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January 14, 1983

To: Members and Associates of the Interim Committee

From: The Secretary

Subject: Eighth General Review of Quotas - Report of the Executive Board to the Interim Committee

The attached report of the Executive Board to the Interim Committee on the Eighth General Review of Quotas relates to Item 4(a) of the provisional agenda for the meeting of the Interim Committee scheduled on February 10-11, 1983.

The text of this report is the same as that circulated to Executive Directors as SM/82/249, Revision 2 and Correction 1 on January 14, 1983.

Att: (1)

INTERNATIONAL MONETARY FUND

Report of the Executive Board to the Interim Committee of the Board of Governors on the International Monetary System on the Eighth General Review of Quotas

January 14, 1983

I. Introduction

1. The communique of the Interim Committee, issued after its 19th meeting held in Toronto, Canada in September 1982, stated that:

> "There was widespread support in the Committee on the urgent need for a substantial increase in quotas under the Eighth General Review. The Committee reiterated its view that quotas must remain the primary source of financial resources for the Fund's operations and that, therefore, the Review should result in an increase in quotas that would be large enough to enable the Fund to perform its functions in an effective manner in the 1980s. The Committee also reiterated its view that the occasion of an enlargement of the Fund under the Eighth General Review should be used to bring the quotas of members more in line with their relative positions in the world economy, taking account of the case for maintaining a proper balance between the different groups of countries. The Committee also asked the Executive Board to assess the adequacy of existing arrangements to deal with major strains in the international financial system.
>
> The Committee urged the Executive Board to pursue its work on the issues of the Review as a matter of high priority, so that the remaining issