Mr Bonney

IMF MEETINGS - SOCIAL EVENTS

As usual, the Chancellor has received a large number of invitations to social functions during the IMF Annual Meetings. These are set out in an annex.

2. Some will take place after the Chancellor has left while others clash either with working engagements or officially sponsored social events which it is traditional to attend. The Chancellor arrives on Friday 23 September and will be tied up then and on Saturday with G5/G7 dinners. The timing is still a little uncertain but this will leave no real time for social engagements on these days.

3. Sunday 25 September is Interim Committee. There will probably be a lunch (maybe to discuss the communique). This means that the other lunch interventions would have to be declined. Monday 26 September sees the Development Committee and we already know that Ishaq Khan (the Chairman) has proposed a lunch.

4. Tuesday 27 September sees the only really firm social engagement - the lunch for bankers which the Chancellor and Governor traditionally host. Other social events at this time will clearly have to be declined. Official events which it would be expected for the Chancellor to attend are the Spanish Chairman's reception on Sunday evening and Larosiere's reception on Tuesday evening. This would entail declining social events held simultaneously.

5. In 1982 Mr Clausen arranged a lunch for the Ministers of the Summit Seven and Saudi Arabia and Kuwait. The Chancellor was not able to attend because it clashed with his bankers' lunch. Clausen suggested that the lunch should become an annual fixture. This year it has been fixed for Wednesday, 28 September - Clausen seems to have gone to some trouble to avoid a clash with other engagements. Mr Anson was of the view that it would be helpful if the Chancellor could attend if at all possible. It would seem to be a good idea for the Chancellor to attend.

6. Clashes with other more important events mean that practically all unofficial events have to be declined. However, providing no other major events crop up, the Chancellor might like to accept the Morgan Guarantee dinner on Monday, 26 September.

ie don't let's accept yet.

G

V. G. Daly

P.P. P T SHERIDAN

C

PS We have now heard that there is also to be a Development Committee dinner on Sunday, 25 September. Officials advise that you should accept.

C I agree with all this. But I don't think we need decline quite as many of the receptions as this suggests: "try to look in" might be the formula for those marked * (some of which can be fun, and we might be feeling bored!)

G

	Saturday, 24 September	
DECLINE	5.00 pm	Cocktail Buffet - Goldman Sachs
	Sunday, 25 September	(INTERIM COMMITTEE)
DECLINE	11.00 am	Lunch - American Security Bank
DECLINE	12.00	Buffet Lunch - Continental Illinois
		Interim Committee Lunch
DECLINE	5.30 pm	Reception - Euro-clear Clearance System
ACCEPT	7.00 pm	Reception - Chairman of Annual Meetings (Miguel Boyer of Spain)
[DECLINE] *	8.00 pm	Reception - Morgan Stanley
ACCEPT		Development Committee Dinner
	Monday, 26 September	(DEVELOPMENT COMMITTEE)
DECLINE	8.00 am	Breakfast - American Security Bank
ACCEPT		Development Committee Lunch
DECLINE	5.30 pm	Reception - Marine Midland
ACCEPT?	8.00 pm	Dinner - Morgan Guarantee
	Tuesday, 27 September	
	Chancellor's lunch for bankers	
DECLINE	12.30 pm	Lunch - Chemical Bank
[DECLINE] *	5.00 pm	Reception - Morgan Guarantee
DECLINE	6.00 pm	Cocktail Reception - First National Bank of Chicago
DECLINE	6.30 pm	Reception - American Express
DECLINE	7.30 pm	Reception - Abecor
ACCEPT	8.00 pm	Reception - Mr Clausen/Mr Larosiere
	Wednesday, 28 September	(SPEECH/PRESS CONFERENCE)
ACCEPT	Lunch with Clausen	Leave for home that night
DECLINE	7.00 pm	Reception - Gulf International Bank
DECLINE	7.30 pm	Dinner - Mr and Mrs Allbritton
DECLINE	8.00 pm	Dinner - Morgan Bank
	Thursday, 29 September	
DECLINE	12.30 pm	Lunch - Goldman Sachs

Goldman Sachs 5.00pm 24/9.

28/9 - Tgos.

FROM: R J BONNEY
DATE: 5 August 1983

Mr Littler.

we spoke.

[initials] 5/vii

1. Mr ~~Beastall~~ [initials] 5/8
2. ~~PPS~~ ✓

cc Mr Littler
Mr Carey o/r
Mr Bottrill
1. Mr Basi
2. FMA

DELEGATION FOR CFM

You asked for a further note in amplification of Mr Basi's submission of 2 August.

2. On the question of FCO representation, FCO wish to send Mr Appleyard <u>in place of</u> the ODA Assistant Secretary who normally attends the CFM and the IMF/IBRD meetings to support Sir W Ryrie. Mr Appleyard is head of FCO's Economic Relations Department (which is a joint Diplomatic Wing/ODA Department) and it has apparently been past practice for ERD and ODA's UN(B) Department to take turns in attending the CFM and Annual Meetings. We see no reason to object to this arrangement. Any change would need to be negotiated at a high level with FCO/ODA.

not in 81 or 82 – no FCO man was at the IMF/IBRD meetings in either year. [initials]

3. As for the Bank of England, I have spoken to Mr Balfour who was the Bank of England representative who did not go to Nassau in 1981. He was unaware that he had been prevented from going - his recollection was that his absence had simply resulted from the last minute change of venue from New Zealand to the Bahamas. The reason for Bank of England attendance is (a) tradition and (b) the presence of other central bankers at CFMs. These are admittedly not very strong reasons. On the other hand the Bank pays its own way and might take it amiss if it is instructed not to send a representative. Mr Balfour is reflecting on the position and we would be grateful for any guidance on the Chancellor's views.

Quite — because I concealed the fact that G.H. vetoed his attendance! (Actually I think G.H. was <u>wrong</u>)

4. We have arranged with FCO for a communications officer to be drafted into Trinidad, as the local staff is said to be inadequate.

[signature]
R J BONNEY

Mr Bowey
Paul, for ...

FROM: J O KERR
2 August 1983

MR BEASTALL

c c Mr Littler

DELEGATION FOR THE CFM AND IMF/IBRD MEETINGS

Please see the attached submission.

2. I foresee no problems with the Chancellor over the proposed Treasury team. But I am puzzled by the suggestion that an FCO representative should accompany us in both Port-of-Spain and Washington. Although there were some FCO staff lurking in the background at Lancaster House last year, I cannot recall that we took any to Nassau two years ago. And we certainly have had no FCO chaperone at any of the IMF/IBRD meetings I have attended. Are we sure that we want to set a precedent? Good though Mr Appleyard is, not all his successors might be as helpful. And I am not clear what precisely he would do.

3. The submission also suggests that the Chancellor should decide whether he needs the services in Port-of-Spain of a "communications officer". Neither he nor I would have the faintest idea how to answer this question. The communications officer in Nassau was imported because the communications staff in Nassau were unable to cope with the flow of telegrams which the delegation would generate. I do not know what communications staff there is in Port-of-Spain. Could you settle this one with the FCO Conference Officer?

4. If we are all agreed that we need an FCO chaperone - and that we want to revive the tradition of having someone from the Bank at the CFM - the note to the Chancellor had better, I suggest, explain why. For he is likely to ask. And perhaps the unanswerable question about the communications officer could be suppressed and settled separately with the FCO?

JOK.

FROM: R J BONNEY
DATE: 5 August 1983

MISS SIMPSON Donna.

cc Mr Bottrill
Mr Sheridan

IMF MEETINGS - SOCIAL EVENTS

Further to Mr Sheridan's note of today. You may have seen from the 2 August telex from Ghulam Ishaq Khan to the Chancellor that he proposes to hold a Development Committee dinner on Sunday 25 September in addition to the traditional lunch on Monday 26 September. I think this should probably take

X precedence over the Morgan Guarantee dinner. (EF agree).

RJ Bonney

R J BONNEY

We spoke - X seems to be on 26 Sept. anyway.

FROM: MISS J C SIMPSON
DATE: 8 August 1983

MR SHERIDAN

cc Mr Bottrill
Mr Bonney

5034.

IMF MEETINGS - SOCIAL EVENTS

The Chancellor has seen your minute of 5 August. He agrees that we should accept the following invitation:-

Sunday, 25 September 7pm Reception - Chairman of Annual Meetings

?8pm Development Committee Dinner

Monday 26 September Development Committee Lunch

Tuesday 27 September Bankers Lunch (Chancellor to host)

8pm Reception - Mr Clausen/Mr Larosiere

Wednesday 28 September Lunch with Mr Clausen

2. He would like to reserve his decision, for the time being, on the question of the Morgan Guaranty Dinner on Monday 26 September.

JS.

MISS J C SIMPSON

INTERNATIONAL DEBT AND IMF FUNDING: KEY DATES

15 August	Mexican drawing under IMF programme.
20 August	Due date for drawing under Argentine IMF programme.
24 August	Possible IMF Board discussion of Argentina.
10 September	BIS - opportunity to discuss Brazil and financing arrangements for IMF.
(10/11 Sept	ECOFIN.)
15 September	Informal rollover of BIS loan for Brazil expires.
(21/22 Sept	Commonwealth Finance Ministers, Trinidad.)
(23 September	G5 Ministers, Washington, IMF issues.)
(24 September	G10 Ministers, Washington, IMF issues.)
25 September	IMF Interim Committee, Washington, IMF issues.
(26 September	Development Committee, Washington.)
(27-30 Sept	IMF/IBRD annual meetings, Washington.)
15 November	Mexican drawing under IMF programme.
20 November	Argentine drawing under IMF programme (subject to renegotiation if necessary).

Country notes

Yugoslavia	IMF mission to review programme in September.
Nigeria	IMF programme likely after election - perhaps in September.
Venezuela	IMF mission to return in mid-August, agreement on programme hoped by early September.
Brazil	Renegotiated IMF programme still to be discussed in Board - possibly in September (or later).

ARGENTINA

Yesterday, 8 August, the Argentine authorities reported both to the IMF and to the representatives of commercial banks in New York that they had removed discriminatory restrictions (and, we understand, met certain other requirements demanded by the commercial banks). Full details are awaited, but the IMF understanding is that a new Law has been or is being introduced which cancels those parts of the Law under which discrimination was imposed against various kinds of payments by UK banks and other companies in Argentina. The IMF are inclined to read this, subject to confirmation, as satisfactorily eliminating existing restrictions and removing the legal basis for future restrictions.

2. In itself, this is satisfactory news. It can be regarded as the result of firmness of the IMF itself and of other leading countries in response to our pressure, fortified by the tough message which the international commercial banks sent to Argentina late last week, as a result of representations by British participants prompted by the Bank of England.

3. Argentina is now pressing for very rapid action both on the IMF standby and on the commercial bank loan:

- On the former, subject to confirmation the IMF staff are proposing to circulate a paper for discussion and decision in the Executive Board on Wednesday 24 August; we have no ground for objecting to that procedure, but shall want to be sure that our conditions are met before approval is given.

- On the commercial bank loan, Argentina has asked for a meeting for signature on Friday, 12 August; this seems to us to be rushing matters far too quickly.

4. The Bank of England will be urging British banks to seek a deferment of the proposed signature meeting, on the reasonable ground that so serious a step should not be taken until the Argentine position with the IMF is further clarified. Indeed, our view is that the commercial banks should not sign ahead of a positive Executive Board decision which cannot occur before 24 August. The Bank of England will hope to persuade British banks to take this view, and persuade their international colleagues, in their own commercial interest. If necessary, however, they will indicate that the Government would consider premature signature ill-advised and be prepared to say so publicly.

5. An element in the commercial bank loan is the requirement for a certificate by the IMF, to the effect that the standby agreement with Argentina is still in operation, before money can be drawn under the loan. Separately, we are asking our Executive Director in Washington to urge the Acting Managing Director not to give any such certificate until the situation is genuinely clear, again probably meaning after the Executive Board discussion on 24 August.

CONFIDENTIAL

Very slightly amended. M.

C.
Argentina note OK?
I hope I'll be able to
add a sentence giving
the UK Banks reaction
to the Balfour/Littler
message - para 4.

FROM: J G LITTLER
DATE: 9 AUGUST 1983

MR KERR

cc Mr Unwin o.r.
Mrs Case
Mr Bottrill
Mr Perfect

INTERNATIONAL DEBT QUESTIONS (below)

Following your note of yesterday, I attach a short draft letter for you to send to No.10, covering a list of meetings and dates. I have also thought it right to include a short note on the latest developments on Argentina. I have dictated this before the meeting of the Bank of England and the commercial banks this afternoon. You might think it sensible to wait until this evening. I shall try to get an account of the meeting from the Bank of England. If what emerges is a clear position of the British Banks, we could incorporate that news - for the better, I hope - in the attached note.

(J G LITTLER)

Copies of this letter and enclosures
go to John Holmes at the FCO and John Bartlett at the Bank.

FROM: MISS J C SIMPSON
DATE: 9 August 1983

MR NEEDLE
EOG5

cc PS/Mr Middleton
Mr Bonney
Miss Lyons

FINANCE MINISTERS' MEETINGS IN TRINIDAD AND WASHINGTON, SEPTEMBER 1983

The Chancellor will be attending the Commonwealth Finance Ministers' Conference in Trinidad, from 20 to 23 September, and the International Monetary Fund Annual Conference in Washington from 23 to 28 September. Mrs Lawson has been invited to accompany him, and I am in the process of obtaining the Prime Minister's permission for her to be regarded as an official member of the party. Hospitality in Trinidad will be provided by the Trinidad Government, and in Washington by the British Embassy. I should be grateful for your advice on what level of subsistence will be payable to the Chancellor, and, assuming the Prime Minister gives her consent, to Mrs Lawson.

JS.

MISS J C SIMPSON

Mr Needle
Mr Bonney
Miss Lyond
PS/Mr Middleton

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

9 August 1983

W F S Rickett Esq
10 Downing Street

Dear Willie,

The Chancellor is proposing to attend the Commonwealth Finance Ministers' Conference in Trinidad from 20 to 23 September, and the International Monetary Fund Annual Meeting in Washington from 23 to 28 September. As in previous years, his wife has been invited to accompany him on both occasions. Hospitality in Trinidad will be provided by the Trinidad Government, and in Washington the Lawsons have been invited to stay with Sir Oliver Wright at the British Embassy.

I should be grateful if you could ascertain whether the Prime Minister is content that Mrs Lawson should be regarded as a member of the official party. Lady Howe has in previous years accompanied the former Chancellor to both these meetings as a member of the official party. Mr Middleton, as the Accounting Officer for the Treasury, has confirmed that he has no objection to this.

Yours,
Judith

MISS J C SIMPSON
Private Secretary

MRS HEDLEY-MILLER ← 95/1

From: A J C EDWARDS
10 August 1983

Principal Private Secretary

I agree with Mr Edwards. c/ ie to reject the specific & keep an open mind about the general content? JS.

[signature] 12/8

cc Mr Littler
Mr Unwin o/r
Mr Fitchew o/r
Miss Court
Mr M A Hall
Mr Peet

Agreed [initials]

BELGIAN ROYAL INSTITUTE OF INTERNATIONAL RELATIONS :

PROPOSAL FOR SPEECH BY CHANCELLOR ON EUROPEAN TOPICS

The Belgian Royal Institute of International Relations in Brussels have asked whether a senior British Minister could give an address there at a time to be determined.

2. Our Ambassador to Belgium has asked in turn whether the Chancellor or the Minister of Agriculture might be persuaded to accept this invitation. His idea is that the Minister concerned might give an address on European matters when visiting Brussels anyway for a Council meeting (flag A below).

3. The Ambassador says that the address should attract good coverage outside Brussels.

4. The Ambassador's suggested date of 12 October is in fact a non-starter. The Chancellor is due to address the Conservative Party Conference on that day, and there is to be a meeting of the the Special Council, probably in Greece, as well.

5. The question is, therefore, whether the Chancellor might offer another date in the autumn for giving such an address. The Chancellor himself may have particular reasons for wanting or not wanting to undertake such a commitment now. Subject to those, I would advise <u>against</u> offering the Institute a date now, for the following reasons:

i. The natural subject for such an address to a European audience would be the UK's ideas on the safety-net and an agricultural expenditure guideline. We have however already circulated papers on these subjects to the Council, and Sir Geoffrey Howe is expected to make a major speech

17/8

in Europe, probably in early October, covering this ground. We would not normally advise the Chancellor to devote the considerable amounts of time which such engagements take unless there is a new and important message which needs to be put across to the wider European audience and/or some compelling negotiating reason (eg vis a vis the European Parliament) for giving a public speech at a particular time.

ii. There could be a time later in the year or early next year - eg shortly before the Athens European Council or the critical European Parliament session in December, or alternatively in January of next year - when a major speech by the Chancellor would be especially valuable and timely.

iii. We would also like to check further how good a forum the Belgian Institute would be for reaching the European audience.

6. MAFF officials will be consulting Mr Jopling on his return from holiday about whether he would like to take up the Institute's invitation.

7. Subject to the Chancellor's own views, and Mr Jopling's reaction, we would suggest that the Embassy in Brussels might be asked to tell the Institute that British Ministers do not immediately see the occasion for an address but much appreciate the invitation and would like to bear it in mind against some possible future occasion.

8. We should be grateful to know whether the Chancellor would be content with this.

AJCE

A J C EDWARDS

We should like a decision on para 3 fairly quickly, as the FCO need to know — Trinidad is desperately short of staff. Mr Bonney's note of 5 Aug. below says that the communications officer has already been drafted.
B.

FROM: J G LITTLER
DATE: 11 AUGUST 1983

MR KERR

cc Mr Carey o.r.
Mr Beastall
Mr Bottrill
Mr Bonney
Mr Basi

DELEGATIONS FOR CFM AND IMF/IBRD MEETINGS

I have had some difficulty trying to sort this out, because of people being away on leave. The position is still not absolutely clear, but I hope the following will do for the time being.

Treasury

2. What is proposed is normal and, I think, uncontentious:

For Trinidad: The Chancellor (and Mrs Lawson), Mr Kerr, Mr Littler, Mr Carey, Mr Hall and (see below) a Personal Secretary and a Communications Officer/Clerical Officer.

For Washington: The Chancellor (and Mrs Lawson), Mr Kerr, Sir T Burns, Mr Littler, Mr Lavelle, Mr Hall.

Apparently in 1981, a PS was provided by the FCO.

3. I think the only question here is whether the Chancellor will want a Personal Secretary and a Communications Officer; and if so, does he wish to take his own Personal Secretary, or should we negotiate for the FCO to send somebody from Washington, which would be cheaper? X

Bank of England

4. I think there is now no problem here either:

For Trinidad: Nobody (I have agreed this with Mr Balfour, who would simply like - as I have agreed - to reserve the position for future occasions: what they tend to do, very reasonably, is to suggest inclusion of a Bank of England delegate if the location is such that useful business can be done in the margins or immediately before or after, which is not the case on this occasion).

For Washington: The usual delegation of Governor, Mr Loehnis and Mr Gilchrist.

FCO/ODA

5. Sir William Ryrie will join us in both Trinidad and Washington - normal and necessary because of the substantial ODA business involved in both. On some past occasions he or his predecessor has had support from his own staff or the FCO. On this occasion, it was suggested that Mr Appleyard (FCO should join the party.) I do not think we should object, although my latest information is that there is some doubt whether in fact he will go to Trinidad. Perhaps we could keep him on the list for bookings, etc, but be ready to cancel.

For Washington: Like you, I raised an eyebrow at the suggestion that Mr Appleyard should be among the delegation for Washington also, particularly when I heard that there would be a team from ODA in Washington at the same time for special IDA meetings. However, I have now confirmed with the ODA that their team for the IDA negotiations is proposed to be Sir William Ryrie and Mr Appleyard. I have made it clear to Mr Thomas at the FCO (who entirely accepted what I said) that there would really be no place for Mr Appleyard as part of our IMF (and G5, G10, etc) team. But on the basis that he will be required by Sir William Ryrie to help on the IDA front, I think we can tolerate his presence this time, and it would be a matter of convenience, to Sir William Ryrie, to include him in the IMF/IBRD delegation.

(J G LITTLER)

(PM)

10 DOWNING STREET

EXCHEQUER
12 AUG 1983
ACTION Mr Needle
COPIES Mr Bonney
Miss Lygnd

From the Private Secretary

11 August 1983

PS/Mr Middleton

Dear Judith,

Thank you for your letter of 9 August seeking the Prime Minister's permission for Mrs. Lawson to accompany the Chancellor when he attends the Commonwealth Finance Ministers' Conference in Trinidad and the International Monetary Fund Annual Meeting in Washington in September.

Mrs. Thatcher is content for Mrs. Lawson to be regarded as a member of the official party on both occasions.

Yours ever
Tim

Tim Flesher

Miss Judith Simpson,
H.M. Treasury.

FROM: MISS J C SIMPSON

DATE: 15 August 1983

MR EDWARDS

(PJ)

cc Mr Littler (or)
Mr Unwin (or)
Mrs Hedley-Miller
Mr Fitchew (or)
Miss Court
Mr M A Hall
Mr Peet

BELGIAN ROYAL INSTITUTE OF INTERNATIONAL RELATIONS:
PROPOSAL FOR SPEECH BY CHANCELLOR ON EUROPEAN TOPICS

The Chancellor has seen your minute of 10 August. He agrees with the suggestion in your paragraph 7, that for his part we should suggest to the British Embassy in Brussels that they tell the Institute that British Ministers do not immediately see the occasion for an address, but much appreciate the invitation and would like to bear it in mind against some possible future occasion.

JS.

MISS J C SIMPSON

FROM: MISS J C SIMPSON
DATE: 15 August 1983

MR BASI

cc Mr Littler (or)
Mr Carey (or)
Mr Beastall
Mr Bottrill
Mr Bonney

DELEGATION FOR CFM AND IMF/IBRD MEETINGS

Mr Littler minuted Mr Kerr on 11 August, with a suggested delegation for both Trinidad and Washington. He particularly drew our attention to the question of whether the Chancellor wanted to take a Personal Secretary and a Communications Officer; and you were kind enough to find out for us the respective costs of providing a Personal Secretary from Washington and from London.

2. The Chancellor's Senior Personal Secretary will in fact be on leave that week, and will not therefore be available. We should therefore be grateful if you could open negotiations to get the Chancellor a Secretary from Washington. On the question of a Communications Officer, I understand from Mr Bonney's minute of 5 August that arrangements have already been made for one to be drafted in.

3. We think that the rest of what was proposed in Mr Littler's minute is quite acceptable.

JS.

MISS J C SIMPSON

FROM : J S BEASTALL
DATE : 14 SEPTEMBER 1983

CHANCELLOR OF THE EXCHEQUER

c.c. Mr Littler
Mr Unwin
Mr Carey
Mr Lavelle
Mr Bonney

COMMONWEALTH FINANCE MINISTERS' MEETING : LEAD SPEAKERS

The Commonwealth Secretariat have asked if you would be one of the two lead speakers on World Bank affairs at the CFM. They are hoping that the lead speakers will be as follows :-

World Economic Situation (including Study Group report)	:	New Zealand (Mr Muldoon) India
IMF affairs	:	Canada Ghana
World Bank affairs (including IDA)	:	Yourself Bangladesh
(plus Commonwealth Technical Co-operation	:	Secretary-General Uganda)

2. It is the custom to have an introductory speech on each main topic from one developed country and one LDC. It is suggested that these speeches last 15 minutes each. The floor is then thrown open to other contributors. World Bank affairs are likely to be discussed on the second morning (Thursday).

I agree.

3. We would recommend you to accept this invitation. It is certainly appropriate for the UK to make one of the lead speeches and although you will be under pressure from the LDC's on IDA, World Bank affairs are probably the least embarrassing of the three main topics for the UK to speak on.

4. The Commonwealth Secretariat will be writing to you formally about this. However in view of the shortage of time it would be most helpful if you would say now whether you are content.

JSB

J S BEASTALL

It doesn't of course prevent you zapping Muldoon earlier on!
GH

FROM: J O KERR
DATE: 15 September 1983

cc Mr Littler
Mr Unwin
Mr Carey
Mr Lavelle
Mr Bonney

MR BEASTALL

CFMM: ORDER OF SPEAKERS

The Chancellor was grateful for your minute of 14 September. He agrees that we should accept the Commonwealth Secretariat's proposal that he should be the lead speaker on the IBRD/IDA item in Trinidad next week.

JOK.

J O KERR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Middleton
Mr Littler
Mr Cassell
Mr Corney
Mr Unwin
Mr Lavelle
Mr Monck
Mrs A Case
Mr Bottrill
Mr Hall
Mr Peretz
Mrs Bennett

PWP

G10

FOR

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

M C Scholar Esq
10 Downing Street
London SW1

19 September 1983

Dear Michael,

INTERNATIONAL FINANCIAL SCENE

I enclose the latest assessment of the international financial scene by the Bank of England, which the Treasury have discussed with the Bank and other Departments. The Prime Minister may find it useful background for her forthcoming visit to Canada and the United States.

2. The general tone of this latest assessment is little changed from the last assessment in July. The Chancellor has however asked me to draw attention to the following particular points which arise from our consideration of the assessment.

3. On the positive side, the Bank's note points to the improvement in economic activity in the major industrial countries, particularly in the US, which is of direct help to many of the major debtors. This more optimistic tone, as regards the US economy at least, has been reflected in the recent IMF World Economic Outlook paper.

4. The outcome of the conference on debt held by the Organisation of American States in Caracas from 5-9 September was better than anticipated. Speeches by the delegates were on the whole moderate, and there was no call for a debtors' cartel. Ministerial sessions at the end of the meeting endorsed a factual paper analysing the present position on international debt. Attempts to agree a draft resolution on policy were abandoned. It is encouraging that the Brazilians and Mexicans took a particularly moderate line in the discussions.

5. On the debit side, it is still not clear how the wrangle in Congress over the IMF quota legislation will be resolved. Sittings of the Conference Committee of both Houses have now begun but are not expected to be completed for some weeks. The odds still are that the legislation will go through, subject to a number of restrictive provisions. But meanwhile the uncertainty also casts a shadow over operational decisions on such issues as IMF access limits, and hence over the forthcoming IMF/IBRD Annual Meetings.

6. On individual countries Brazil remains the main focus of concern. The assessment does not on this occasion include a detailed section on Brazil, in view of the Prime Minister's discussion with the Chancellor and the Governor earlier this week. It is, however, worth reporting that at a meeting of G5 deputies in Paris this week our representative, with strong support from his French and German colleagues, made it clear to Beryl Sprinkel that we were not prepared to go further than support through the Fund and official (Paris Club) rescheduling. Sprinkel will report this back to the Fund Managing Director. We shall let the Prime Minister have up to date briefing on Brazil before her visit to the US.

/7.

7. Of the other countries, the Philippines are becoming a bit worrying, given the political tensions. A JIC assessment is in preparation and the Fund have promised an assessment for the informal group of G5 officials.

8. I am sending copies of this letter to Brian Fall (FCO), John Rhodes (DTI) and John Bartlett (Bank of England).

Yours ever,

John Kerr.

J O KERR

CONFIDENTIAL

INTERNATIONAL FINANCIAL SCENE

General Situation

1 There seems, in so far as one can generalise, to have been marginally encouraging progress on the international debt scene over the past two months, evident most noticeably in Mexico and Chile, helped by - on balance - more favourable developments in the world economy, Fund programmes and domestic retrenchment. However, the Brazilian situation remains on a knife edge. The problems of the Philippines have been rendered more acute by political uncertainties and differences with the IMF over the standby arrangement; and a few more countries have applied for debt relief (eg Morocco) or are preparing to do so (Liberia). Although their problems add little to the size of the global debt problem they do contribute to the cumulative impact on banks' reluctance to lend more to ldcs.

Economic background and interest rates

2 The pick up in economic growth in the major industrial countries overall is proceeding a little faster than seemed likely earlier this year. Certainly this is true in the United States where GNP grew at an annual rate of more than 9% in the second quarter. This exceptional pace may now be slackening but growth of 5-6% in the year to 1983 Q4 now seems likely compared to the US Administration's January forecast of 3%. Renewed growth is also evident in Canada and Japan, both of which are benefitting from the US upturn. In Europe the recovery is less impressive: the positive growth of around 1/2% now forecast in Germany for 1983 as a whole is an improvement on the earlier forecast GNP decline, but France and Italy have yet to show much sign of a sustained revival. The improvement in the industrial world generally is directly helping a number of major LDC debtors, particularly in Latin America, where one-third of exports go to the United States. The impact is likely to be felt not only in improving export volumes terms but also in their terms of trade: the Economist index of dollar commodity prices, for example, has risen by 25% since its October 1982 trough.

3 Against this, however, US short-term interest rates touched a peak for 1983 in August, although they have since eased somewhat; and high US interest rates and the strength of the dollar remain, for countries whose debt is largely dollar-denominated, a major impediment to any more significant improvement in the general debt situation.

Lending attitudes

4 Another adverse factor for ldcs is the continuing slowdown in international lending. The interbank market has shared in this slowdown but major difficulties in it have been avoided. Nevertheless there is evidence that some as yet credit-worthy developing countries are finding it more difficult to obtain financing needed for imports.

Problem countries (other than Brazil)

(i) Latin America

5. The atmosphere surrounding Venezuela's negotiations with creditor banks has worsened significantly. The talks continue to be hampered by substantial interest arrears (some $600 mn) leading to a growing gulf between the Venezuelan authorities and creditor banks, and some banks are taking legal action. The authorities have ruled out an approach to the IMF prior to December's elections and although this will jeopardise the Venezuelan's chances of reaching an outline agreement with the banks by end-September, a further 90-day extension of the existing moratorium appears inevitable. Final agreement on a rescheduling is thus unlikely to be reached until next year.

6. In contrast, Mexico's position continues to improve. IMF targets are being met and the first three rescheduling agreements were signed on 26 August. Mexico's liquidity is underlined by a surplus on current account in the first half of the year which has notably led to a punctual repayment of the outstanding balance of the BIS facility. There are signs of improvement also in Chile where access to IMF resources is restored, agreements have been reached with the banks for new medium- and short-term credits and reserves seem to have stabilised after earlier dramatic losses.

7. In Argentina, the IMF's approval of the steps taken by the authorities to remove discriminatory restrictions against the UK, has paved the way for the release of the final tranche of the banks' bridging loan and agreement over the $1.5 bn new money loan. The Department of Trade continues to monitor Argentina's fulfilment of her commitments to ensure that restrictions are not reimposed. The banks, meanwhile, have delayed disbursement of the new loan because of the discriminatory interpretation of the Bankruptcy Law by an Argentine judge. More seriously, the IMF fears that the standby agreement programme for Argentina may be under strain because of increasing pressure on the Government to ease wage restraint, accelerating inflation and an increase in the public sector deficit.

8. Elsewhere refinancing agreements have been signed for Peru (Paris Club) and Uruguay (commercial banks) whilst the rescue package for Ecuador has been effectively finalised apart from a few relatively minor difficulties. This should be completed in the near future.

(ii) Eastern Europe

9. Recent developments in Eastern Europe suggest slow and patchy progress. Official creditors have agreed in principle to resume rescheduling negotiations with Poland in October and the commercial banks have agreed in principle to reschedule 1983 maturities, but the underlying situation offers little ground for optimism. The 1983 international support package for Yugoslavia is nearly complete. Signature of the commercial bank element is proceeding and disbursement is now expected before the end of October. As soon as the IMF have been advised of the availability date for the first advance of the commercial bank agreement the Fund will be able to release the blocked drawing of $110 mn originally scheduled for 15 August. Disbursement of the $200 mn gold-backed tranche from the BIS (which had as an interim measure postponed the repayment due in August) now seems imminent following the waiver of a negative pledge clause by a Kuwaiti-led syndicate. The Bank of England's participation has been eliminated by the second instalment of HMG's loan. With the assistance of international agencies Hungary appears to be having success in raising sufficient new funds to meet 1983 debt maturities but there is concern for 1984 when commitments are set to rise. Timar, President of the National Bank of Hungary, who met the clearers on his visit to London, looked for their support in the smaller syndicated loans which the Hungarians hoped to raise towards the end of this year or in early 1984. There has been no confirmation of earlier reports that the GDR has opened bilateral negotiations with a number of (unnamed) creditors to reschedule some of its maturing debt.

(iii) Southern Europe

10. Several countries in this area are faced with uncomfortably large borrowing programmes to refinance their continuing external deficits and although none seems likely to run into debt difficulties in the foreseeable future their position needs watching. Portugal has recently concluded talks with the IMF on terms for an 18-month \$480 mn standby arrangement which should assist market sentiment towards an expected approach in the autumn. In the meantime there are reports of an approach to the BIS for a \$300 mn gold-linked loan in addition to the facilities arranged in March and June. Growing concern is being expressed about Greece as poor export performance and reduced invisible earnings have led to a widening of the current account deficit and placed increased strain on already sharply reduced foreign exchange reserves. Although Spain seems potentially a larger problem because external earnings have been growing more slowly than the rising service on external indebtedness and progress in improving the current account is slow, the recently concluded \$750 mn loan suggests continued market confidence. Although sheltered by financial support from the United States, increasing awareness of the weakness of the Israel economy has prompted introduction of a number of measures including a 7.5% devaluation and public sector expenditure cuts. If a period of political instability follows Begin's resignation the external situation could deteriorate further.

(iv) Far East

11. There have been no major developments in the economies of the Far Eastern problem countries. In the Philippines, however, the assassination of the prominent opposition politician Aquino, and renewed speculation about the health of President Marcos, by raising concern about the prospects for political stability, may further weaken international banking confidence. The Philippines' chances of avoiding rescheduling, in the short-term, remain delicately balanced, but Indonesia and South Korea look reasonably placed at least for the remainder of the year.

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Note: An estimate of the country's total external debt is given at the beginning of each note and a statement of ECGD's position and the exposure of UK banks is given at the end.

ARGENTINA

Total external indebtedness at end-1982 was estimated at $39 bn.

An exceptional IMF Executive Board meeting on 15 August gave early approval of Argentina's exchange system, following her belated compliance with the Fund requirement to remove discriminatory financial restrictions against UK companies. The Argentines had introduced a new Law 22820 on 6 June giving the National Vigilance Committee power to lift the discriminatory effects of Law 22591 introduced in May 1982 but initially the authorities were only prepared to make Law 22820 effective for British banks in the hope that signature of the $1.5 bn commercial loan would follow. When it became evident that only the full removal of discriminatory exchange restrictions against all UK companies would satisfy both the Fund and the banks the Argentines informed the Fund on 8 August that restrictions on current international payments by British non-financial firms were being lifted. A preliminary check of the British companies concerned satisfied HMT that this was the case and the new situation enabled the Executive Board to complete the review of the Argentine exchange system. In the review the Board decided that any reintroduction of discriminatory exchange restrictions or any liberalisation of payments on a discriminatory basis would make Argentina ineligible for further drawings.

However, British companies have so far generally proved reluctant to test the effectiveness of the Argentine assurances after 15 August. They apparently have no wish to be singled out as "trouble makers" in the interest of future commercial relations. Of the six companies that have obtained permission to remit via BONEX, only LBI, BBI and RTZ have done so.

Moreover, before the second conditional tranche of the fifteen-month standby can be drawn (it has been theoretically available since 20 August) the Argentines must still ensure that all payments arrears, except those subject to rescheduling agreements with the commercial banks, are eliminated and that they had met all quantitative performance criteria at end-June. An IMF technical mission arrived in Buenos Aires in mid-August and is expected to

confirm Argentina's compliance with the performance criteria but a further Board meeting will probably be necessary when all commercial and other arrears are cleared to approve release of the second conditional tranche. This is unlikely before end-September.

Once the IMF had formally approved the exchange system, signature of the $1.5 bn commercial loan began in New York and it was expected that all banks would have signed the loan book by the first week in September. However, there are two outstanding issues affecting the drawdown of this loan. Firstly, drawings under the loan are subject to a model public sector rescheduling agreement for Aerolineas Argentinas being concluded. There is still thought to be some dissatisfaction with the draft rescheduling agreement and it is unlikely that final agreement will be reached before mid-September. Secondly, the intention of an Argentine judge to invoke Article IV of the Bankruptcy Law (which discriminates against foreign bank creditors) in resolving the affairs of the private company Celulosa Argentina could well cause further delays in releasing the new money. Although disbursements are not conditional on the promised amendment to Article IV, there is increasing evidence that banks may delay disbursements if Article IV is enforced. A further condition for releasing the new money will however have been satisfied with the elimination of interest arrears incurred in May, made possible by the release on 24 August of the $300 mn final tranche of Argentina's $1.1 bn bridging loan. Interest payments from May onwards have been met on time.

Looking ahead, recent economic indicators suggest that compliance with future Fund targets could be difficult to achieve particularly given the uncertainties generated by the forthcoming presidential elections to be held on 30 October.

At end-1982, ECGD had an estimated total of $370 mn at risk. Argentina remains off cover. At that date, UK-registered banks' consolidated external claims on Argentina totalled $3.3 bn; of which unguaranteed claims by British-owned banks totalled $2.3 bn.

BRAZIL

Total external indebtedness at end-1982 was put at $83 bn by the Central Bank.

Amongst debtor countries, Brazil's situation remains the most serious. Although the IMF Managing Director's approval of a revised EFF programme is expected shortly, the banks have been taking a tough attitude. During recent Advisory group discussions in New York, they made it clear that they would not be willing to put up more than $6 bn out of the $7.6/8.4 bn required to see Brazil through the remainder of 1983 and 1984. The residual, which already assumes the rescheduling of Paris Club maturities, would have to come from governments and official bodies, and the banks insist, should be on terms comparable to their own lending (ie an 8 year maturity) The urgency with which the official sector will have to react is highlighted by the country's severe cash liquidity position with the accumulation of some $2.0 bn in gross arrears: and by the banks' insistence that they will not launch their new package without an assurance that adequate official support will be forthcoming.

The present position on the various elements of the financial package is as follows:-

1 IMF. Brazil's revised letter of intent to the IMF is still being refined according to the new Central Bank President Affonso Pastore. However, it is understood that agreement with the Fund on major issues was reached towards the end of August; inter alia, the target for the rate of inflation is to be 2.5% per month by the end of 1984 compared with some 13% now, the operational budget is to show a small surplus (0.2/0.3% of GDP) in 1984 compared with a deficit forecast for 1983 of 2.7%, and the current account deficit of the balance of payments is to be $6 bn in 1984 ($7.7 bn in 1983). The IMF Managing Director will wish to be assured that all elements of the financial package are agreed in principle before bringing the revised EFF to the Executive Board. The board discussion may take place towards the end of October. The undrawn end-May and end-August tranches (each for SDR 374 mn) are then expected to be made available.

2 Commercial banks. Discussion of Phase II of the banks' assistance continues. The banks are considering "acceleration" of disbursement of tranches 2, 3 and 4 (totalling \$1.9 bn) of the Phase I jumbo loan of \$4.4 bn (\$2.5 bn having been disbursed). Acceleration would permit repayment of the balance of an earlier bridge loan (\$1.3 bn outstanding, including interest, fees etc) and some reduction of Brazilian arrears. Before taking action, however, the banks require the IMF Managing Director to signal his approval of the Brazilian EFF programme and his confidence that all necessary official financial support will be forthcoming.≠ The banks are also considering raising \$6 bn in new money for Brazil, disbursement of which would be linked to disbursement from the EFF; refinancing 1984 maturities of principal on their medium-term lending to Brazil on more generous terms (longer maturity and grace period and? lower fees) than the 1983 refinancing; and maintaining trade and money market lines on a committed 360 day basis. The new money would not be available before late November/December; even this assumes no problems on the IMF timetable.

The commercial banks have indicated that they might not insist on full repayment of their bridge loan if the official sector (= BIS) left in some of its present lending. This would ease the liquidity pressure on Brazil. The Brazilians have suggested that liquidity relief could be provided by the banks agreeing to the capitalisation of interest falling due from now until end-1984. This would be tantamount to a loan of \$8.4 bn and would relieve Brazil of the need to seek finance from the official sector (governments). This proposal is strongly opposed by de Larosiere and by most banks on the Advisory Committee; Deutsche Bank, however, and possibly the Bank of Tokyo tend to favour the idea.

3 Official sector. There is some prospect of the IBRD and IDB providing "several hundred" million dollars more than is at present forecast. Eximbank has recently offered a \$1.5 bn guarantee

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≠ Later indications are that the banks may not "accelerate" until the revised EFF has been approved by the Executive Board.

facility which the Advisory Committee may now consider an acceptable official contribution provided disbursement is rapid ie reduces the cash gap. The facility still faces opposition in the US and may not be approved. It is in any case conditional on other governments making "comparable facilities" available, which may be made difficult by Brazil's approach to the Paris Club. ø

4 Paris Club. On 17 August Brazil formally applied for the Paris Club rescheduling of loans from or guaranteed by governments and their agencies together with officially guaranteed supplier credits. It is not yet clear whether, in addition to arrears accumulated since March ($109 mn) and maturities of principal and interest falling due between 1 August 1983 and end-1984 (around $2.1 bn) the rescheduling of 1985 and 1986 maturities will also be requested. The Paris Club is to have a first meeting on 15 September; meanwhile the authorities are reported to have suspended payments of principal and interest on official debt.

5 The BIS have meanwhile decided to put the end-August $400 mn repayment on the same footing as the three-times postponed end-May repayment. Further discussion of this will take place at the Basle meeting on 12/13 September.

At end-1982, ECGD had an estimated $2.5 bn at risk. Brazil still remains on cover but ECGD is about to propose making no new cover available until the Paris Club negotiations are complete. At end-1982 UK-registered banks' consolidated external claims on Brazil totalled $7.9 bn of which unguaranteed claims by British-owned banks totalled $4.4 bn.

ø At official level it has been proposed and broadly agreed that HMG's policy should be to offer additional but unspecified insured export credit facilities.

CHILE

Total indebtedness at end-1982 was $18 bn (two-thirds private sector).

Chile remains on course to return to the original path of its IMF standby arrangement by end-September following Fund approval of its request for a waiver of end-June performance criteria on 27 July and signature of a $1.3 bn new money facility. The first tranche ($500 mn) of the latter, however, has reportedly not yet been drawn, presumably because Chile is trying to demonstrate that her position is improving: after a dramatic loss in reserves in the first quarter the level seems to have stabilised in the second. The second and third disbursements of $570 mn and $230 mn respectively are linked to Chile's scheduled purchases from the Fund in mid-August (SDR 108 mn - including the suspended May drawing of SDR 54 mn) and mid-November (SDR 54 mn).

The existing moratorium on principal payments in respect of medium-term lending by commercial banks was extended for a further 90 days from end-July to enable a rescheduling agreement to be finalised: reportedly this has now been done, but it is not yet officially confirmed. Although a separate short-term trade-related facility was over-subscribed by some $0.5 bn, indications are that the full amount will not be used.

With unemployment around 30% and violence in the streets, social and political pressures on the government are considerable. Since the IMF programme leaves little room for any expansion of the domestic economy, the authorities may seek some relaxation of next year's targets to alleviate the effects of the recession. Such a move seems unlikely, however, until Chile has drawn down the final tranche of its 1983 new money facility.

At end-1982, ECGD had an estimated total of $0.06 bn at risk. Chile remains on cover. At that date UK-registered banks' consolidated external claims on Chile totalled $1.8 bn; of which unguaranteed claims by British-owned banks totalled $1.1 bn.

ECUADOR

Total external indebtedness at end-1982 was $6.3 bn.

Ecuador's commercial bank financing package is in the process of being finalised. Signature of the new money loan has still not taken place - although full commitments to the targetted $431 mn have apparently been obtained from the banks. Various difficulties remain over the mechanics of how private sector obligations will be transformed into central bank obligations prior to rescheduling/refinancing by the banks. However, with bankers' commitment to the package now having been secured, the IMF are satisfied that drawings under the SDR 157.5 mn IMF standby (approved in principle on 1 June) may proceed. The government has already taken a number of austerity measures and faces considerable difficulties in implementing the programme in the run up to next year's elections. Although not confirmed, it is assumed that, after an initial first tranche, subsequent disbursements under the new money facility will be contingent on disbursements under the standby.

Agreement was reached on the rescheduling of official debt at a meeting of the Paris Club on 27-28 July; principal and interest payments on such debt had been suspended from 1 June whilst negotiations took place. The rescheduling will be over 8 years, including 3 1/2 years' grace, and will cover 85% of principal and interest falling due from 1.6.83 to 31.5.84. Of the remaining 15%, 10% will be payable according to the original schedule (not later than 30.11.83 where maturities are already overdue); and 5% will be paid on 31.12.84. The Ecuadorians had originally sought to reschedule $268 mn principal (some $30 mn relating to ECGD) and $104 mn interest falling due up to 31.5.85. At the meeting there was agreement in principle to hold a further meeting after 31.5.84 to consider maturities falling due up to 31.5.85.

At end-1982, ECGD had an estimated total of $0.1 bn at risk. In early August HMT agreed to suspend all cover outside the short-term. At end-1982, UK-registered banks' consolidated external claims on Ecuador totalled $0.75 bn; of which unguaranteed claims by British-owned banks totalled $0.5 bn

MEXICO

Total indebtedness at end-1982 was an estimated $83 bn.

A healthier than expected trade balance and prudent husbandry of resources have produced an improvement in Mexico's external financial situation. In the first seven months of this year the trade surplus totalled $7.4 bn, equivalent to 90% of the originally forecast outturn for the whole of 1983 and largely attributable to a 58% reduction in imports over the same period last year. Mexico's liquidity position has improved; international reserves at end-August were $3.55 bn compared with $1.7 bn at end-November 1982. The authorities are confident that they will not need additional new money from banks in 1983. However, new money requirements from banks for 1984 are still put at the originally forecast amount of $4 bn.

Disbursements under the the $5 bn medium-term commercial bank loan, signed in March, and linked to EFF purchases, were used on 23 August to repay the parallel BIS and US bridging facilities totalling $1,850 mn (UK share of $140 mn), put into place at the height of the crisis last year. After two advance repayments at end-May and in mid-August, the outstanding balance of $1.2 bn was repaid on the due date.

Attention in recent months has largely centred on negotiations to restructure public and private debt. Rescheduling agreements for three of 24 public sector entities accounting for over half of some $19 1/2 bn of public sector principal payments due to banks between 23 August 1982 and end-1984, were signed on 26 August. Agreements for other state agencies are expected to be signed in due course. The debt is being rephased over eight years.

However two Mexican schemes to reschedule some $3-5 bn of supplier credits and some $10-14 bn in non-guaranteed private sector debt owed to banks (in this case over a minimum of 6 years) have been less successful: $900 mn had been rephased by end-June. Both schemes involve the provision of forward foreign exchange cover to debtors who establish dollar-denominated deposits by making peso payments equivalent to the amount of debt owed. On 3 August the Bank of Mexico announced

an extension of the supplier debt scheme following failure of a large number of debtors to meet the original 15 July deadline. The bank debt scheme stays open to 25 October but may also have to be extended or refined. Many companies do not have sufficient liquidity to join, even where peso loans are made available, or are still working out their cash-flow projections for the various complex repayment options afforded by the scheme. Indeed, the ten largest Mexican industrial groups, reportedly accounting for half of total outstanding private sector debt, have yet to agree. Those who have joined the scheme are mainly the subsidiaries of foreign companies.

Following multilateral agreement on the restructuring of some \$1 1/2 bn of officially-guaranteed private sector debt, signed on 20-22 June, the Mexicans are currently negotiating implementation on a bilateral basis. There have however been reports of difficulties with certain creditors (eg Canada) over the extent of Mexican responsibility for commercial risk.

The improvement in Mexico's liquidity position is expected to enable the authorities to accelerate repayment of private sector interest arrears which have been paid off in instalments under a special scheme devised last December.

At end-1982, ECGD had a total of \$1.8 bn at risk. At that date UK-registered banks' consolidated external claims on Mexico totalled \$8.3 bn, of which unguaranteed claims by British banks were \$5.2 bn.

PERU

Total external indebtedness at end-1982 was an estimated $12 bn.

Despite the encouraging progress with the country's various refinancing packages (see below), there are worrying indications that future adherence to the IMF programme (whose targets were being met at end-July) will be threatened by measures introduced towards the end of August. These included a slowdown in the removal of subsidies, a halving of the pre-announced rate of devaluation and a credit injection by the Central Bank.

The $450 mn new money loan was finalised in the third week of July. Rebates to the banks in respect of over-subscription has meant that the increase in their exposure had been scaled back to around 10 1/2% from the 12% originally requested. The first $250 mn tranche was disbursed on 3 August.

A final figure for the refinancing loan had still not emerged, but the amount is likely to be around $410 mn.

Progress on the rollover of $2 bn short-term debt has been slower than expected. Although the value of commitments to the rollover had been sufficient (66/67%) to trigger disbursement of the first tranche of new money, there are still a host of very small lines, mainly out to Peruvian private sector banks, in respect of which amounts need to be reconciled, documentation drawn up and agreements signed. Such lines, which are also trade and not just working capital related (as originally advertised by the Peruvians), have to be dealt with since there has been no agreed cut-off point.

On 26 July, Peru reached agreement with Paris Club creditors to reschedule, over 8 years, including 3 1/2 years' grace, 90% of principal and interest on medium-term debt due from 1 May 1983 to 30 April 1984.

Around October the banks will be turning their attention to the need next year for a further restructuring of Peruvian debt maturities.

At end-1982, ECGD had a total of $0.2 bn at risk. At that date, UK-registered banks' consolidated external claims on Peru totalled $0.8 bn of which unguaranteed claims by British banks were $0.4 bn.

URUGUAY

Total external indebtedness at end-1982 was an estimated $4 bn, of which $2.7 bn was public and publicly-guaranteed.

On 23 August the Fund waived breaches in balance of payments and net domestic assets performance criteria under the SDR 378 mn standby negotiated last April on the grounds that these were small and fully explained by delays in reaching agreement on refinancing external debt and securing new medium-term foreign bank credit. However, recent indications suggest there will be difficulty in complying with end-year targets. According to a Central Bank spokesman public expenditure targets will be adhered to but revenue targets may not be met owing to a fall in export volumes and high levels of tax evasion.

Negotiations on the commercial bank package were finally completed on 29 July, four months after agreement to the Uruguayan proposals by the Advisory Committee. The agreement covers the refinancing of 90% ($629 mn) of public sector principal payments falling due in 1983/84, and the extension of a new medium-term loan of US$240 mn. The first disbursement of this loan for US$120 mn took place on 17 August and the second and final instalment is to be released in early December. Repayment is over six years, including two years' grace, but with near-end loading to ease the effect of the short grace period; interest is at LIBOR +2 1/4% or at US prime +2 1/8%.

In addition banks have agreed to roll-over, for up to one year, $75 mn trade-related credit lines to the public sector and $7 mn in lines to private Uruguayan banks.

At end-1982, ECGD had an estimated total of $10 mn at risk. At that date UK-registered banks' consolidated external claims on Uruguay totalled $350 mn of which unguaranteed claims by British-owned banks totalled $300 mn.

VENEZUELA

Total external indebtedness at end-1982 was estimated at $34 bn.

Following consultations with the IMF in August, Finance Minister Sosa has announced that Venezuela will not be seeking conditional IMF assistance this year but he hoped that a one-year facility could be agreed early in 1984. This move has been prompted by the proximity of Presidential elections (due to be held on 4 December) and some improvement in the external position. Underscored by a moderate pick-up in the world oil market and a reduction in imports, a current account surplus of $2 1/2 bn is forecast as against a previously expected deficit. No new money will be sought from the banks this year and financing needs will be met instead by drawing down reserves by $1 1/2-2 bn from their present level of $10 bn.

As a result, the Advisory group of banks has been left with little leverage, although the Advisory Committee announced last week that no agreement can be reached on the rescheduling of public sector maturities ($18.4 bn due in 1983/84) until Venezuela has made satisfactory progress on negotiating an IMF programme. The Venezuelans still hope to reach agreement with the banks by the year end and officials are next expected to meet the 13 Bank Advisory Committee in New York in the week beginning 12 September. The banks look as though they will have no option but to agree to an extension of the present moratorium which expires at end-September.

Relations between the Venezuelans and the banks continue to be hampered by the prevalence of interest arrears now totalling around $600 mn ($200 mn public sector and $400 mn private sector). Several default suits are reported to be in the pipeline, with particular concern surrounding the position of Banco Industrial de Venezuela which has external debts of $3.7 bn. Although Sosa has repeatedly assured the banks that arrears will be eliminated, little positive action has been evident. However, in response to bankers' demands, specific measures to streamline the administrative procedures were outlined at a meeting with the Advisory Committee on 11-12 August. Public sector interest payments are to be centralised within the Ministry of Finance and a mechanism is to be established for guaranteeing the current preferential

exchange rate on private sector debt contracted before 18. 2.83. The private sector has been virtually unable to service its foreign debt since controls were imposed in February as the central bank has objected to disbursing the necessary dollars because of the lack of an official registry. A telex sent to the Government from the banks stating that, unless certain interest payments are made, legal action may be taken has forced official awareness of the potential dangers of the continuation of private sector interest arrears. It is now hoped to overcome this problem through the exchange guarantee mechanism and by making foreign exchange available even if the paperwork on each request has not been completed by the Differential Exchange Controls Office, RECADI. Nevertheless differences between the Central Bank and the Ministry of Finance on this and on the way negotiations with the IMF have been conducted have been brought into sharp focus by recent public statements by the President of the Central Bank which will further affect confidence.

At end-1982, ECGD had an estimated total of $0.08 bn at risk. Although not officially off cover, new medium-term business is unlikely to be approved until it is clear that a Paris Club approach is not envisaged. At end-1982, UK-registered banks' consolidated external claims on Venezuela totalled $3.05 bn; of which unguaranteed claims by British-owned banks totalled $2.4 bn.

EAST GERMANY (GDR)

Total convertible-currency indebtedness (perhaps as much as $15 bn at end-1981) probably declined in 1982.

Gross debts to BIS area banks (excluding banks in West Germany) fell from over $10 bn at end-1981 to $8.9 bn at end-1982. The GDR gives considerable publicity to the improvement in its BIS position but the $0.5 bn increase in deposits with BIS area banks to $2 bn at end-1982 probably owed much to window-dressing. Existing undrawn credit facilities remain considerable but inability to raise substantial new medium and long-term credit from Western banks has largely confined the GDR to short-term borrowing. Gross debt maturities (including short-term), which probably exceeded $5 bn in 1982, are unlikely to fall much below that in 1983 and 1984. GDR importing agencies in general have been obliged by the government to seek longer credit terms. ECGD is still on limited cover but has introduced tighter market limits which, if other agencies are acting similarly, will not help. A substantial improvement in the trade account in 1982 was achieved primarily by drastic import cuts (other than from the FRG, with which there was an increase in bilateral indebtedness after the decline in the earlier part of 1982). The liquidity position remains tight and amid reports that the GDR is negotiating bilateral rescheduling agreements with a number of (unnamed) creditor countries there is some evidence that the DM 1 bn balance of payments loan from the FRG in June may not have provided much relief. Although the initial reaction of banks was to take comfort from the availability of new credit it has begun to reinforce existing doubts about longer term prospects.

At end-December 1982 UK-registered banks' consolidated external claims totalled $1,498 mn, of which $1,393 mn was unguaranteed (cf $1,543 mn and $1,463 mn respectively at end-June 1982). Claims by British-owned banks totalled $906 mn, of which $811 mn was unguaranteed (cf $941 mn and $863 mn respectively). ECGD has £113 mn at risk.

HUNGARY

Convertible currency debt at end-1982 totalled $7.5 bn.

The performance criteria under the one-year IMF standby arrangement are being met and the mid-term review passed smoothly. The formal target for the surplus on the convertible-currency current account has been reduced from $600 mn to $500 mn following Hungarian pessimism about the prospects for exports and particularly prices for agricultural exports. However, in view of recent and prospective measures (including further depreciation of the exchange rate, price increases and a wage freeze in the government sector) the IMF staff remain confident that a surplus of $600 mn can be achieved, though this will depend on continuing Soviet willingness to pay convertible currency for Hungarian exports while allowing Hungary to pay non-convertible currency for a number of essential imports, including oil.

The capital account is weak - there was an outflow of $400 mn in the first quarter partly as a result of a reversal of end-year window-dressing - and the financing gap is proving difficult to cover despite IMF drawings and a club loan for $200 mn earlier this year. More recently two IBRD loans totalling $239 mn have been agreed, a $200 mn eurodollar loan with IBRD participation has been fully underwritten (although there are reports that the selling down is meeting resistance) and discussions are continuing with commercial banks on a $72 mn yen loan with IBRD co-financing. The liquidity position is likely to remain tight next year when medium and long-term capital outflows are set to rise from $1 bn to $1.6 bn. Timar, President of the National Bank of Hungary, who met the clearers on his recent visit to London looked for support for the smaller syndicated loans which the Hungarians hope to raise towards the end of the year or early 1984.

UK-registered banks' consolidated external claims, largely unguaranteed, fell from $833 mn at end-June 1982 to $802 mn at end-December 1982. Claims by British-owned banks rose from $488 mn to $527 mn during the same period. ECGD commitments are modest and under tight control with £17 mn at risk.

POLAND

Total convertible-currency indebtedness is now about $27 bn.

Official creditors met in Paris on 29 July, agreeing in principle to resume rescheduling negotiations with Poland which were suspended following the imposition of martial law in December 1981. The US wished implementation to be deferred, however, until it was known that the Poles had released the vast majority of political detainees by 22 August. Negotiations with the Poles (initially covering arrears under the suspended rescheduling agreement for 1981 before considering the restructuring of debt due in 1982 and 1983) will provisionally start in Paris on 13 and 14 October. Meanwhile the creditors' group will meet on 15 and 16 September to examine technical issues and a small team will visit Warsaw at the end of September to clarify outstanding technical points with the Poles.

Last year the commercial banks signed rescheduling agreements for 1981 (95% of $2.3 bn principal over 7 years) and 1982 (95% of $2.3 bn over 7 1/2 years). Poland has met interest repayments under both agreements; but, under the second, 50% of interest due in 1982 was lent back in the form of new three-year credits. For 1983 maturities the banks' working party have agreed in principle to reschedule 95% of medium-term debt over 10 years, including five years' grace and to recycle 65% of interest in the form of revolving short-term credits over five years.

Much of the net hard currency earnings of Poland in 1983 will be absorbed by meeting commitments to the banks under their rescheduling agreements; and it is hard to see how the remainder can be stretched to cover arrears due to governments from 1981, together with any partial payment on the restructuring of official debt for 1982 and 1983, without exceptionally generous governmental treatment. The prospect is for the progressive increase in the stock of debt to continue during the rest of the decade as a substantial element of interest due is capitalised.

At end-December 1982 UK-registered banks' consolidated external claims totalled $1,749 mn, of which $811 mn was unguaranteed (cf $1,839 mn and $791 mn in June 1982 respectively). Claims by British-owned banks totalled $1,449 mn, of which $543 mn was unguaranteed (cf $1,553 mn and $542 mn respectively). ECGD is off cover: the amount at their risk is £821 mn.

YUGOSLAVIA

Total external indebtedness is about $18 bn. Early this year an extensive support operation was mounted involving governments, banks and international institutions.

A memorandum of understanding signed by representatives of 15 creditor countries in Berne in January envisaged governmental funds of about $1.3 bn being made available in medium-term credits (mostly export credits), though the Yugoslavs do not expect to be able to utilise some of the tied credits. The second half of a £38 mn financial loan from HMG was disbursed on 15 August; the £40 mn loan guaranteed by ECGD to refinance payments due to UK exporters is expected to be signed shortly.

The agreement with the commercial banks, involving refinancing $1.4 bn medium-term maturities and the banks' share of an estimated $1.8 bn short-term debt due in 1983 together with the provision of up to $0.6 bn new money, is now in the process of being signed by the participating banks. A Kuwaiti-led Arab syndicate has waived its negative pledge clause which precluded use of Yugoslav gold as collateral and thereby frustrated access to $200 mn of the $500 mn BIS facility. The BIS, which had as an interim measure extended the maturity of the instalment due on 15 August, will now be in a position to release the gold-backed tranche. The $25 mn Bank of England participation in the BIS facility was taken out by the disbursement of the second half of the HMG loan.

Funds totalling $0.5 bn net should be available this year from the IMF/IBRD. Although a number of creditor governments are unhappy about the nature and pace of adjustment in Yugoslavia, the mid-term review of the IMF standby was approved on 29 July with further waivers of performance criteria; the blocked SDR 100 mn drawing originally due on 15 August will be released as soon as the IMF have been advised of the availability date for the first advance of the commercial bank agreement which is unlikely to be disbursed until end-October. The Yugoslavs have

expressed interest in a further standby following completion of the current programme, but several major governments have misgivings.

At end-December 1982 UK-registered banks' consolidated external claims totalled \$1,660 mn, of which \$1,301 mn was unguaranteed (cf \$1,745 mn and \$1,395 mn respectively at end-June 1982). Claims by British banks totalled \$1,226 mn of which \$899 mn was unguaranteed (cf \$1,271 mn and \$941 mn respectively). ECGD remains on cover for short-term business, their total amount at risk is £839.3 mn.

ISRAEL

Total external indebtedness was $21 bn at end-1982 (98% of GDP).

In response to both a deteriorating external position, exacerbated by an insufficient depreciation of the shekel over the last eight months, and continuing high levels of inflation (126% year-on-year in July) the Government has introduced a number of measures aimed at dampening demand and restoring the competitiveness of exports. These have included a 7.5% devaluation of the shekel (in addition to the policy of continuous adjustment of the shekel in relation to a basket of trade-weighted currencies), the imposition of a 15% interest-free shekel deposit on a range of consumer imports and the introduction of an insurance scheme for exporters to cover exchange loss. The Government is also to implement a $700 mn programme of public expenditure cuts.

The trade deficit for the year is forecast to reach $3.8 bn (1982: $3.7 bn). The current account deficit is set to rise from $1.9 bn (9% of GDP) to $2.4 bn (11% of GDP) this year. Despite the concessional nature of much of its debt Israel has an external financing requirement this year of $7 bn (including the rolling-over of $3.3 bn of short-term debt) which, unless there is a sharp turnabout in the current account, is unlikely to diminish over the next two to three years and could well increase. With continuing US aid and the support of World Jewry, Israel is currently experiencing no financing difficulty. However, it is already having to turn increasingly to commercial borrowing and, should such high external deficits persist and its present position as a net creditor to the BIS reporting banks be reversed, Israel could begin to meet difficulty in funding its borrowing requirement. Foreign exchange reserves at end-April totalled $4 bn, equivalent to five month's imports.

At end-December 1982 UK registered banks' consolidated external claims totalled $603 mn, of which $554 mn was unguaranteed (cf $498 mn and $456 mn respectively at end-June 1982). Claims by British-owned banks totalled $480 mn, of which $431 mn was unguaranteed (cf $347 mn and $309 mn respectively). At end March ECGD had £126.9 mn at risk under Section I and £11.5 mn under Section II.

PORTUGAL

Total external indebtedness was $14.2 bn at end-April (58% of GDP).

The Portuguese external balance deteriorated further during 1982 with the current-account deficit increasing to $3.2 bn. Although there was a sharp improvement during the first quarter of 1983 Portugal continues to experience severe liquidity difficulties: whilst gold reserves at current market prices are in the order of $9 bn, foreign exchange holdings ($486 mn at end-May) amounted to only about three weeks' merchandise imports.

Austerity measures were taken by the outgoing government in March (an interim budget aimed at reducing the government deficit to 7.5% of GDP, a 2% step reduction in the Escudo effective rate, a widening of the monthly exchange-rate depreciation to 1% and a tightening of monetary policy). These were supplemented by a 12% step devaluation in June and a review of public sector expenditure. Agreement has been reached with the IMF on a $480 mn 18-month standby programme, which may be supplemented by a CFF of up to $280 mn. It is understood that the programme will involve a further cut in public spending and aims at a sharp reduction in the current account deficit to $2.2 bn in 1983 and $1.5 bn in 1984 with strict limits on the growth in external debt.

To ease its tight liquidity position Portugal arranged facilities with the BIS for $400 mn in March and $300 mn in June, while gold holdings were being mobilised. A further $300 mn bridging loan was arranged with the BIS in August.

Agreement with the IMF may help restore banking confidence (a request for a $400 mn eurocredit earlier this year was scaled down to $300 mn partly because of unappealing terms and inept timing during the political interregnum) but there is increasing concern that, even with the Fund programme, Portugal may have a $1 bn to $1.5 bn financing gap in 1983. An approach to the markets for a further $300 mn is apparently contemplated in the autumn but, even if it is more successful than last time, Portugal's external financing position could remain difficult unless the current account improves further than foreseen.

At end-December 1982 UK registered banks' consolidated external claims totalled \$1,178 mn, of which \$1,001 mn was unguaranteed (cf \$1,089 mn and \$941 mn respectively at end-June 1982). Claims by British-owned banks totalled \$945 mn, of which \$770 mn was unguaranteed (cf \$807 mn and \$659 mn respectively). At end March ECGD had £145.6 mn at risk under Section I and £115.5 mn under Section II.

INDONESIA

Total external indebtedness is estimated at $26 bn at end-March 1983, excluding short-term debt of the public sector.

Further details on the Government's policy of retrenchment on investment spending are now available. To date a total of 47 major industrial projects have been rephased with estimated savings in 1983/84 of $3.5 bn and a further $6.5 bn in the next few years. Reflecting the cuts in capital expenditure, this year's budget is now expected to be in balance, or a small surplus, even after some increase in labour-intensive projects to contain the contractionary impact of the investment cuts. In a further effort to stimulate the domestic economy, substantial changes in banking regulations have been introduced, including the lifting of credit ceilings on domestic lending and the freeing of most state bank interest rates. The fourth Five Year Plan (April 1984-1989), recently announced, projects a growth rate of 5% per annum: emphasis is placed on boosting revenue from outside the oil and LNG sectors by means of a series of major tax reforms - long urged by the IMF.

There has been some market speculation that Indonesia may well come to the market again, possibly before the end of the year, for an amount of $500 mn but no firm proposals have yet been made. A Compensatory Finance Facility of SDR360 mn, based on a shortfall in non-oil exports, was approved in July by the IMF. The Fund have indicated to the Indonesian authorities that their present policies would be adequate to support a request for a standby facility: however, for political reasons the Indonesians are unlikely to seek an SBA at this stage.

Reserves at end-May stood at $7.2 bn [of which $3.7 bn ($3.4 bn in March) was held by the state commercial banks].

As at end-March 1983,ECGD had an estimated £209.1 mn at risk under Section 1, and £802.4 mn under Section 2. At end-December 1982 UK-registered banks' consolidated external claims in Indonesia totalled $1,159 mn; claims by British-owned banks totalled $1,014 mn, of which $598 mn was unguaranteed.

THE PHILIPPINES

Total external indebtedness at mid-1983 is estimated at up to $25 bn (including short term banking debt).

The position of the Philippines remains under considerable strain. Although the central bank claim, in confidence, that the large international banks are continuing to roll-over credits, they admit concern at a pattern of shortening maturities. Moreover, the recent assassination of the prominent opposition politician Aquino, and speculation about the health of President Marcos, by raising concern about the prospects for political stability, may further weaken international banking confidence. The overall balance of payments deficit for the first half of 1983 is officially put at $562 mn (compared with a target under the SBA with the Fund of $600 mn for the whole year) with the current account deficit at $1.64 bn. Exports were 8% down on the comparable period of 1982 while imports fell only 2 1/2%: a sharp increase in workers remittances - attributed to the introduction of a raffle system to encourage workers overseas to remit more of their earnings through official channels - brought a modest improvement in the non merchandise deficit.

The report of the IMF's mid-term review under the standby arrangement, conducted in June, may not now be available before October. We have been informed in confidence that the delay reflects in part disagreements over the definition of external debt (probably the short-term element): some of the performance criteria at mid-year had also been breached. Drawings are now suspended (SDR 215 mn of the total SDR 315 mn remains undrawn) and although negotiations are continuing it may prove necessary to replace the present programme with a new arrangement.

The Philippine authorities have over the past few weeks introduced a number of measures to restrict bank lending on certain categories of imports and to extend deferred credit terms for others: they have also announced tighter rules on foreign borrowings by public and private sector bodies. Manufacturers Hanover have been appointed to advise on debt management - and have reportedly concluded that the authorities will face debt service difficulties.

As at end-March 1983, ECGD had an estimated £217.5 mn at risk under Section 1, and £7.4 mn under Section 2. At end-December 1982 UK-registered banks' consolidated external claims in the Philippines totalled $1,777 mn; claims by British-owned banks totalled $1,609 mn, of which $1,162 mn was unguaranteed.

SOUTH KOREA

Total external indebtedness at end-June 1983 was $38.2 bn.

Trends in output and prices remain favourable. GNP growth for the current year is now estimated to reach 8% (5.3% in 1982), which would be the highest level since 1978; inflation, however, still remains under control, the year-on-year increase in consumer prices for July being just 2.8%. A further encouraging feature is that wholesale prices have fallen 1% during the first half of 1983 with the outturn for the full year likely to see an overall increase of only 1%.

Against this, however, the performance of the current account has been less encouraging; the deficit for the first half of 1983 was $1.32 bn ($722 mn for the same period in 1982). In particular, the loss of earnings from Middle East construction work - revenues down 30% in the first six months of the year - is having a marked impact. The government is still predicting a reduction in the current account deficit to $2 bn ($2.6 bn in 1982): the target under the SBA agreed with the Fund in July is $2.3 bn for 1983, with $2 bn for 1984. Export growth (8% in the first seven months of the year, from a year earlier) shows signs of picking up but, even so, the government's forecast looks difficult to achieve.

The Korean authorities have initiated a revision of their current five-year plan (1981/86) to take account of the changed outlook for oil prices: the country's external debt is now forecast at $45 bn by the end of the plan period (compared with an original forecast of $64.5 bn).

Market confidence in Korea remains firm.

As at end-March 1983,ECGD had an estimated £209.1 mn at risk under Section 1, and £503.4 mn under Section 2. At end-December 1982 UK-registered banks' consolidated external claims in South Korea totalled $3,060 mn; claims by British-owned banks totalled $2,596 mn, of which $1,995 mn was unguaranteed.

MOROCCO

Total external indebtedness (excluding military debt and private non-guaranteed debt) was about $11 bn (72% of GDP) at end-1982. Medium and long-term debt totalled $10 bn, of which about $3.5 bn was owed to commercial banks and about $4 bn in the form of bilateral loans.

As a result of increased balance of payments pressure, Morocco has reached agreement with the IMF over a SDR 300 mn Standby programme expected to be formally approved in September. Major creditor banks have been invited to debt rescheduling talks in Rabat on 9 September: short-term debt is specifically excluded. Morocco has also applied to the Paris Club for a rescheduling of officially guaranteed debt maturing between August 1983 and December 1984. This request is to be discussed at a creditors-only meeting of the Paris Club on 15 September; a full meeting will probably be called for October.

At end-December 1982 UK registered banks' consolidated external claims totalled $357 mn, of which $289 mn was unguaranteed (cf $303 mn and $263 mn respectively at end-June 1982). Claims by British-owned banks totalled $207 mn, of which $157 mn was unguaranteed. ECGD remains on cover, though a market review us shortly expected to reduce limits: total amount at risk is £191.2 mn.

INDEBTEDNESS AND BRITISH EXPOSURE

$ billion

	Total external debt (end-December	British banks unguaranteed claims 1982)	ECGD amounts at risk (end-March 1983)
Latin America			
Argentina	39	2.3	0.4
Brazil	83	4.4	2.3
Chile	18	1.1	0.05
Ecuador	6	0.5	0.1
Mexico	83	5.2	1.6
Peru	12	0.4	0.2
Uruguay	4	0.3	0.01
Venezuela	34	2.4	0.08
Eastern Europe (convertible Currency)			
East Germany	15	0.8	0.2
Hungary	7	0.5	0.08
Poland	27	0.5	1.2
Romania	10	0.4	0.6
Yugoslavia	18	0.9	1.2
Southern Europe			
Portugal	14	0.8	0.4
Greece	11	0.7	0.4
Spain	28	2.4	0.2
Israel	21	0.4	0.2
Far East			
Indonesia	26⁄	0.6	1.5
Philippines	25*	1.2	0.3
South Korea	38*	2.0	1.0
Other			
Morocco	11	0.2	0.2

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

⁄ End-March 1983   * End-June 1983

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SOUTH AFRICA

Summary

South Africa's economy is in recession, partly because of external factors but also of severe drought. GDP fell by 1% last year and a larger fall is forecast for this year. Following current account deficits of US$4.5 bn and US$2.8 bn in 1981 and 1982 respectively, a surplus (US$1-2 bn) is forecast for this year as a result of an improvement in the gold price and lower imports. South Africa has borrowed on the international capital markets, resorted to gold swaps and drawn on the IMF.

The volume of South Africa's indebtedness gives no cause for concern, but there are latent worries about the risks associated with the mismatch by banks in borrowing short-term abroad for longer-term domestic lending and the exchange risk associated with uncovered borrowing by individual firms where funds are converted into local currency. The South African authorities, however, are alive to this point and our contacts with them give us reassurance that the situation will be monitored in South Africa (as it will be here).

External Debt

South Africa's public sector external debt remains low by the international standards - amounting to US$5.87 bn at end-September 1982; the debt service ratio is modest - around 7% in both 1982 and 1983.

At end-March 1983, figures show gross and net claims of banks in the BIS reporting area on South Africa of US$13.7 bn and US$11.5 bn respectively - approximately double the end-1980 figures.

At end-May, ECGD had £973 mn at risk under Section 1 and £1,153 mn under Section 2 - South Africa represents ECGD's second largest exposure after Hong Kong. At end-1982, UK-registered banks' consolidated external claims amounted to US$5,234 mn; claims by British-owned banks totalled US$4,961 mn, of which US$4,257 mn is net of outward risk transfer.

Economic situation

The South African economy continued its cyclical downturn in 1982 when real GDP declined by 1%, after growth of 8% and 5% in 1980 and 1981 respectively; a further decline - of 2 to 3% - is forecast for this year with the recovery picking up from mid-1984. The downturn principally reflects the large fall in the gold price from its 1980 levels; recession in the Republic's export markets; and, more recently, serious drought in some parts of the country. Inflation remains high at 12.1% in the year to end-July and, though significantly lower than the peak of 16.5% recorded in the year ended April 1982, is now regarded as the country's major economic problem. Externally the current account, which swung from a surplus of US$3.5 bn in 1980 to a deficit of US$4.5 bn in 1981 almost returned to equilibrium by Q4 1982, although a US$2.8 bn deficit was recorded for calendar 1982. In addition to falling imports, the current account was strengthened towards the latter half of 1982 by some recovery in the gold price, while the capital account benefited from inflows encouraged by high domestic interest rates and by expectations of an appreciating rand. As a result, by end-February 1983, gross reserves had risen sharply to US$4.3 bn but they have since fallen to US$3.5 bn at end-July (equivalent to 2 1/2 months' imports). This decline is largely attributable to capital outflows as a result of the abolition of non-resident exchange control in February this year.

Recent borrowing policy

During much of 1981/82, the South African authorities encouraged borrowing abroad by both public and private sectors for balance of payments financing (by providing forward cover on favourable terms). In addition, a series of gold swaps were concluded by the SARB while, in November 1982, South Africa secured IMF assistance (a CFF and Standby Arrangement) totalling SDR 1 billion. However, following a sharp improvement in the balance of payments current account from mid-1982, most outstanding official foreign short-term liabilities - which totalled US$1.64 bn at mid-1982 - were repaid prior to end-February 1983; meanwhile the South Africans have indicated that they will not fully utilise the available IMF assistance (only SDR 0.8 bn has been drawn down) and, indeed, that they are contemplating early repurchases.

Since late last year the authorities have endeavoured, in providing forward cover for external borrowing, to pursue a neutral policy which takes account of interest rate differentials, so that no net incentive for increased borrowing is given but there is no incentive to reduce borrowing. The amount of outstanding borrowing abroad is not, itself, so large as to give cause for concern. There are, however, two risks in relation to private borrowing which should not be overlooked: first, where it is on an uncovered basis and, second, where there is a risk of mismatch in on-lending borrowed funds. Most uncovered borrowing is concentrated on a few major groups (e.g. de Beers and Anglo American) which are very experienced in international borrowing operations and financially very strong and therefore able to take the risk inherent in uncovered borrowing. The risk of mismatching where short term funds are borrowed for on-lending for longer-term operations carries greater dangers, but the banks, which act as agent in these operations are, we have been assured, very alive to the risks, and the position is being closely monitored by the central bank.

Beyond these risks there is the political risk inherent in all lending to South Africa. When there were moves in the UN Security Council in 1977-79 to secure mandatory economic sanctions, international banks, particularly British banks were, because of their traditionally large exposure to the Republic, considered to be vulnerable to counter-measures which South Africa might take in response to UN sanctions. The anti-South African lobby in the Third World has, however, more recently been more concerned with its own economic difficulties so that subsequent UN action has been limited to more routine non-binding General Assembly resolutions and unsuccessful attempts to induce the IMF to expel, or at least not lend to, South Africa. On the other hand, the anti-South Africa lobby in the United States has achieved amendments to the draft IMF quota increase legislation which, if they become law, could result in the withdrawal of US support for South Africa in the IMF Board, and this could give rise to difficulties in the future if South Africa wished to increase her recourse to IMF facilities.

THE WORLD BANK
Washington, D. C. 20433
U. S. A.

A.W. CLAUSEN
President

September 24, 1983

Dear Mr. Lawson:

My colleagues and I are looking forward to seeing you at luncheon on Wednesday, September 28, in the Kennedy Room of the Sheraton Washington Hotel at 1:00 p.m.

While there are many issues for possible discussion, we in senior management at The World Bank would like your counsel on the role of the Bank in these difficult times. Are there new directions which we should be exploring? Are there new programs that we should be emphasizing? Are there additional ways for us to be a catalyst in marshaling additional funds for development purposes? I realize these are difficult questions but your thoughts and advice can help us in our efforts to make the Bank more responsive to the needs of its shareholders.

Moeen Qureshi, Ernest Stern, Munir Benjenk and I are pleased that you can join us.

Sincerely,

Tom Clausen

The Right Honourable
Nigel Lawson, P.C., M.P.
Chancellor of the Exchequer
London, England

PWP

CORRECTED NOTE FOR RECORD

BoE

Whole Document

cc: Chancellor/Mr. Kerr
Governor
Mr. Littler
Mr. Loehnis
Mr. Lavelle
Mr. Wicks
Mr. Appleyard
Mr. Hall
Mr. Bottrill (HMT)

RECORD OF A DISCUSSION BETWEEN
THE CHANCELLOR AND THE IMF MANAGING DIRECTOR
8.40 AM, SEPTEMBER 24, 1983

Present: Chancellor
Governor
Mr. Littler
Mr. Loehnis
Mr. Wicks
Mr. Kerr

Mr. de Larosière
Mr. Whittome
Mr. Carter

1. It was clear that Larosière's principal concern was over access limits, and the US proposal as leaked to the press: this was the only subject discussed.

2. Larosière said that the effect of the US proposals, if agreed, would be that, given repayments, the Fund would in practice effect a major withdrawal. This would be absurd and illogical at a time of continuing financial crisis. There would be no possibility of any new drawings by Brazil or Mexico before 1990. Of course, the principle of phasing down enlarged access must be restated; and it might be right for the phase-down to be seen to start. But to commit the Fund to a brutal phase-out, and precise figures several years ahead, would be quite wrong. Quite apart from the direct effects on countries now or potentially in difficulty, agreement to the Regan proposal would mean that the Fund lost all credibility vis-a-vis the commercial banks, and would no longer be able to persuade them not to withdraw from countries in difficulty.

3. Larosière added that the discussion of the effects of agreement to the US proposal was, however, a little academic; given that there was no chance that it would secure an 85 per cent majority at the forthcoming meetings. He hoped, however, that British pragmatism would help to secure agreement on a more reasonable plan. The essence of it might be the two-tier proposal which the UK had tabled, and which he had all along supported. Normal access would be 102 per cent; but 125 per cent would not be excluded *in extremis*. The arrangement might be given a two-year life, and one could look again at year three in due course.

4. The Chancellor said that the US argument clearly was that a very tough line on access was needed to secure Congressional approval of the IMF quota increase. He was a little sceptical--and Larosière warmly agreed--as to the

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degree of Congressional understanding of the access question. But, if Regan had a point, he had scored an own goal by publishing his proposal on access; for any retreat from it would now be seen by Congress as weakening. It might, therefore, be best not to force a showdown on access now; and instead to postpone agreement until Congress had approved the quota increase.

5. The Chancellor added that he suspected that, if one could secure an agreement now, it might be best to make it apply to 1984 only, perhaps adopting the two-tier idea; and certainly reaffirming the principle of phasing-out, but without attaching a precise timetable. Best of all might be a firm steer along these lines from the Interim Committee to the Executive Board, but no final decision on access now.

6. Larosière agreed. The choice was between going for a reasonable deal on access, which might perhaps be finalised in the Executive Board in a month's time, or waiting until the next Interim Committee meeting in Spring 1984. He was delighted that the Chancellor agreed that the option of agreement to the Regan proposal was not a runner.

JOK

J.O. Kerr
September 25, 1983
Washington DC

LUNCH

CHANCELLOR:

PMP

cc: The Governor
Mr Littler
Mr Wicks
Mr Smith

WORLD BANK ISSUES

Mr Clausen's letter of 24 September asks for your views on a number of questions about the future of the World Bank for tomorrow's lunch. It is a little difficult to offer helpful advice on this in these times when shortage of resources makes it so difficult to pursue new initiatives. We think the main directions being pursued by the Bank are right:-

- a continuing expansion in the lending of the IBRD (and an SCI to help support this in the short-term);
- a major effort to maintain concessional aid through IDA combined with exploring ideas for shortening the length of IDA lending so that money can revolve more rapidly;
- serious efforts on co-financing with the private sector, so as to maximise the flow of resources going into development by tapping the private sector and at the same time using the skill and expertise of the Bank to make sure that those resources go into good projects.

2. At the same time, discussion continues on a number of issues about the manner in which the Bank operates. We are eager to persuade the Bank to play a larger part in co-ordinating the efforts on donors in some countries. This is something which has to be done country by country, depending on the local circumstances, and also something which is best done in a low key and informal manner so as to minimise the risk of raising the hackles of the recipient government. But if it is done in the right way, it can help to make all our aid efforts more effective.

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3. In the same connection, we have been moving in the ODA in the direction of applying aid in some countries to sectors of the economy (e.g. railways, power, irrigation) which can have the advantage that a smallish input of aid can help to influence policies over a wider area than if we simply operate through ordinary projects. The Bank has influenced policies in sectors usefully in a number of countries. We think that a lot of the benefits of the Bank's activities comes in this way. We would like them to keep this up and perhaps to consider sector aid of the kind which we have promoted.

4. This is all, in short, part of the business of conditionality. The Bank's conditionality (in contrast to that of the Fund which is concerned with macro economic policies) is concerned with development policies, but this is often interpreted in a very wide sense. We think the Bank is influencing a number of countries in a very constructive way in the management of their development effort and we would like to encourage and co-operate with the Bank management in this kind of activity.

5. One particular aspect of this which we are emphasising more in our own aid effort is the efficient functioning of institutions and the supply of skilled manpower for this purpose. We would like to have more discussions with the Bank about ways in which we can co-operate on this, especially in Africa.

W.R.

William Ryrie
27 September 1983

CONFIDENTIAL

cc: Chancellor/Mr Kerr
Governor
Mr Littler
Mr Loehnis
Mr Lavelle
Mr Wicks
Mr Appleyard
Mr Hull
Mr Bottrill (HMT)

NOTE FOR THE RECORD

BoE

Whole Document

RECORD OF A DISCUSSION BETWEEN
THE CHANCELLOR AND THE CHILEAN FINANCE MINISTER
5.30 PM, SEPTEMBER 27, 1983

Present:	Chancellor	Senor Caceres
	Governor	Mr Errazuriz
	Mr Loehnis	Chilean Ambassador to Washington
	Mr Lavelle	
	Mr Appleyard	

1. Senor Caceres began by expressing his appreciation for the support given by the British government and British banks to Chile's rescheduling programme. The Midland Bank had taken the lead on the private banking side. The overall economic situation in 1983 was now under control. He would welcome the Chancellor's views on the economic situation in Europe since a recovery in the industrialised nations would have considerable importance for Chile's export performance.

2. The Chancellor said that he was hopeful that recovery in Europe would be sustained. So far the European economies had been much less buoyant than North America. The outlook for 1984 seemed considerably better. The UK economy had gone into recession sooner but had emerged sooner. The low point had been Spring 1981: since then the economy had been recovering at the pace of about 2½ - 3% per year. His expectation was that this pace of recovery would be continued through 1984. The German economy had gone into recession later and had consequently emerged later. The signs were that the German economy would move ahead fairly strongly in 1984. This would have a helpful effect on the Dutch and other European economies. The French situation was very different since France had begun the necessary measures later. There was little prospect of growth in France in 1984. The prospects for Britain's exports to Europe looked better in 1984.

3. Senor Caceres asked about unemployment. The Chancellor said that unemployment was still very high in the United Kingdom at about 13%. However, the growth in the rate of unemployment had been reduced and job vacancies had increased sharply over the past year. His guess was that the employment level in 1984 would be at substantially the same as this year.

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4. Senor Caceres asked about interest rates in 1984. The Chancellor replied that this would depend very largely on developments in the US economy. Given UK fiscal and monetary policies he expected the trend in UK interest rates to be downwards. But there was a limit to the extent to which this process could continue independently of US interest rates, which in turn derived the from US fiscal deficit. There did not seem to be much chance of a positive reduction in the US fiscal deficit before the Presidential elections next year, though he hoped that action would be taken thereafter. The US authorities forecast a fall in interest rates but this remained to be confirmed. European economies were trying to decouple themselves from US interest rates. His view was that on balance, in 1984 interest rates probably would go down but not by much. Diminished inflationary expectations on both sides of the Atlantic would be a helpful factor.

5. Senor Caceres gave an account of the Chilean economy. He said that in 1984, a difficult year, Chilean GNP had fallen 15%, unemployment had reached 27% and the balance of payments had been in severe difficulty. In 1983 both the balance of payments and unemployment had posed problems. Nevertheless, in consultation with the Advisory Committee, Chile had signed an agreement with the banks in July. An IMF Facility of $1.3 billion had been agreed. Public works programmes within Chile should help to reduce unemployment, which should be down to 18% by the year end. The central banks had opened credit lines for the major corporations which had re-financed 50% of their debts this year. He expected Q4 1983 to show a growth rate of 7-8% compared with Q4 1982, with an overall annual growth in 1983 of about 0.5%. This showed a major shift in the pattern of the economy. There should be a $1.2 billion surplus on the trade account. Reserves should be up to $2.5 billion. The 1984 forecast growth rate was 5-6%, with inflation at 15-18% and the level of unemployment down to 10% by year end 1984. Chile would still need a new financing facility from the private banks of between $800m - $1 billion in 1984. The Chilean government would negotiate this with the Advisory Committee. An IMF mission would travel to Chile in October to discuss the 1984 programme. The Chilean government hoped to have everything in place by March 1984.

6. There had been a significant decline in real interest rates in Chile. In 1982 real interest rates had been 35-40%. He expected real interest rates to be down to 12% by the end of 1984. In short, the economy is now back under control but the cost of adjustment had been severe. Chile hoped now to benefit from the effects of recovery in Western economies.

7. The Chancellor asked about the political situation. Senor Caceres said that there had been a lot of problems recently with riots in some cities. However, the new Minister of the Interior had opened up a dialogue with the leader of the Opposition and was preparing a law on the electoral process which would result eventually in a return to democracy in 1989.

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A referendum would be held in late 1986/early 1987 which would bring about Congressional elections in 1987. Economic recovery would help to shore up the return to democracy. Important decisions will be needed on the capitalisation of the five major banks, with whom the government had intervened, by the end of the year. Discussions were already in train.

L V Appleyard
27 September 1983

CONFIDENTIAL

cc: Chancellor/Mr Kerr
Governor
Mr Littler
Mr Loehnis
Mr Lavelle
Mr Wicks
Mr Appleyard
Mr Hull
Mr Bottrill (HMT)

NOTE FOR THE RECOI BOE

Whole Document

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Mr Loehnis
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Mr Appleyard

Senor Caceres
Mr Errazuriz
Chilean Ambassador to Washington

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4. Senor Caceres asked about interest rates in 1984. The Chancellor replied that this would depend very largely on developments in the US economy. Given UK fiscal and monetary policies he expected the trend in UK interest rates to be downwards. But there was a limit to the extent to which this process could continue independently of US interest rates, which in turn derived from the US fiscal deficit. There did not seem to be much chance of a positive reduction in the US fiscal deficit before the Presidential elections next year, though he hoped that action would be taken thereafter. The US authorities forecast a fall in interest rates but this remained to be confirmed. European economies were trying to decouple themselves from US interest rates. His view was that on balance, in 1984 interest rates probably would go down but not by much. Diminished inflationary expectations on both sides of the Atlantic would be a helpful factor.

5. Senor Caceres gave an account of the Chilean economy. He said that in 1984, a difficult year, Chilean GNP had fallen 15%, unemployment had reached 27% and the balance of payments had been in severe difficulty. In 1983 both the balance of payments and unemployment had posed problems. Nevertheless, in consultation with the Advisory Committee, Chile had signed an agreement with the banks in July. An IMF Facility of $1.3 billion had been agreed. Public works programmes within Chile should help to reduce unemployment, which should be down to 18% by the year end. The central banks had opened credit lines for the major corporations which had re-financed 50% of their debts this year. He expected Q4 1983 to show a growth rate of 7-8% compared with Q4 1982, with an overall annual growth in 1983 of about 0.5%. This showed a major shift in the pattern of the economy. There should be a $1.2 billion surplus on the trade account. Reserves should be up to $2.5 billion. The 1984 forecast growth rate was 5-6%, with inflation at 15-18% and the level of unemployment down to 10% by year end 1984. Chile would still need a new financing facility from the private banks of between $800m - $1 billion in 1984. The Chilean government would negotiate this with the Advisory Committee. An IMF mission would travel to Chile in October to discuss the 1984 programme. The Chilean government hoped to have everything in place by March 1984.

6. There had been a significant decline in real interest rates in Chile. In 1982 real interest rates had been 35-40%. He expected real interest rates to be down to 12% by the end of 1984. In short, the economy is now back under control but the cost of adjustment had been severe. Chile hoped now to benefit from the effects of recovery in Western economies.

7. The Chancellor asked about the political situation. Senor Caceres said that there had been a lot of problems recently with riots in some cities. However, the new Minister of the Interior had opened up a dialogue with the leader of the Opposition and was preparing a law on the electoral process which would result eventually in a return to democracy in 1989.

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A referendum would be held in late 1986/early 1987 which would bring about Congressional elections in 1987. Economic recovery would help to shore up the return to democracy. Important decisions will be needed on the capitalisation of the five major banks, with whom the government had intervened, by the end of the year. Discussions were already in train.

L V Appleyard
27 September 1983

PWP

PERSONAL AND CONFIDENTIAL

PRIME MINISTER

You may find it useful, before you see the Americans tomorrow, to glance at the attached notes updating your brief on the IMF/IBRD issues, and Brazil; and a revised brief on unitary taxation.

The Administration ought to be fairly happy with the outcome of the IMF/IBRD meetings. The proposal which we put forward on access, and which was eventually agreed, is one which should help, rather than hinder, their efforts to get the IMF Bill, ratifying Geoffrey Howe's February IMF agreement on increased quotas, through Congress. (And it is of course very important that it should go through.)

On Brazil, the heat was on us early on, as I mentioned to you on the telephone on Sunday. But our position seems, at least for the present, to have been accepted. Regan and Larosière know that we shall not be contributing any new government money, in addition to the Paris Club arrangements; and Larosière has told the bankers, in Volcker's hearing, that the financial gap is filled. Regan's final request to me was only that we should not come out against the "package": that creates no problem. I had an hour with him in his office yesterday, and the word Brazil was not mentioned. The President may, I suppose, still decide to press the matter with you, perhaps as much in order to reduce the bill for the Americans as to reduce the risk of the "package" collapsing. But I am sure you will wish to hold the line.

I pressed Regan hard on unitary taxation. He is Chairman of the Working Group which the President has set up, and I think it would be helpful if you would make some of the points in the new brief, which reflects our meeting.

NL

N.L.
28th September, 1983

cc: Sir Oliver Wright

Attachments

CONFIDENTIAL

BANK/FUND ISSUES

The key issue overhanging discussions at the IMF/IBRD Annual Meetings was the IMF Bill's fate in Congress. In meetings over the week-end, Secretary Regan expressed confidence that it would go through; and discussions on IMF financing proceeded on this assumption. In his speech on 27 September the President firmly restated the Administration's commitment to the Bill.

The main item for decision at these meetings was the limit on access by any borrower to Fund resources.

Developing countries sought an annual limit of 150% (the old ratio) applied to the new increased quotas. The US argued for 102% of new quotas, giving the same average cash access as 150% of old quotas. The Fund staff had suggested 125%. Agreement was eventually reached (over objections from India, China, Zimbabwe and Algeria) on a British proposal to combine a normal limit of 102% with a very exceptional second tier up to 125%. This will apply for one year, and be reviewed annually with the intention of further phasing down in future. Mr. de Larosière is clear that it should be possible to finance borrowings within the new limits from resources likely to be available.

The decision is tough but has a sensible margin of flexibility. The US are pleased with the outcome. Secretary Regan believes that it, and the fact of some developing country disappointment with it, will ease the US Administration's task of getting the IMF quota legislation through Congress.

No significant progress was made on the issue of the IDA Seventh replenishment. The US maintained that its maximum annual contribution would be $750 mn, which implies a substantial reduction in the total replenishment compared with IDA 6.

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/Officials

Officials will meet again in Paris in November. If the IMF Bill is by then through Congress, the US may conceivably be able to show some flexibility.

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BRAZIL

As the Prime Minister knows the Administration and the IMF have during September tried to mobilise new government support as part of a package to fill a "financing gap" for Brazil up to the end of 1984, which the IMF forecast at some $11 billion. The full package was to be as follows:

(a)	Commercial banks	$6-7 bn
(b)	Rescheduling	$2 bn
(c)	New government money	$2½ bn

In G5 on 23 September and G10 on 24 September Regan and Volcker confirmed that the US would contribute $1.25 bn under category (c) and pressed other industrial countries to "subscribe". The Chancellor pointed out that the UK were already contributing through their agreement to Paris Club rescheduling. He firmly resisted pressure for an additional contribution in category (c). France, Germany, Italy and Japan refused to commit themselves to particular amounts under category (c), but indicated some scope for continuing export credit (in some cases possibly not much more than running off existing uncompleted contracts and related supplies).

On 26 September Volcker and Larosiere - accompanied by Leutwiler - met representatives of the commercial banks, informed them that the funds required under categories (b) and (c) had been secured, and obtained their agreement to help mobilise $6½ billion under category (a). The Bankers issued the following statement:

"The commercial bank component of the IMF financing package for Brazil is $6½ billion. The Bank Advisory Committee has agreed to present that figure to the commercial banking community around the world and recommend its acceptance. Details of the proposed

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financing arrangements will be worked out in committee meetings this week and next."

Larosière then issued the following statement, also on 26 September:

"After consultations between the International Monetary Fund, Governments, multilateral agencies and the Advisory Committee of Commercial Banks on Brazil, an agreement in principle has been reached on the financing of the Brazilian adjustment programme for the period covering the remainder of 1983 and 1984."

Since 25 September, the UK has not been pressed for a contribution under category (c), and Secretary Regan did not raise the matter during his meeting with the Chancellor on 27 September. But the President may still raise the matter with the Prime Minister, for contribution from us, while apparently no longer needed to save the package, would still save the US part of their share. At present Larosière is confident that the US will raise their contribution to offset any shortfall.

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UNITARY TAX

Secretary Regan has now announced the Administration's disappointing decision to refrain from submitting an amicus curiae brief in support of Container Corporation's petition to the Supreme Court for a rehearing of its case, (copy of press release at Annex A) and also announced the setting up of a tripartite working group to study unitary taxation further. The Chancellor spoke to Secretary Regan about this issue yesterday. A new suggested line, which takes account of that discussion, is set out below.

Line to Take

The Administration's Decision

Surprised that you did not wait to hear my views personally before making a decision not to submit an amicus brief in the Container case, particularly since it was not necessary to make a decision before 7 October (the Supreme Court would have accepted an amicus brief from the Administration up to that date). I should have liked to have had the chance to influence the final outcome.

2. I understand the political difficulties, but the submission of an amicus brief would surely have been useful even if it did not secure a rehearing for the Container Corporation. It would have been a legal and political statement of the Administration's view, which would influence forthcoming Supreme Court cases involving foreign parent multinationals, and discourage the spread of worldwide combined reporting. As it is, the decision may well be interpreted as meaning that the Administration's Chicago Bridge and Iron brief no longer stands (i.e. the decision is a step backward) and will give encouragement to those States at present using unitary taxation, and encourage others to follow suit.

/3. It will

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3. It will also encourage the spread of unitary tax to LDCs. No country has more to lose from this process than does the United States. I hope the decision can be reversed.

4. But if Administration intervention in a case involving a domestic parent is politically impossible, I hope that amicus curiae briefs will be submitted in forthcoming Supreme Court cases involving foreign parents, e.g. Alcan, Shell and EMI. I understand that Secretary Regan told the Chancellor yesterday that this was a strong possibility. But the hearings to decide the substance of these cases are still some way off (at least a year and probably more) and I would feel more justified in resisting pressure for retaliation in the UK, and the Community, if I had an early assurance that the Administration will intervene in a suitable foreign parent case when it arises. In the meantime, a first step would be Administration support for Alcan's and Shell's procedural request to the Supreme Court for Federal jurisidiction over their cases.

5. Working Group

(i) We hope that the tripartite Working Group will include objective representation, including representation from States which have a heavy concentration of foreign multinationals such as Illinois (where there is a helpful reporting system) as well as other States which have worldwide combined reporting.

(ii) Industry representatives on the Group should include foreign multinationals, especially since the largest problems of worldwide combined reporting are those caused to these multinationals.

(iii) The Working Group (as suggested in the press release) should also receive advice from a panel, separate from the Working Group itself, including representatives of the US's trading

/partners

partners, since unitary tax is clearly an international issue of concern to governments. The UK would like to be represented on this.

I understand that Secretary Regan gave positive assurances on all these points to the Chancellor yesterday. I shall be watching the Working Group's progress and hope that it can report speedily.

5. Defensive

Secretary Regan mentioned to the Chancellor yesterday that he had never seen the accounts of a single foreign corporation which showed how much extra tax it paid because of worldwide combined reporting. He argued that it was necessary to have a Working Group to establish the facts.

6. The US estimate the cost for all companies concerned at $600-900 million a year for all profits earned beyond the water's edge. But the burden of unitary taxation on companies is not simply the extra tax, but also the immense administrative burden of preparing accounts of worldwide profits according to US accounting standards in each State with worldwide combined reporting, together with the uncertainty about whether a corporation will be declared "unitary" when it makes an initial investment. Unitary taxation conflicts with the working principle that companies should not be taxed twice on the same profits. Above all there is the risk of the practice spreading to other States and abroad, with the cost escalating correspondingly.

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ATTACHMENT

In brief this suggests you explain your disappointment about the timing of the Administration's Container Corporation decision so as to lead the way to a firm request, first, for amicus curiae briefs to be submitted in forthcoming cases involving foreign parents and, second, for balanced arrangements for representation in the working group.

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FROM: J O KERR

DATE: 30 September 1983

MR BATTISHILL

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
PCC
Mr A Ridley
Mr Lord
Dr Rouse
Mr Makeham

IMF/IBRD ANNUAL MEETINGS: CHANCELLOR'S SPEECH: 28 SEPTEMBER

I attach the full text of the Chancellor's speech in Washington on Wednesday.

J O KERR

IMF SPEECH

It is 22 years since I first had the privilege of attending the Annual Meetings of the Bank and Fund-- although on that occasion, in Vienna, I held the very different responsibility of a financial journalist.

Last year's Annual Meetings in Toronto, when the UK was represented by my distinguished predecessor, Sir Geoffrey Howe, coincided with the low point of the recession for the world economy as a whole. Deep concern was then expressed about the prospects of recovery, and there was some hesitation over the right strategies for national economies. And the first major outbreak of the debt problem had just occurred.

/Since then we have

Since then we have experienced an eventful and troublesome year, for governments and peoples alike, and for the institutions in which we meet today. Debt problems have multiplied, and we are still far from seeing a clear way through all of them. The course of exchange rates and interest rates has been unsettled, and present levels, particularly interest rate levels, cannot be regarded as satisfactory. The economic and political strains of adjustment have inevitably proved painful. Impatient voices are heard demanding new approaches, new systems, new institutions.

But despite all that there has been undoubted progress; particularly on the all-important struggle against inflation; and recovery is now clearly under way. We are not yet out of the wood, but we are moving forward again. It is a good time to take stock of how best to make further progress, and tackle the problems which remain.

That is our common purpose at these meetings. An occasion such as this is one on which the Finance Ministers who bear many of the political burdens of painful adjustments can share their experiences and

/perhaps even

perhaps even fortify each other thereby. So it may be helpful if I spend a few minutes describing our recent experience in the United Kingdom, where a clear adjustment strategy was adopted four years ago, has since been steadily pursued, and is showing good results.

UK Economy

In the United Kingdom we have, during these past four years, followed a three-part strategy. We have exercised steady downward pressure on monetary conditions. Despite the recession, we have reduced our budget deficit significantly as a percentage of GDP. And we have introduced reforms to remove structural rigidities in the economy, abolishing a whole raft of controls, on pay, prices and dividends, on industrial development and consumer credit, and perhaps most important of all, on foreign exchange transactions.

What results has the strategy brought? First, inflation has been reduced dramatically. It has fallen from a rate of around 15 per cent for much of the 1970s to around 5 per cent now. The long upward trend of rising inflation rates from one cycle to another has been decisively broken. Secondly, we have secured

renewed economic growth. Despite unfavourable world trade conditions which impact particularly sharply on the UK, our economy has been growing at an average annual rate of around 2½ - 3 per cent since the trough of the recession in the first half of 1981. This compares favourably with our long-run pre-recession trend. And unemployment, although still tragically high, is starting to level off.

Some observers in the UK used to argue that such a recovery was impossible without government stimulus. So far from that being the case, economic recovery in the UK can now been seen to have started in the immediate wake of my predecessor's courageously tough budget of 1981.

Now the critics argue that the recovery is not sustainable; that it is unbalanced; and that inflation is bound to rise again. I shall briefly explain why I believe they are wrong on all counts.

It is true that the recovery so far has been primarily based on increased personal spending and the end of destocking. But that is not a cause for concern, for all recoveries have that characteristic in the early stages. That is a well-established cyclical patte

/What is significant

What is significant is that on this occasion the familiar first stages of an end to destocking, a rise in spending on consumer durables, and an acceleration of house-building, came about without any Government stimulus to demand: they resulted instead from lower interest rates, increased confidence and above all low inflation, which in turn have been the result of responsible monetary and fiscal policy.

It would now be normal for the emphasis of the recovery to switch from the personal sector to the company sector, in the form of increased capital investment and positive stockbuilding. The pattern - in no way unusual or surprising - that investment follows consumption increases should be encouraged by the very substantial increase in company sector profitability which we have seen over the past year. Certainly, there are no signs, in the forward indicators, that the UK recovery is coming to an end. Quite the contrary.

Provided that monetary control is maintained - and it will be - and that inflationary expectations continue to improve, and providing we can continue to hold down our budget deficit and avoid unnecessary pressure on interest rates, which are still too high, we will see the recovery spread more widely throughout the economy.

/As for

As for the critics' concern that UK inflation would rise with economic recovery, the fact is that there is no sign so far of re-emerging inflationary pressure even though, as I have explained, the recovery has already been under way for two years. Of course, there will be temporary variations caused by special factors, but there is no sign in the inflation figures, when we strip out the volatile impact of changes in housing costs (themselves the result of changing interest rates) and seasonal food prices, of any change in the underlying trend. The growth of labour costs per unit of output continues to be low, helped by substantial increases in productivity.

THE WIDER STRATEGY

I think it worthwhile to set out these facts from this rostrum, for there is an important conclusion to be drawn from all this, and it applies, I believe, not only to the United Kingdom.

It was one of the characteristics of the cycles of the 1960s and 1970s that many observers underestimated the continuing strength of recovery. Indeed, one of

the reasons for accelerating world inflation during the 60s and 70s was that, at the stage of the cycle which the UK has now reached, governments worried about the strength of recovery and were persuaded to stimulate the level of demand. Because that stimulus was in addition to the already powerful forces of recovery the result was excessive inflationary pressure.

The lesson of that experience is one which we should all heed. It is important that we all recognise that powerful forces arising from lower inflation, lower interest rates and lower labour costs can both start and sustain recovery; and that the factors which are most likely to damage recovery would be an excessive expansion of demand by mistaken monetary and fiscal policies, bringing about their own inevitable reverse, and in particular an unsustainable structural budget deficit that puts damaging pressure on interest rates.

Let us also remember that high interest rates bear particularly heavily on developing and debtor countries; and that protectionist forces are inevitably strengthened when exchange rates are determined more by capital flows than by trade flows.

/So let me

So let me now draw some specific conclusions from our UK experience -

First, the strategy works: our experience demonstrates that it is possible for governments to reduce and control inflation through appropriate monetary and fiscal policies; and that financial discipline does not stifle growth - on the contrary, it helps to create the conditions for healthy and sustainable growth.

Secondly, perseverance is necessary, and it is important for the government to convey its determination to persevere; this is not easy, because it takes time before benefits are seen, and it may take additional time to see the benefits convincingly, even after they have begun to take effect. But is is crucial to demonstrate to the markets that there is, and will remain in place, a firm medium-term financial strategy.

Thirdly, although conditions in different countries may vary, I am convinced of the need to have monetary and fiscal policy operating in harmony. Otherwise, there will be risk of severe strain,

/especially if public

especially if public sector borrowing so pre-empts flows of savings that monetary restraint can be achieved only at the cost of very high real interest rates.

Fourthly, while no country can insulate itself against the rest of the world economy, the more firmly engaged any country is on a sound financial strategy, the better it will be able to withstand external shocks or weaknesses.

Fifthly, liberalising industry, cultivating competition, and giving free rein to market forces helps recovery. This applies across as well as within national frontiers: liberalisation of trade and payments contribute importantly to the development of world trade and economic activity.

Sixth, our general election result earlier this year has demonstrated that, despite all the inescapable pains of adjustment, a Government which steadfastly pursues this strategy, and which clearly explains to the people the need for the policies it is carrying out, has no cause to fear that it is exceeding the bounds of the politically possible.

/I make no apology

I make no apology for having dwelt at some length on the U.K. experience. At repeated international meetings Finance Ministers have agreed that the successful pursuit of a firm anti-inflationary strategy is the only sound basis for recovery. The Managing Director of the Fund has consistently and helpfully urged this on us all, not just those who are immediate clients in drawing on IMF resources. He did so again, most eloquently, from this rostrum yesterday. What is happening in my country is, I believe, both relevant and encouraging.

DEBT

The Fund's main concern over the past year - and that of the World Bank too - has been with countries facing debt problems. The growth of such problems in the last 18 months has been dramatic because a number of factors came together at the same time. A combination of world recession and sharply reduced commodity prices has limited export earnings by debtors. Very high dollar interest rates, applying to borrowing of which an increasing amount had become short-term, have magnified their problems.

Both elements in this squeeze have already eased a little, and should ease still further as world economic recovery continues, and particularly if the relative

/ burden of dollar

burden of dollar interest rates can be reduced. Because of this, it is important not to overstate the problem, while remaining mindful of the risks.

On the other hand, it is abundantly plain with hindsight that the scale of reliance on borrowing by some countries had by 1981 become greatly excessive, reflecting the over-ambitious quest to maintain unsustainable growth rates in a deteriorating world environment.

Balancing these various factors, the IMF have produced, in their latest survey of the World Economic Outlook, a careful assessment of the risks and possibilities in both directions. I do not dissent from it. My own view is that our joint efforts to sustain world recovery and maintain the attack on inflation will help, but that there is an unavoidable, urgent and continuing need for adjustment by the major debtors.

There can be no escaping the need for adjustment, and the IMF has served us all well in holding firmly to this basic requirement. I should also like to add a word of appreciation, indeed congratulation, to those of our colleagues who have displayed the determination and political will to move quickly and decisively in the right direction.

If adjustment is crucial, so also is the provision of some time for its effects to be achieved. I believe we have developed a sensible emergency strategy, with the IMF playing a central role in working out necessary programmes of adjustment, which unlock IMF assistance, and in turn some mobilisation of new commercial lending. But I suggest we should now begin thinking further into the future.

Three issues might be worth pursuing.

First, many of the arrangements which are being made create the prospect of a very considerable hump of debt maturities a few years ahead. If - and I emphasise this basic requirement yet again - if the course of adjustment is satisfactory, it seems to me that it would be right for the borrowers and lenders concerned to think in terms of trying to reshape maturities for a further period ahead, on a longer time-scale. Much will depend on the degree of confidence in the borrower, and on world prospects generally; much may also depend on the evolution of interest rates and international flows of funds generally. In the main, however, we are dealing with countries which have considerable potential resources, if they can be effectively mobilised.

/Second, it is very

Second, it is very likely that the pattern of international flows of funds in the next decade will differ sharply from what we have seen in the last decade. We are already well past the peak period of accumulation of surplus wealth by the major oil-producing countries. We may well be moving into a period in which the current deficits which are the natural condition of most of those countries in the developing stage will have as their counterpart the more traditional surpluses of industrial countries, whose capital formation and distribution are very different. There is food for reflection here for commercial banks, but particularly also for the borrowing countries themselves. I suggest in particular that many of them ought to look again at their attitudes towards private investment, and to reflect on the advantages they could draw from encouraging long-term flows in that form, rather than the short-term borrowing of which they have had such uncomfortable recent experience, and which may in any case be less freely available.

Finally, as the world economy recovers strength, we need to give increasing attention to ways of strengthening the role of the World Bank, and to means of association between it and private investment. No country should delude itself that massive increases of official assistance are likely--or indeed would be helpful in securing sustainable growth. But there is some scope for a stronger role here.

IMF FINANCE

I have already spoken of the key role of the IMF in helping to encourage and support adjustment policies. Recognising that the Fund must be equipped with sufficient resources to discharge this task, the Interim Committee, under the Chairmanship of my predecessor, reached important decisions in February on the 8th Quota Review. The effect of this, together with that of the decisions reached in advance on the enlargement of the GAB, should be to double the useable resources available to the Fund.

It is clearly essential that these decisions are implemented as soon as possible by all Fund members. I am glad to say that the United Kingdom has already passed the necessary legislation. It would be difficult to overstate the importance of the US Congress doing so too, and on time.

Provided that they do, the decisions reached,at the end of the day, at the latest meeting of the Interim Committee, in which the United Kingdom was glad to have been able again to offer some assistance, will provide a firm but flexible basis for carrying forward the Fund's work.

/Given uncertainties

Given uncertainties about future developments it would not have been sensible to seek to reach a view on the level of members' access to the Fund more than a year ahead: nor was that necessary. The Committee, rightly in my view, envisage a gradual phasing out of the enlarged access arrangements. But it is evident that their extension into 1984 was necessary and fully justified.

I believe the Committee was also right not to conclude that a case has yet been established for a further SDR allocation. There clearly is imbalance in the distribution of world liquidity: but I am not convinced that there is an overall world liquidity shortage. At the same time I welcome the fact that further studies in this field are being put in train, and that the issue remains on the table.

IBRD/IDA FINANCING

The World Bank, too, cannot perform its role without adequate funds, and a selective capital increase is now required in order to help raise the level of lending which the Bank can sustain. I have accordingly suggested that an increase of around \$8 billion might be appropriate, provided that the details were settled in a satisfactory way, taking account of adjustments in the relative positions

/ of shareholders

of shareholders.

But we must recognise that an increase in World Bank lending will not help the poorer countries whose credit-worthiness precludes substantial borrowing from commercial banks. For them, IDA is crucial. The UK has always been a strong supporter of IDA, which we regard as a highly efficient means of channelling resources to the poorest countries. We are prepared to play our part, with due regard to our relative economic capacity, in securing a Seventh Replenishment of adequate size. I hope that all countries will be willing similarly to play their part, and I would particularly like to appeal to our United States colleagues, as IDA's originators and generous supporters, to consider whether there is more they can do to contribute to a satisfactory agreement. Their role in the final settlement will be crucial.

/INTERNATIONAL MONETARY SYSTEM

INTERNATIONAL MONETARY SYSTEM

I would like, in conclusion, Mr Chairman, to add a word on the perennial question of the overall working of the international monetary system. The International Financial Institutions represented here have served us well over the years, developing to match changing circumstances and meet new needs. Provided that we continue to equip them with adequate resources, I am convinced that this will remain the case.

They h ve shown resilience and adaptability in confronting the difficult issues arising in a period of transition from one of high inflation. The past few years have in a very practical sense been a period of evolution in which all our countries have shared, in particular through participation in the operational decisions of the Fund.

In the wake of the second oil price increases, the international community has reached a general agreement on the stance of policy which can best provide the basis for sustainable non-inflationary growth. This strategic consensus provides a framework in which we can consider what further improvements to the operation of the monetary system might be sensible.

/It is right that there

It is right that there should be continuing exploration and debate about specific aspects of the system. The recent Commonwealth Study Group report represents a thoughtful contribution to that debate. And I welcome the decision of the Group of Ten to carry out further work to identify areas where progressive improvements might be sought.

But I would just add this. Let us remember that it was inflationary domestic policies that precipitated the breakdown of the original Bretton Woods arrangements, not the other way about. When things go wrong, there is a temptation to blame the system. This is a temptation to assume that all problems that are not cyclical must be systemic, and can be solved only by changes to the international system. But none of us can in fact duck responsibility for the way we conduct our domestic economic and financial policies. That in the end is still what this discussion is really all about.

/Conclusion

CONCLUSION

It was for that reason, Mr. Chairman, that I began my remarks today with an account of our recent experience in the United Kingdom, and suggested some conclusions about the roots of our current recovery which might have wider relevance and applicability. It was for that reason too that, in discussing current debt problems, and putting forward some suggestions for their handling in the medium and longer term, I have stressed the cardinal importance of appropriate adjustment programmes. And it is precisely because both the Fund and the Bank play a key role in encouraging the adoption of such policies, and helping countries see them through, that I have today emphasised the importance of ensuring that both institutions continue to have the resources they need to do their job, supporting and sustaining a soundly-based recovery in national economies, and hence in the world economy. If we do not fail them, I am confident that they will not fail us.

Thank you, Mr. Chairman.

NOTE OF A MEETING BETWEEN HERR LANC, AUSTRIAN FOREIGN MINISTER, AND THE CHANCELLOR OF THE EXCHEQUER, AT 11 DOWNING STREET ON WEDNESDAY 2 NOVEMBER

Present:- Chancellor of the Exchequer
Mr Ingham
Herr Lanc
Dr Seyffertity
Dr Bauer
Dr Knitel
Dr Diezinger
Dr Thomas
Dr Alexander

PW

Herr Lanc said that he would be interested to hear the Chancellor's views about international debt management, and state guaranteed loans to countries like Poland and Central and South America. He was also interested in the difficulties faced by developing countries, and the whole of the north-south question. The Chancellor acknowledged that this was a very difficult question. He felt, however, that with the passing of the oil price shocks, and signs of a real fall in oil prices, the situation had eased. As other commodity prices had generally begun to rise, the position of the developing countries in particular should improve. He felt that there were two quite separate problems that needed different treatment. One concerned the very poor countries, who were dependent upon international aid for their survival. He thought that the UK's views had been clearly shown by the efforts he had made in Washington to persuade the US to increase its contribution to the IDA 7 replenishment. Separately from this, there was a problem of the international debt crisis. These countries had no problem in earning foreign exchange, but they had over the past years accumulated enormous indebtedness, which because of their domestic high inflation, high dollar interest rates and the general world recession they could not now pay off. The Chancellor felt there were two ways out of this problem. The first depended on a fall in the dollar interest rates, which in turn depended on reducing the size of the US budget deficit and he felt there was no realistic prospect of this before the Presidential election. The second was to depend on IMF-organised adjustment programmes, which could form the basis for more substantial bank lending. This type of approach had worked well in the case of Mexico, and the signs were hopeful that it would do the same for Brazil. The results of the recent Argentine General Election were also very encouraging. Obviously, there would continue to be a delicate and difficult debt problem for many years.

2. Herr Lanc thanked the Chancellor for his explanation. It was generally in line with his own understanding, but there were two particular points on which he would like to express a slightly different view. He accepted the need for IDA and grant finance to the poorest countries, but he thought it important to have other development programmes that did not depend entirely on subsidies but which would enable the countries in question to do more to help themselves. These countries had never been particularly hit by the oil price shocks, because they did not make a large use of oil in their economies. They were, however, very dependent on the price of other commodities and the basic trend in these prices was downwards throughout the 1970s to 1982, while other prices were rising and the gap therefore widening. He thought therefore that a structural solution must be found in the development of a system of balanced prices for commodities and industrial goods. He saw otherwise the danger of similar cartels to OPEC developing for other commodities, with potentially damaging political consequences. On the question of the more developed countries, he stressed the importance of seeing what was politically possible without hindering the movement towards democracy and humanitarianism. On this basis, he was doubtful if the IMF programme would eventually prove acceptable to Brazil.

3. The Chancellor said he agreed with the need to balance political and economic considerations, but he was hopeful that an acceptable solution could be reached in Brazil. He also pointed out that it would totally undermine the IMF's credibility if it lent without conditionality. On encouraging the economies of the poorest countries, he felt the most important thing was to avoid any form of protectionism in the developed world. He did not, however, share Herr Lanc's fear of the development of OPEC-like cartels. There had been a number of special factors in the development of OPEC which were most unlikely to be repeated.

4. Herr Lanc then turned to consideration of the Polish situation. He reported the latest news that the US had now agreed to permit negotiations with the Paris Club to go ahead. He asked if the Chancellor expected the negotiations scheduled for mid-November to proceed quickly or whether he saw the likelihood of additional problems. The Chancellor said he was not aware of the latest American development, but the UK's traditional position had always been to consider these two questions of debt management and political influence separately, so to that extent he would agree with the Austrian and Swiss views that political sanctions on the opening of further talks were not acceptable.

5. The Chancellor then asked Herr Lanc about the prospects for the Austrian economy. Herr Lanc reported that the budget deficit had been cut back 30 per cent, two-thirds by increased taxation and one-third by reduced spending. They had been careful, however, not to reduce expenditure that went to support investment, especially that in the infrastructure. It would be necessary next year to discuss a new form of financing the social security programme because of the speed with which t
Government contribution was increasing. He hoped to com

this next year, and therefore lay the ground for a real consolidation of the budget by the end of the 1980s. There were several hopeful signs in the economic field, such as the balance of payment surplus and further improvement was in prospect. The Austrian economy was in any case in much better shape than many developed countries, and the Government intended to do what was necessary to keep up the progress.

JS.

MISS J C SIMPSON

Distribution:-

PS/EST
Mr Unwin
Mr Fitchew
Mr Edwards
Miss Court
Mr Ingham
Miss J A Edwards

CONFIDENTIAL

cc CST
FST
MST
EST
Mr Middleton
Mr Littler
Mr Cassell
Mr Unwin
Mr Lankester
Mr Lavelle
Mr Mountfield
Mr Bottrill
Mr Monck
Mr Peretz
Mr Hall
Mr Denison
Mrs Case

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

7 November 1983

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Dear Andrew,

INTERNATIONAL FINANCIAL SCENE

I enclose the latest assessment of the international financial scene by the Bank of England, which the Treasury have discussed with the Bank and other Departments. The Prime Minister may find it useful background reading before the Anglo-German Summit.

On Brazil, our approach remains as agreed between the Prime Minister and the Chancellor in September. Problems over the introduction of the wage de-indexation law have however caused fresh uncertainties about the IMF package, and the Fund are currently assessing the impact of the revised law. Our Executive Director and other G10 colleagues saw the Managing Director on 3 November. There is no sign so far that the Fund staff are taking a less stringent view of Brazil's adjustment requirements. The Executive Board discussion is still planned for 18 November. At the 3 November meeting the Managing Director's main concern was to try to firm up an official package in order to be able by 14 November to indicate its approximate size to the commercial banks, who have been asked to make their commitments by then. The Americans confirmed that they were prepared to fill up to half of the $2.5 billion "financing gap" but that they looked to other official creditors "in the aggregate to make a matching commitment". So far only the Canadians ("an appropriate share") and the Dutch ("if the US contribution were more than 50 per cent") have made any commitment. The Japanese and the Germans remain unforthcoming: both see problems in providing new export credit to a country rescheduling its debts, but neither has finally ruled out making a contribution. We propose (and this is understood by the Fund and our G10 colleagues) to stick on our participation in the Paris Club rescheduling. The Chancellor is confident that the American contribution will in the end be above $1.25 billion.

/As for Argentina,

As for Argentina, it is too early to say exactly how the election results will affect debt repayment. Sir Alfonsin has said that Argentina will honour its international debt obligations, and his policy line is more moderate than that of the Peronists. But the transitional period, before he and his government assume power, will inevitably be one of further risk to the implementation of the IMF programme. We shall be monitoring the situation closely, and work has of course started on the remit from last week's Cabinet on arms sales and the commercial bank loan.

Our next overall assessment will come forward in mid December.

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

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

CONFIDENTIAL

bf. [illegible] on Thurs-night
with MS for Fontenay.

From: J WILLIAMS
Date: 5 December 1983

<u>NOTE OF A MEETING</u>

cc PS/Chancellor —
PS/Financial Secretary
Mr Littler
Sir T Burns
Mr Unwin
Mr Lavelle
Mr Wicks
Mr Bottrill
Mrs Diggle
Mr Bailey
Mr Battishill

<u>UK ARTICLE IV CONSULTATION</u>

On 2 December, Monsieur de Fontenay and Mr Vittas of the IMF Article IV consultation team paid a courtesy call on Mr Middleton. Mr Wicks and Mr Lavelle were also present.

2. Monsieur de Fontenay said that the Fund team intended to focus their analysis for this consultation on the medium term and how policy and the economy were likely to evolve over the second term of this Administration. Their analysis would need to consider the achievements made so far under the MTFS and how the economy had performed against expectations. Particular medium term issues which the team would wish to address included:

(i) the likely consequences of the slow down in oil production and revenues towards the end of the 1980s and the ways in which the UK authorities proposed to react to this situation;

(ii) long term trends in public expenditure in the UK and how the Government was preparing to finance

the continuing substantial expenditure on social programmes. This type of issue was being faced in all major industrialised countries but the long term solutions to the difficulties created by the need to finance expanding expenditure programmes in a non-inflationary way were far from clear. The team would like to discuss this issue in particular with the Chancellor;

(iii) the measures being taken to improve the functioning of the supply side of the economy and how the remaining structural problems of the economy could be tackled in a medium term perspective. The team would wish to consider the privatisation programme under this heading and hoped to be able to discuss privatisation with the Financial Secretary during their visit in the light of his recent speeches.

3. In reply, Mr Middleton welcomed this medium term orientation. The basic stance of macro-economic policy had changed little, with the emphasis being on applying downward pressure on the monetary aggregates and continuing to reduce the PSBR as a proportion of GDP, and was set to continue. The Treasury had been analysing the long term trends in public expenditure and although there was at this stage little numerical work, officials would be pleased to discuss the analysis which was underway. The Government's approach to the problem of long term public expenditure had been initially to identify and to focus public attention on the difficulties and then to develop prescriptions. Tackling the growth in public expenditure would be a gradual and phased process. Similarly, now that the rate of inflation had been markedly reduced, the Government would be paying increasing attention to supply side issues, although this was an area in which results took a particularly long time to come through.

JW.

J WILLIAMS

X - available from Cabinet Office.

FROM: J GRAHAM
DATE: 17 November 1983

CHANCELLOR

cc: Mr Littler
Mr Unwin
Mr Mountfield
Mr Beastall
Mr Sheridan

COMMONWEALTH HEADS OF GOVERNMENT MEETING, NEW DELHI
23-29 NOVEMBER 1983

The Prime Minister's briefing meeting for the Commonwealth Heads of Government conference is to be held at 9.00 on Friday 18 November in No 10.

2. The main briefs for CHOGM have already been circulated as X the PMVE(83) series. In all there are 89 briefs though the bulk are on individual Commonwealth countries. The briefs have been split into three categories:

A - prepared statements	(7)
B - Ministerial briefs for use in formal sessions	(28)
C - background briefs	(54)

The FCO brief on which is not really worth reading

3. The major Treasury interest will be in the follow up to the Commonwealth Study Group report "Towards a New Bretton Woods". It is probably the most important of the three Commonwealth Studies, all of which are, rather unhelpfully, covered in one brief, PMVE(83)B17; the other two concern protectionism and the North-South dialogue. Other important briefs for the Treasury are; the world recovery and IMF issues, PMVE(83)B15; IDA7 PMVE(83)C3; and relations with developing countries, PMVE(83)B16, which is something of a rag bag including debt, UK aid policy and the World Bank together with other topics such as UNCTAD etc. There is some overlap amongst these briefs. There is also a brief on the UK economy, rather lost in the list, PMVE(83)C11.

Towards a New Bretton Woods

4. The Commonwealth Study Group report was presented and discussed at the September CFM. The background and our approach are dealt with fully in PMVE(83)B17. Mr Muldoon, who was mainly responsible for initiating the idea has recently written to Mrs Ghandi implying that the Williamsburg declaration was intended to lead to a reform conference. A copy was sent to the Prime Minister. A reply before CHOGM is unnecessary. The main points to note are:

- we together with the Canadians are opposed to a new conference and will have to resist Mr Muldoon and most other Commonwealth countries who will be pressing vigorously for one;

- the Prime Minister has endorsed the Foreign Secretary's view that the best way forward is to pursue the proposals you put forward at the CFM. These envisaged a Commonwealth group discussing with representatives of the major international institutions what changes within the existing institutions would be generally acceptable. The Trinidadian Prime Minister is expected to refer to this at CHOGM;

- we should recommend the meeting agrees to further work on these lines. But we shall need to ensure it does not duplicate work being undertaken by the G10 Deputies. They had their first meeting today. Mr Littler will be able to provide an oral report.

World Economic Prospects

5. The main brief, prepared by the Treasury, is at PMVE(83)B15, while a short prepared statement is given in PMVE(83)A4. The latest OECD forecasts, which are being discussed today and tomorrow by the OECD Economic Policy Committee in Paris, sees recovery in the industrial countries continuing next year with inflation levelling out at around 5½ per cent. US growth may

slow from now on and inflation pick up a little. The dollar is expected to depreciate given the large US current account deficit.

6. In the US M1 growth has declined in recent weeks and has now slipped below its 5-9 per cent target range for the second half of the year, leading to calls for some relaxation of the monetary stance. With the economy still growing strongly and expected to do so next year the Fed is unlikely to respond.

7. On the US IMF Quota Bill, there is the possibility that new proposals, which avoid the conference procedure between both Houses of Congress, could allow the Bill to be passed before the recess on 18 November 1983. Ratification by the US is seen as a precondition to the BIS loan to the IMF and ultimately that from Saudi Arabia as well.

Protectionism and Rollback

8. The main brief on the Commonwealth study on protection at PMVE(83)B17 deals with this fully. The UK should take a positive stance on this at New Delhi. We should make it clear we accept the commitment from the OECD Ministerial meeting and the Williamsburg Summit, to halt and reverse protectionism as recovery proceeds. We support the (rather modest) proposals currently being considered in the EC which are listed in the brief. But we do not think that the acceleration of the Tokyo round tariff cuts should wait until EC growth reaches 2 per cent; it should be done straight away.

9. We should accept that action to tackle non-tariff barriers is even more important and while some import restrictions may be necessary to allow time for restructuring, these restrictions should only be temporary. The DTI tend to be more hesitant than this. But movement among the developed countries will be fairly slow anyway; so it costs us nothing to adopt a positive tone in our public pronouncements. (The UK line is to be considered collectively by Ministers shortly on the basis of a paper by DTI, but this will not happen until after CHOGM.)

IDA 7

10. This is covered in brief PMVE(83)C3. Negotiations on IDA 7, effective from July 1984, are stalled because the US refuses to go beyond a contribution based on a $9bn replenishment (IDA 6 was $12bn and the LDCs are pressing for a significant increase). The UK position is that we could support a replenishment of up to $12bn, but must reduce our own share more in line with our relative economic strength. The line to take in New Delhi is that progress depends on the US and that at the appropriate time - which should be after Congress has passed the legislation for the IMF quota increase - we would be ready to join others in pressing the US to improve their offer.

Relations with Developing Countries

11. The most important items covered in this brief PMVE(83)B16 are international debt, the World Bank and UK aid policy.

(a) International Debt. Nigeria is the major problem among Commonwealth countries. Most other members have avoided the extreme financial difficulties associated with the major Latin American debtors. The attached note considers the more difficult Commonwealth IMF programmes.

(b) World Bank. The UK is ready to support a selective capital increase but at a compromise figure of $8bn not $20bn as some have suggested.

(c) Aid Policy. For defensive purposes, we should point out that the best contribution the developed countries can make towards the prosperity of the Third World is to create the conditions for a sustained recovery; we are doing this and it inevitably involves restraint in public expenditure, including official aid programmes; nevertheless UK is determined to maintain a substantial aid programme within the limits of what we can afford; we concentrate it on the poorest countries; and it is mainly grants rather than loans.

North/South Negotiating Procedures

12. The other Commonwealth study, also covered in PMVE(83)B17, has been produced as a result of an Australian initiative at CHOGM two years ago. The report has turned out better than expected. The G77 are urged to show greater flexibility and realism, concentrating on practical measures. We can support a number of the proposals in the report. However the G77 have not accepted it despite being urged to do so at UNCTAD VI. Commonwealth G77 members, and the Commonwealth Secretary General, should be urged to adopt a more positive attitude to it.

J Graham

J GRAHAM

17/11/83

CWD
WPS
PS/Lady Young
PS/Mr Raison
PS/PUS

Sir J Leahy
Mr Squire
Mr U rc

CH/EXCHEQUER
REC. 17 NOV 1983 17/11
ACTION Mr Lavelle.
COPIES TO CST-PST. MST-EST
Mr Middleton.
Mr Littler.
Sir T Burns. Mr Unwin.
Mr Bottrill Mr Peretz Mrs Case. Mr Lankester.

PM/83/91

PRIME MINISTER

1. In preparation for your CHOGM Briefing Meeting on 18 November, I attach a short paper covering the major issues likely to arise at CHOGM, including Grenada and Cyprus. I also attach a copy of the draft agenda (to be finalised by Senior Officials in New Delhi on the eve of the Conference). The paper follows the order and heading of the draft agenda.

2. It would be helpful if on Friday we could consider in particular the following points which arise from the paper:

Style and Format: Will you wish to use the Restricted Session following the opening ceremony to press for a shorter and more readable communiqué?

Grenada: Are you content with the line in paragraph 2 of the paper?

Security of Small States: Paragraph 3 of the paper suggests that we should not initiate in plenary sessions any discussion of the security problems of small states. This might prove counter-productive and open up divisions (eg within CARICOM). Do you agree?

Southern Africa/Namibia: Are you content with the approach in paragraph 5 of the paper?

World Economic Issues: Are you content with the line in paragraph 6 of the paper?

Functional Cooperation: Do you agree that, with the exception of the Commonwealth Foundation, we should resist anything that would increase the Secretariat's expenditure in real terms? (An agreement to participate in any

Commonwealth help for Grenada would of course also have financial implications).

3. Additionally, there is likely at CHOGM to be a fairly full discussion on the general question of disarmament and arms control. Such a discussion would give you an opportunity to emphasise your commitment to arms control and to an improvement in East-West relations, and to stress that the Americans individually and NATO collectively continue to make genuine efforts for progress. We wuld wish to discourage any specifically Commonwealth initiative on global security or disarmament. (We thought at one time that the Indians and Mr Ramphal might intend some Commonwealth statement on the subject, but have had no recent indication of this).

4. I am copying this minute to Sir Robert Armstrong.

GEOFFREY HOWE

Foreign and Commonwealth Office

17 November, 1983

c: PS/PUS

COMMONWEALTH HEADS OF GOVERNMENT MEETING (CHOGM), NEW DELHI: PRIME MINISTER'S BRIEFING MEETING, 18 NOVEMBER

Style and Format.

1. Mr Ramphal has already adopted some of the Prime Minister's proposals for securing improvements in the conduct of CHOGMs. A major further improvement would be to revert to the shorter and more readable communiqués of the early '70s, where related subjects were grouped together by paragraph, without itemising the various views expressed. Sir Geoffrey Howe has spoken about this to Mr Ramphal, who suggested that the Prime Minister might raise the matter at the Restricted Session following the opening ceremony. We have already canvassed our thoughts fairly widely at official level, and can expect support from a range of countries, including Canada, New Zealand, Singapore and Fiji.

World Political Scene: Global Trends and Prospects

2. Grenada is bound to be discussed. There is likely to be a widespread wish that it should not become a major matter of controversy. Our aim should be to look to the future rather than to the past and respond to requests from Grenada once the interim administration has had time to assess needs in the light of the timetable for US withdrawal and the security situation in Grenada. The Advisory Council has been appointed and its rôle and powers defined. Mr McIntyre will arrive on 21 November and take charge. The Governor-General will then step back from Government and will only act and legislate on the advice of the Council. It seems unlikely that Grenada will have been able to formulate detailed requests for Commonwealth help in time for consideration at CHOGM. We therefore hope Commonwealth Heads of Government will keep options open and indicate willingness to respond individually or collectively to requests when received. The Prime Minister might rehearse what we are prepared to do on a bilateral basis particularly with helping with police advisers and training. If we were asked at New Delhi whether we would contribute to a Commonwealth security presence in Grenada, we could repeat that we would

/consider

consider sympathetically requests for help in restoring conditions of peace and security but would want to look closely at the details. A main objective at CHOGM will be to encourage healing of breaches in CARICOM. One way of achieving this would be participation from Caribbean non-intervening countries in supplementing the OECS police contingent if this were acceptable to Grenada. A more likely rôle for the Commonwealth could be assistance with the organisation and supervision of elections which under the Governor-General's timetable would be held in six to twelve months. Monitoring of elections is something that the Commonwealth has done frequently and successfully, most recently in Zimbabwe and Uganda. It will be much too early to take firm decisions about this in New Delhi. If the subject comes up, the Prime Minister might say that we would naturally be glad to contribute to a team if asked and provided the finances were worked out satisfactorily in advance. (Costs incurred by the Secretariat for the Uganda exercise totalled £229,000 and not all the countries which indicated that they would pay in the event did so.)

3. Security of small states. When he called on the Prime Minister on 10 November, Ramphal mentioned the question of the security of small states which he thought should be looked into "when the dust has settled". It would probably not be sensible for us to raise it in CHOGM, at least in plenary. If others did so, the Prime Minister would want to signal British interest, and might propose that the Commonwealth Secretariat consider what should be done. It might also be useful to take the opportunity to discuss the question in the corridors with eg, the Canadians, Australians and New Zealanders.

4. The Turkish Cypriot declaration of independence on 15 November makes it certain that the Greek Cypriots will press for more extensive discussion of Cyprus than they would otherwise have wanted. We must obviously try to limit the damage caused by UDI. Intensive diplomatic activity is already under way, much of it initiated by the Government. We have called for a meeting of the Security Council which, as a result, met informally on 15 November to consider a British draft Resolution. We have also proposed a meeting of the Guarantor Powers (Greece and Turkey) in accordance with the 1960 Treaty of Guarantee and are in close consultation with our main Allies. Current action is therefore focussed on New York.

We see no immediate rôle for the Commonwealth at this stage. Members of the Commonwealth can be united however in the communiqué in calling for non-recognition of the Turkish Cypriot state.

5. World Political Scene: Southern Africa/Namibia. Our objective should be to encourage the Africans to be realistic. We have done what we can to prepare the ground. Ramphal has told Sir Geoffrey Howe that he has encouraged Nyerere to work for a practical, well-focussed discussion; and Sir Geoffrey hopes to have private meetings in New Delhi with the Foreign Ministers of Tanzania, Botswana and Lesotho. The Canadians should be encouraged to share with us some of the burden of defending the Contact Group's position. But we are likely to come under strong pressure to use our influence with the Americans to drop their insistence on Cuban withdrawal. We should urge the Meeting to accept that there is a practical problem about this which has to be overcome. In any case, we must expect a difficult discussion.

World Economic Issues.

6. Our line is now clear; we support many of the detailed points in "Towards a New Bretton Woods", but cannot accept the proposal that work should now be set in hand for an international monetary conference. Instead, as the Chancellor proposed at Port of Spain, we should work for a Commonwealth Group to discuss the issues with international financial institutions. The Prime Minister might additionally offer to bring Commonwealth views to the attention of next year's Economic Summit in London.

Functional Cooperation.

7. The Commonwealth Foundation's present budget of £1.1 million was agreed in 1979. It will ask at CHOGM for an increase to £1.6 million. Many countries will consider that an increase is due, but will balk at one of this size. We plan to urge a compromise of £1.3 million next year, with further increases in future years. Apart from the Foundation, our main concern must be to resist anything that would increase the Secretariat's expenditure(of which we contribute 30%) in real terms. Any other real increases would place an intolerable strain on the planned FCO Vote. We need not be apologetic about this, and can take legitimate credit for the substantial financial contribution we make to the Commonwealth.

8. Mr Ramphal may also ask the Prime Minister to say something about the future of Marlborough House, whose maintenance has been the responsibility of successive British Governments since 1959. The work which the PSA consider necessary will take about 3½ years, will cost at least £4 million, and will entail rehousing the Secretariat while work is in progress (at a probable cost of a further £3 million). PSA Ministers have (reluctantly) accepted these costs as a charge on their Vote, and the PSA are discussing alternative accommodation with the Secretariat with a view to starting work during the second half of next year. The Prime Minister could tell CHOGM that the Government will bear the full costs of repairing Marlborough House, and will do their utmost to minimise inconvenience to the Secretariat while repairs are taking place. (She should be aware that the Secretariat still hope to persuade the PSA to let them use some rooms in Marlborough House while work is in progress: or, failing that, to let them use part of Lancaster House. But the PSA consider that neither of these ideas is practicable.)

Foreign and Commonwealth Office
15 November 1983

COMPREHENSIVE MASTER PROGRAMME AS AT 15.11.83

<u>Monday, 21 November</u>

Prime Minister, Secretary of State Cabinet Secretary, PUS and others depart for New Delhi.

<u>Tuesday, 22 November, 08:00</u>

0800	Prime Minister etc arrive..
0930	? Prime Minister attends opening of Textile Exhibition.
?1200	Prime Minister and Secretary of State to meet HC staff (spouses).
1300	? Lunch for OECS leaders (Prime Minister, ? Secretary of State, Cabinet Secretary, PUS).
1430	Senior Officials Meeting (Cabinet Secretary and PUS).
?1700	Delegation Meeting (Cabinet Secretary, PUS)
?1800	Prime Minister's briefing meeting (Secretary of State, Cabinet Secretary, PUS).

1845	Queen's Reception for British community (?Prime Minister, Secretary of State, Cabinet Secretary, PUS) (spouses)
2000	The High Commissioner's private dinner for Queen and Duke of Edinburgh (Prime Minister and Secretary of State) (spouses)

Wednesday, 23 November

?07.30	Prime Minister's working breakfast for Mr Hawke (? Secretary of State, Cabinet Secretary, PUS).
0845	Most Delegates in place at Vigyan Bhavan (Secretary of State, Cabinet Secretary, PUS). (spouses).
0920	Prime Minister in place at Vigyan Bhavan. (spouses).
0945	Formal opening of CHOGM at Vigyan Bhavan. (spouses).
1100	Executive Session (Order of Agenda, Style, Format - Restricted session Prime Minister only).
1230	Reception by Commonwealth Secretary-General (Prime Minister, Secretary of State, Cabinet Secretary,

	PUS). (? spouses).
1500	Executive session (Prime Minister, Secretary of State, Cabinet Secretary).
1730	Reception by the President of India for Heads of Delegation (Prime Minister).
2000	Queen's Banquet for Heads of Delegation (Prime Minister,)

Thursday, 24 November

?0745	Delegation Meeting. (Cabinet Secretary, PUS).
0845	Prime Minister's briefing meeting (Secretary of State, Cabinet Secretary, PUS).
0930	Executive Session. (Prime Minister, Secretary of State, Cabinet Secretary).
1215	Visit to International Trade Fair followed by lunch for Heads of Delegation given by the Indian Vice-President (Prime Minister).
?1300	HC's lunch for Secretary of State. (spouse).
1500	Executive Session. (Prime Minister, Secretary of State, Cabinet Secretary).
2030	Dinner by the Prime Minister of India

	for Heads of Delegation (Prime Minister).
2030	Indian Foreign Minister's dinner (Secretary of State).

Friday, 25 November

0745	Delegation meeting. (Cabinet Secretary, PUS).
0845	Prime Minister's briefing meeting (Secretary of State, Cabinet Secretary, PUS).
0930	Executive Session. (Prime Minister, Secretary of State, Cabinet Secretary).
1230	Departure of Heads of Government for retreat in GOA (Prime Minister).
1315 for 1330	Lunch for fellow Foreign Ministers by Secretary of State and residents (PUS, ? Cabinet Secretary).
1800	Queen's reception (Secretary of State, Cabinet Secretary, PUS).

Saturday, 26 November

0930	?PUS to Foreign Ministers' retreat in Jodhpur.
am	Secretary of State and Lady Howe to

	Agra.
1500	Foreign Ministers fly to Jaipur (?PUS).

Sunday, 27 November

0830	Senior Officials to Agra (Cabinet Secretary, ?PUS).
am	Secretary of State departs for Brussels.
1530	Foreign Ministers return from Jodhpur to New Delhi (?PUS).
1800	Senior Officials return to New Delhi.
1830 am or 1930 or 2000	Prime Minister returns from GOA to Delhi.

Monday, 28 November

?0745	Delegation meeting (Cabinet Secretary, PUS).
0845	Prime Minister's briefing meeting (Cabinet Secretary, PUS).
0930	Executive Session. (Prime Minister, Cabinet Secretary, ?PUS).
1300 for 1315	Prime Minister's first lunch for fellow Heads of Delegation (Cabinet Secretary, PUS).
1500	Executive Session. (Prime

	Minister, Cabinet Secretary, ?PUS).
1730 to 1915	Prime Minister's presents Jnanapith Literary Award Siri, Fort Building, Asian Games Village.

Tuesday, 29 November

0745	Delegation Meeting. (Cabinet Secretary, PUS).
0845	Prime Minister's meeting (Cabinet Secretary, PUS).
0930	Executive Session. (Prime Minister, Cabinet Secretary, ?PUS).
1300 for 1315	Prime Minister's second lunch for fellow Heads of Delegation. (Cabinet Secretary, PUS).
1500	Executive Session (Prime Minister, Cabinet Secretary, ?PUS).
1700	Press Conference: Prime Minister of India and Commonwealth Secretary-General.
2230	Prime Minister departs New Delhi for UK (Cabinet Secretary, PUS).

Wednesday, 30 November

0710	Prime Minister's party arrives in UK.

CONFIDENTIAL

INTERNATIONAL FINANCIAL SCENE

General situation

Two major developments since the last Report have created much uncertainty on the international debt front. First, Congress has not yet endorsed the USA's higher contribution to the Fund which, together with the related delay in the BIS' credit facility to the Fund, threatens to restrict the IMF's ability to lend at a critical stage. Second, prospects for the Brazilian package - on which much else hinges - now depend essentially on the Fund's reaction to the recent decree on wage indexation. With the Philippines having entered the emergency ward and the long anticipated Argentine elections imminent (30 October), the general atmosphere is highly tense, and confidence in current case-by-case techniques of debt management will be severely tested in the months ahead. The run-up to the IMF Board discussion of Brazil on 18 November will be a crucial period.

Economic background

Economic recovery is continuing in the major industrial countries. In particular, there have been encouraging signs during the third quarter of further non-inflationary growth in the United States. This industrial revival should benefit indebted countries in terms of export demand and has already given some impetus to commodity prices, thus improving the terms of trade for some ldcs - although a number of others continue to suffer from weak prices for their main exports. Recent declines in US short-term interest rates from their peak in August should also bring some relief, but they still remain well above the level obtaining for much of the past year. Moreover, the future course of US interest rates remains highly uncertain. While these developments are on the whole encouraging, there is no general confidence that the recovery in industrial countries is yet broadly or firmly based.

International lending

Recent figures confirm the marked slowdown in international bank lending. The latest BIS statistics show that international banks'

total net lending rose by $15 bn in the second quarter, compared with $30 bn in the corresponding period of 1982, and a quarterly average of $24 bn last year. Data for the third quarter from the London market suggest that the downward trend has continued. Within the total rise in the second quarter, net lending to non-oil developing countries increased by $4 1/4 bn, bringing the rise in the first half-year to some $6 bn. So new bank borrowing by ldcs in 1983 is likely to be much less than was expected at the beginning of the year; and the IMF, for example, have reduced their projection from $20 bn to $15 bn. Managed borrowing will predominate, and could "crowd out" other borrowers, who might then face severe balance of payments financing problems. For the most part, only prime borrowers are at present able to raise funds in the market.

Problems of this kind have already arisen for the Philippines, which has been forced to call a 90-day moratorium on its debts (estimated at $25 bn), pending a rescheduling. For the present, the market is responding calmly to this development, with no signs yet of any tendency to link the Philippines with other Far Eastern borrowers such as South Korea, Thailand and Indonesia, since these countries are considered to have managed their economies, and their external debt, extremely well. Indeed, some of them have already reacted swiftly to the situation in the Philippines by cutting back borrowing programmes and making the necessary adjustment to their economic policies. Nevertheless, there is still a risk that a further general cutback in lending would produce cash flow problems, even for these previously relatively creditworthy borrowers.

In contrast, minor OECD countries, over some of which question marks have been raised in the past, continue successfully to be able to raise funds. Moreover, the market is still prepared to lend, though modestly and at a price, to Latin American borrowers such as Panama, Paraguay and Colombia, which have not experienced debt servicing problems.

Current problems

The whole process of international rescues for problem countries is currently being severely tested on a number of fronts simultaneously.

In the key country, Brazil, rejection by Congress of law 2045 on wage determination, and two subsequent replacement decrees - the latest of which reduces its severity - has created renewed uncertainties, after the encouraging response to the "roadshow". It remains to be seen how the IMF and the banks will react to the latest decree. Meanwhile, efforts are being made to assemble the components of a financial package within the next three weeks. De Larosiere has asked for written assurances by 14 November that $6 1/2 bn will be available from banks, and $2 1/2 bn from governments, to enable him to recommend the Brazilian programme to the IMF Executive Board on 18 November. The sheer size of the bank credit, its softer terms and the need to muster a quorum of committed banks to make the syndication viable, make selling the loan package to the banks a formidably difficult task. In particular, the banks will watch closely for assurances that the official contribution is fully subscribed and represents genuine new money. Such contributions will be seen not only as a signal of confidence in the recovery programme, but may also influence the degree of bank commitment to the present and prospective packages for Brazil (and other countries).

In many ways, Argentina is even more worrying than Brazil, because domestic political uncertainties make breakdown more likely. The political will to tackle the debt problem seems to be lacking, and the IMF programme could be on the verge of collapse, while the central bank's liquid assets are dangerously low. By itself, the uniquely difficult domestic political situation in Argentina, combined with its essentially favourable balance of trade, should make it an isolable problem; but a breakdown in Argentina at this rather delicate stage elsewhere could lead to a damaging deterioration of confidence. Developments in Mexico, on the other hand, remain encouraging, with a government willing and able to undertake appropriate adjustment; and there is unlikely to be much difficulty in securing the requisite new funds for next year, even though the authorities seem certain to demand, and might well be thought to deserve, better terms.

Role of the IMF and BIS

The effectiveness of the IMF in providing leadership, as well as credible adjustment programmes, could be impaired by apparent lack of official support. Latest expectations are that the IMF bill, which is crucial to the Fund's ability to take part in rescues, should ultimately be passed by the US Congress before the Thanksgiving recess beginning 19 November. In the meantime, agreement on a special BIS credit facility of SDR 3 bn to the IMF (which will next be discussed on 7 November in Basle) has been delayed, because some central banks - notably the Bundesbank - will not give their approval until it becomes clear that the American quota increase will be forthcoming, and partly because some central banks have still to swallow more fundamental reservations about the tenor of the loan and the USA's non-participation in it. This has already obliged the IMF to restrain the granting of new commitments.

Conclusion

The next few weeks will severely test the informal coalition between borrowers, banks, creditor governments and the IMF, which has so far managed to contain the debt crisis. A successful outcome, especially on Brazil, will be vital if considerable knock-on effects are to be avoided, and if confidence in present case-by-case techniques of crisis management is not to be seriously weakened. Without such confidence, the outlook for next year will be bleak.

The following sections assess the current position in major debtor countries in rather more detail.

Brazil

Brazil is still the largest single problem country on the international debt scene, and prospects are now even more uncertain after the Brazilian Congress' rejection of the crucial wage de-indexation Decree (No 2045) on 19 October. Although the

government lost little time in issuing a new substitute Decree (No 2064), this in turn has now been replaced by a further, and less severe, decree (No 2065): it is not yet clear whether the IMF will consider this adequate. The provisions of Decree 2045 were at the heart of the revised IMF programme, for which the Brazilians signed a letter of intent on 15 September. Indeed, the IMF Managing Director not only required sufficient finance to be committed in support of the programme, but was also not prepared to recommend the programme to the Executive Board until the Decree had passed into law. A financing gap of $11 bn has been identified for the remainder of 1983 and 1984, which it is proposed to fill through a $6.5 bn new commercial bank loan, a $2 bn Paris Club rescheduling, and $2.5 bn from export credit and other official sources. The bankers' Advisory Group has agreed to market the new money loan on significantly better terms than for earlier funds, which is likely to set a precedent for other Latin American countries to follow. (Indeed, the Argentines have already sought similar concessions, both for the 1983 debt currently being discussed and for 1984 debt to be rescheduled). Initial reaction from banks, who have been asked to commit themselves to the new money loan by 14/15 November, has been one of philosophical resignation. Although political uncertainties within Brazil may create nervousness abroad, bankers' general attitude to the defeat of Decree 2045 and its subsequent amendments, will doubtless be determined by the IMF's reaction.

Prospects for raising $2.5 bn from official sources also remain uncertain. The USA, through the Eximbank, has indicated a willingness to provide $1 1/2 bn export credit facilities, on condition that other countries also contribute. But we are not aware that any other firm commitments have yet been received, while HMG remains opposed to putting up further official money for Brazil (over and above rescheduling of Paris Club maturities).

The latest wage decree improves prospects of early Congressional approval; but if this were not forthcoming before mid-November, the IMF Executive Board meeting (scheduled for 18 November) would be delayed, and further increases in arrears (already nearing $3 bn)

would result. Such a development would be of concern to many US banks, in view of the regulatory requirement to classify loans as non-performing when interest arrears reach 90 days.

Other problem countries

(i) Latin America

Foreign banks' debt negotiations with Argentina have been bedevilled in the last month by increasing political interference ahead of the Presidential elections on 30 October, and by continuing build-up of payments arrears. However, having overcome an attempt by an Argentine federal judge to freeze the rescheduling talks, the Government has now reaffirmed its intention of finalising all rescheduling agreements by 30 November. Disbursement of the long-delayed first tranche of the $1.5 bn medium-term credit is now unlikely before 30 November at the earliest. The further delay reflects continuing payments arrears and a decision by banks to await the outcome of the elections in order to test the authorities' commitment to the refinancing package. The banks' Working Committee is currently seeking to reach final agreement with the Argentines on revised conditions attaching to the disbursement, which will primarily be used to make a repayment under the $1.1 bn bridging facility. Meanwhile, the IMF programme appears to be on the verge of collapsing, and the central bank's liquid assets are now dangerously low.

Relations between the Venezuelans and the banks continue to be soured by the steady accumulation of interest arrears, now totalling around $600 mn. Several default suits are reported to be in the pipeline. Meanwhile, the banks have had no option but to agree to a further extension of the 90-day moratorium which expired at end-September. The Government had sought a 120-day extension, but the banks, conscious of the need to adopt a hard line if progress in rescheduling negotiations was to be made, have granted only 30 days.

If, in the Advisory Committee's view, the Venezuelans have made significant headway towards paying off interest arrears and negotiating an IMF economic adjustment programme, it will recommend a further 90-day extension until the end of January.

In sharp contrast to the other major problem countries, Mexico's position continues to provide grounds for optimism. Agreements to reschedule virtually all public sector maturities up to end-1984 have now been signed, and commitments to Mexico's private sector debt rescheduling scheme have risen rapidly in recent weeks. The authorities are soon to begin negotiations on new money requirements for next year, which are reckoned to be $4 bn from banks and $1.5 bn from official sources.

Elsewhere, Peru has been obliged to approach the IMF for a conditional waiver of the EFF performance targets for September and December. The breakdown of the programme will delay the next scheduled drawing from the Fund in November, and hold up the remaining $200 mn to be disbursed under the $450 mn new money loan from banks.

More encouragingly, the Chileans have reported that their standby arrangement returned to its original path by the end-September deadline, although the authorities are now seeking easier terms under the second year of the programme; and Ecuador's commercial bank refinancing package was signed on 12 October.

(ii) Far East

The liquidity crisis in the Philippines has now obliged the authorities to seek a 90-day moratorium on repayments of debt principal to banks. During this period, a new SBA is to be negotiated with the Fund and a financing plan agreed for the remainder of 1983 and 1984, which will no doubt include a formal rescheduling package. Continuing concern about political stability makes the situation even more delicate. However, there has been no evidence that the problems in the Philippines have weakened confidence elsewhere in South East Asia, although one report indicates that Indonesia may wait for more settled conditions before coming to the market again. Otherwise, both that country and South Korea appear to be making further progress in adjusting their economies in the light of lower oil prices.

(iii) Eastern Europe

Official contact with Poland (albeit still on a conditional and technical basis) has been renewed: the creditors' group sent a fact-finding team to Warsaw in early October and will meet on 26 October to review its report and decide whether to invite the Poles to Paris in November to resume rescheduling negotiations. The US position remains unclear. Meanwhile, the commercial banks are expected to sign their agreement in Luxembourg on 3 November to reschedule 1983 maturities. Although the 1983 support programme for Yugoslavia has for the most part still to be implemented, preliminary soundings are being taken by the IMF on the possible format for 1984.

(iv) Southern Europe

Although the external positions of Portugal, Spain and Greece are likely to remain under strain for some time, no debt servicing difficulties are expected in the short term. Indeed, there are positive signs of improvement from both Portugal and Spain. In Portugal, the fairly rigorous programme recently agreed with the IMF for a standby facility worth \$475 mn over 18 months - approved in conjunction with a compensatory financing facility worth \$275 mn - lays the basis for a staged return to a more sustainable external position, while the current account showed a strong improvement in the first half of 1983. The announcement of the IMF programme also seems to have improved market sentiment: the reception for Portugal's request for a seven-year \$300 mn euro-credit was so favourable that it was raised to \$350 mn. Meanwhile, Portugal repaid \$300 mn of the \$700 mn BIS facility arranged in two tranches earlier this year, and a further credit of \$300 mn was advanced in August. The Spanish current account deficit has also improved somewhat this year, and faster progress seems likely in 1984. Foreign exchange reserves, however, have been severely depleted, and it will be some time yet before Spain is able to stabilise its external indebtedness, let alone reduce it. Even so, there are no signs of serious resistance to Spain's very considerable financing demands from the

market. In Greece, on the other hand, with foreign exchange reserves already low (less than 1 1/2 months' imports at end-June), the current account deficit is expected to worsen slightly this year, reflecting a poor export performance and reduced invisible earnings. Nevertheless, the debt service ratio (including short-term debt) was only 24% in 1982 and should not be much higher this year. Borrowing on the international markets still appears to be well received, and $1 bn was raised in the first eight months of this year, compared with $1.7 bn in the whole of 1982.

INTERNATIONAL BANK LENDING: PROSPECTS TO THE END OF 1984

The IMF has shaded down its 1983 forecast for commercial bank net lending to non-oil ldcs as the year has progressed, and by mid-year had reduced it to a rise of only 5% on end-1982, or some $15 bn. The Bank of England has done likewise, with our latest October forecast coming out at 4%. On the other hand, the BIS, in its press release on the 1983 second quarter figures, sounds a more optimistic note. These forecasts include unspontaneous lending as part of rescue packages, and are based mainly on estimates of the supply of bank credit (ie the willingness of banks to lend), rather than on ex ante demand from borrowers. This slowdown in bank lending has made the borrowers more dependent than usual on official sources of financing: thus, in the first half of the year, the IMF and commercial banks each lent some $6 bn net.

In the next fifteen months, the attitude of the banks is likely to be strongly influenced by the contribution of the IMF, not only financially, but also in designing adjustment programmes which are seen to be effective. In this light, the outcome of the Annual Meetings is hard to interpret. The Fund still lacks the certainty of adequate resources and, without them, the Managing Director is less likely to succeed in persuading banks to extend sufficient new loans. However, the compromise on access limits still gives the Fund some flexibility. On balance, we believe that IMF finance in 1984 will be broadly the same in absolute terms as this year, subject to a number of provisos.

The first, and most important proviso, is that the informal coalition of borrowers and official and private creditors, holds together to make the rescue packages work. This is still assumed to be the case in our central forecast and, if it materialises, 1984 will in many ways resemble this year. But it will not be easy to sustain this coalition: it is subject to a number of risks which vary in their capacity to affect the international financial system. The worst outcome would probably arise from a breakdown of the Brazil package, which might coincide with a breakdown in Argentina and threaten the solvency of some major banks. Each new round of

negotiations puts a further strain on the cohesion of the coalition, as the banks are becoming increasingly aware, in a mood of resignation, that they will be faced with requests for more managed lending over the next couple of years.

Another proviso is that banks' appetite for international lending does not become so dulled by unspontaneous lending that it crowds out lending to other ldcs. There is some anecdotal evidence that banks are undershooting their aggregate lending capacity; and any further reduction in lending could begin to create cash flow difficulties, even for creditworthy borrowers.

The current round of fund-raising for Brazil is a major test of the structure of rescue packages which has emerged over the last year or so. Success will strengthen it, failure probably destroy it. This structure reflects two principles which seem to be the key to success - leadership and burden-sharing. De Larosiere has already assumed the leadership role in this round, in relation to both commercial and official contributions. The Brazilian outcome has been made more difficult to assess by the recent rejection of legislation on wage indexation and its replacement by new - and less severe - legislation, to which the Fund's reaction is not yet known. The banks for their part will certainly be influenced by the amount of official assistance offered. In any case, there is likely to be some shortfall on the commercial bank target of $6.5 bn, as some banks with relatively small exposures refuse to take part. If, in addition, there were to be a shortfall on official funds, this might deter those contributors who have made their share in previous rounds conditional on a general response of close to 100% ie a strong demonstration of burden-sharing. In those circumstances, the package could well collapse and jeopardise other forms of financing, such as maintenance of exposure to Brazilian banks in the inter-bank market.

The reports are that de Larosiere wants commitments for a "critical mass" of 90% of the full amount of the new money from banks by 15 November to justify his recommending the programme to the IMF Board. Brazil does not require the full amount immediately, but it is debatable whether the banks would be ready to disburse the first instalment out of the initial commitments, unless and until these

cover the whole $6.5 bn required. This target represents an average increase for all creditor banks of 10 1/2% of their exposure at the end of 1982. After allowing for their commitment to round 1, the total increase would be over 17% for 1983 and 1984 combined - considerably faster than the average net lending by banks to non-oil ldcs forecast over this period.

The outcome on Brazil will have an important bearing on banks' attitudes towards some of the other major borrowers.

Argentina has managed to survive so far without recourse to most of the 1983 rescue package. A complete breakdown now seems a distinct possibility, because of domestic political factors rather than because of the way in which the package has been assembled. Whether the impact of such an outcome could be insulated from the rest of the market would depend on timing and official reaction. For example, it would be easier to handle if the breakdown came after, rather than during, the formation of the Brazilian package. Other threats to the present policy of a case-by-case approach could be posed by the chaotic management of Venezuela's finances and by the Philippines. There is no sign yet that the effects will spread to the rest of the Pacific basin, but banks will be keeping a careful eye on South Korea after the assassinations.

By comparison, the outlook for Mexico is encouraging. The authorities are shortly to open discussions on financing for 1984: these are likely to proceed relatively smoothly, firstly in view of the track record so far, and secondly because negotiations will not be complicated by rescheduling of public sector debt, virtually all of which has now been completed. In the circumstances, the bankers may be ready to sign up for the $3.5 - 4 bn fairly quickly, although the Mexicans will certainly be demanding better terms.

By now, the East Bloc debts almost seem a problem of a separate kind. Poland apart, the other Bloc countries have in aggregate adjusted hard and have even been able to accommodate some (essentially involuntary) reduction in their net indebtedness to the West.

However, several of them (notably the GDR and Hungary) are almost certainly still under severe financial strain. The banks will continue to watch them with wariness. Yugoslavia remains in a very difficult position and will continue to need a managed approach for some time ahead.

Given the number of uncertainties, it would be surprising if there were not at least one breakdown in the relationship between borrowers and commercial banks. Nor does success in one round guarantee it in the following. For example, Brazil's programme may come to lack credibility because of a hardening belief that a financing gap will open up again in 1984. Moreover, performance under some of the other country programmes could be disappointing and give rise to a financing gap, which would make further - premature - rounds inevitable. If these factors were to be a prelude to a breakdown in the present case-by-case approach, their impact on other countries would depend essentially on speed and presentation: slow disintegration might provide an opportunity to patch up the coalition, while outright repudiation by a borrower could have very damaging consequences for the international financial system. Either would materially increase the clamour for a "long-term" solution.

The risks so far described concern structural areas in the international banking system. But a breakdown of IMF programmes for technical reasons is also a possibility: these are based in the final analysis on assumptions about the behaviour of the international economy, which may not be validated. One such assumption, which has quite wide acceptance, is that real growth of some 2 1/2% - 3% in the OECD countries would be sufficient to "float off" the debt problem. Even if this were to materialise, however, the present round of rescheduling has built up heavy capital repayments for the future: even with an appreciable improvement in world growth, combined with much lower interest rates, further rescheduling of such debt - which will almost certainly be necessary towards the end of the decade - may prove to be difficult to negotiate satisfactorily. But that is not a problem for 1984 - for which our central forecast, notwithstanding the downside risks that this overview, perhaps over-pessimistically, has emphasised, is still that the system should somehow scrape through.

INDEBTEDNESS AND BRITISH EXPOSURE

$ billion

	Total external debt	British banks unguaranteed claims		ECGD amounts at risk
	End-Dec 1982	End-Dec 1982	End-June 1983	End-Dec 1982
Latin America				
Argentina	39	2.3	2.4	0.4
Brazil	83	4.4	4.6	2.3
Chile	18	1.1	1.1	0.05
Ecuador	6	0.5	0.5	0.1
Mexico	83	5.2	5.4	1.6
Peru	12	0.4	0.4	0.2
Uruguay	4	0.3	0.3	0.01
Venezuela	34	2.4	2.3	0.08
Eastern Europe (convertible currency)				
East Germany	15	0.8	0.6	0.2
Hungary	7	0.5	0.4	0.08
Poland	27	0.5	0.6	1.2
Romania	10	0.4	0.3	0.6
Yugoslavia	18	0.9	0.9	1.2
Southern Europe				
Portugal	14	0.8	0.8	0.4
Greece	11	0.7	0.9	0.4
Spain	28	2.4	2.4	0.2
Israel	21	0.4	0.5	0.2
Far East				
Indonesia	24	0.6	0.7	1.5
Philippines	24	1.2	1.3	0.3
South Korea	37	2.0	1.9	1.0
Other				
Morocco	11	0.2	0.1	0.2

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

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(PMF)

NOTE OF A MEETING BETWEEN THE CHANCELLOR OF THE EXCHEQUER
AND M. DE FONTENAY, HELD IN H.M. TREASURY
ON FRIDAY 9th DECEMBER

Present: Chancellor of the Exchequer
Mr Lavelle
Mr Wicks

M. de Fontenay

Mr Vittas

M. de Fontenay said he was grateful to the Chancellor for giving him this opportunity to comment on his first impression of the results of the IMF article IV consultations. The IMF had broadly endorsed HMG policies in the past, and certainly saw no reason to change them now that they were beginning to pay off. He had tried this time to take a longer view, examining where the UK wanted to find herself in 1988, and how it was proposed to achieve this. They had concluded that it was essential to pursue the medium term financial strategy, and important to make room for tax cuts. It was equally important to allow the PSPR to decline, so that interest rates would also fall. It was essential, too, to avoid upward pressure on the exchange rate: the UK could not afford to find herself in the US position. He had been pleased to hear that the latest public expenditure plan proposed to keep spending constant in real terms for the next 3 years, but he wondered whether this was ambitious enough as a programme. Public spending had an inexorable tendency to creep up unless actively kept down, and the UK should therefore be pursuing vigorously a plan to reduce the size of the public sector. Increased investment was essential to encourage the necessary faster growth to catch up with percapita income in other European countries, and steps should therefore be taken to prevent private savings being absorbed by the public sector. M. de Fontenay said that his team had also looked at the supply side. They very much endorsed the policy of privatisation, and hoped that more tax reform would also be possible. They welcomed the Government's present approach to labour legislation, which they thought should encourage the increased possibility of labour mobility, and they also endorsed the conclusions of the NEDO paper. In conclusion, therefore, he thought that the fund report would support present policies while urging firmer and earlier action on some supply side measures and encouraging the Government to do more on the public spending side.

2. The Chancellor thanked M. de Fontenay for his analysis. It was clear that the Government and the fund were very close in their views on the policies needed to revive the UK economy. He wanted to take up a point M. de Fontenay had made about whether the recently-announced public expenditure plan was sufficiently ambitious. He thought one strong indication that it was, was the difficulty there had been in achieving it for 1984/85. Original new departmental bids had amounted to £6 billion, and these had been reduced to £2.5 billion which were regarded as inescapable, mostly because they related to demand-determined programmes. It had then been necessary to find cuts in existing programmes to accommodate these, and this had been the real object of the recent public expenditure round. The success of the latter could be judged by the fact that the contingency reserve had been maintained intact. He believed that it would in the next 3 years be possible to get public expenditure reduced as a percentage of GDP, as the latter rose, and there would then be room to cut taxes. The only point in M. de Fontenay's analysis with which he slightly disagreed was on the extent to which the Government needed to intervene to increase the flexibility of, and investment in, the economy. He felt that both would come naturally as the economy became healthier, especially with the improvement of profitability. It would be the prospect of a good return on capital which would really encourage investment. What the Government needed to do was to remove the restrictions and controls that had previously bound the economy, so that it could demonstrate increased flexibility and adjustibility.

3. M. de Fontenay asked the Chancellor if he could see any way of avoiding creeping public expenditure growth. The Chancellor said that he could see two possible approaches. The first was to take a long-term view at the big areas of public spending, such as health and wealthfare services, and decide how far these had to be met by the state. They would obviously always be a core role for the state eg. in the NHS, but he would like to see an increase in the percentage of discretionary expenditure being provided by the private sector. The same shifting balance could also be applied to pension provisions. Within the state sector, the better allocation of resources was necessary; for example it would be better to charge for somethings rather than maintain the fiction that they were free. The second approach was to encourage public feeling that lower public expenditure was as desirable as lower taxation.

4. M. de Fontenay said that he had not intended to imply that the Government should be directly encouraging investment. He was more concerned with the question of interest

rates, which affected not only capital investment but also the exchange rate and international competitiveness. The Chancellor said that he would certainly like to see interest rates fall in nominal terms, although they were now at their lowest level for 5 years. The UK interest rates could not, however, be looked at entirely in isolation from the impact of US interest rates.

5. Finally, M. de Fontenay asked the Chancellor what the Government's reaction would be if the recovery were weaker than expected. The Chancellor said that they would certainly stick to the medium term financial strategy. He did not, in any case, think the question would arise; the Treasury forecast had a very good track record, and over recent months the outside forecasts had come much closer into line with the IAF. The only fine-tuning in which he intended to indulge was on the lines of his 7 July exercise ie. to pull the economy back onto the path set out in the MTFS: and make it clear to the market that no change in policy was inteded. M. de Fontenay said that the IMF's own forecasting exercise, which was at present taking place, was likely to be revised upward on present indications.

6. The meeting closed at 10.30 a.m.

JS.

MISS J C SIMPSON
12 December 1983

Circulation

Those Present
PS/Financial Secretary
Mr Middleton
Sir T Burns
Mr Littler
Mr Cassell
Mr Bottrill

FROM: R G LAVELLE
DATE: 8 December 1983

CHANCELLOR

cc: Financial Secretary
Mr Middleton
Sir T Burns
Mr Littler
Mr Cassell
Mr Bottrill
Mr Wicks

IMF 1983 ARTICLE IV CONSULTATIONS

Patrick de Fontenay, who is leading the Fund Mission this year, is calling on you at 10 am on Friday, 9 December. He will be accompanied by second in command, Harilaos Vittas. The Financial Secretary will talk to them about privatisation later in the day.

2. Your meeting will take place after the bulk of the detailed discussions with officials have taken place but before a concluding session scheduled for next Monday. At the latter session the Fund traditionally provide a trailer to the assessment to be given to the IMF Executive Board.

<u>Background: the 1982 Consultations</u>

3. Last year's appraisal was sympathetic and positive. It said the mtfs had been broadly adhered to and its credibility generally established. It commended the reductions achieved in inflation levels and interest rates, judged monetary policy to be broadly on track, and endorsed the PSBR objective. There was just a twinge of anxiety about the rate of deceleration of earnings and the trade prospect.

4. The tone of subsequent discussion in the Board was also in general approving and markedly more so than the previous year. A few directors spoke of employment costs of the strategy and suggested more stimulating policies and a more flexible exchange rate policy. But the majority thought the stance of policies right: and there was also widespread support for the measure being taken on the supply side.

1983 Consultations so far

5. The Fund were given a good deal of background material on arrival. The number of general written questions put to us has been reduced but (a deliberate change applying to all consultations) a supplementary batch on detailed trade issues has been added this year.

6. We have broadly been following the usual pattern of meetings. After a call on Mr Middleton the formal sessions of the consultations (which last in all just over a week), began with an overview given by Sir T Burns (copy attached). This preliminary session, which takes place on the Friday afternoon after the team arrive, provides a framework for subsequent discussions. It also gives the Mission a chance to indicate the broad themes they would like to explore. There are then a string of detailed discussions with officials on the forecasts, monetary policy, public expenditure, the labour market and so on. The team spend a day with the Bank of England.

7. De Fontenay, whose first UK mission this is, has decided, as you may have gathered, to try to give the consultations a medium-term orientation this time. De Larosiere usually, as we understand it, goes over their marching orders with the more important Missions, so this may more accurately be regarded as his idea. UK policies in general march so well with Fund beliefs that UK performance is a matter of some concern to the MD.

8. In his discussion with Mr Middleton and the opening plenary session de Fontenay indicated that he would like to examine four theses (characterised by Sir T Burns as "working fallacies") in relation to the UK economy:

- recovery is impossible without a reflationary stimulus by Government;

- reduction of inflation is a necessary but not a sufficient basis for recovery;

- recovery always leads to renewed inflation;

- the laws of supply and demand do not work in the labour market.

In essence he wished to explore the nature of the economy the Government was aiming for in the medium term; the policy stance it believed appropriate to achieve it; what was actually being done: and in similar vein, what had been achieved over the past four years. This seemed to him an appropriate framework for discussion at the start of the second term of the Administration. It might require examination of a range of issues such as: the measures being taken to improve the functioning of the supply side of the economy (including tax reform); medium term trends in public expenditure and how expenditure is to be financed; and whether the balance of payments might operate as a constraint as oil production slows down.

9. My impression is that the Mission came away from the initial sessions reasonably happy with the basis of the short-term forecasts. There was a degree of anxiety about export performance and earnings levels but in general they seemed to have formed the view that the immediate prospects looked quite good.

10. So the question became one of sustainability. Here it is possible that de Fontenay (as a Frenchman) may have expected to find more quantified targetry. But the discussion of the medium term strategy did not suggest any dissent from the general direction of policies, or about their coherence. Fund concerns have seemed rather to be whether public expenditure objectives are sufficiently tough to release private investment; whether earnings deceleration will be sufficient to secure the needed improvement in competitivity and corporate profitability; whether the supply side measures will indeed achieve greater flexibility and restructuring of the economy. At the same time they recognise that in a number of important respects we are now in a new world: since past relationships are no longer operating, future patterns can also not be a matter for demonstration.

11. The session on monetary policy was primarily treated as an educational one to clarify: how targets were set; the approach to interpretation of current conditions, of movements in the aggregates and questions of control; and the characteristics of different aggregates. They appeared content with what they learnt.

12. In the sessions on the balance of payments and fiscal policy, the broad concerns mentioned earlier tended to inform the trend of questions. For example in the public expenditure area they were interested in the implications, in terms of objectives and control, of a more rapid reduction than planned for in inflation. They appear to retain some concern about the extent to which it will be possible in the medium term both to achieve a reduction in interest rates and taxation levels. In the balance of payments context they wanted inter alia to clarify views about the exchange rate level. The response they were given in brief was that this was not a focus for policy: in a floating exchange rate regime preoccupation with the balance of payments had been replaced by determination to get down inflation; that we were not entirely happy with the present constellation of rates but not unhappy with its effective level; our response to shifts depended on the reasons for them.

13. The final sessions will be mostly on supply side questions. There has been some discussion in this context of tax reform but they may touch on this again with the Financial Secretary.

<u>Conclusion</u>

14. On the evidence so far I would expect the assessment will reflect continuing approval for achievements to date, broad endorsement of the direction of policies, plus indications of one or two areas where the Fund will watch future performance with a degree of anxiety. A medium term orientation to this examination seems almost inevitably to have some of that flavour.

15. De Fontenay strikes one as lucid, well-disposed, a professional: with, in a quiet way, some of the style of his master. It seems worth giving him a sense of the political commitment behind the strategy. The Fund assessment is not published but discussion of the UK in the Board - given that the UK is coming to be taken as something of an object lesson by the Fund - is quite important to the climate of Board discussions.

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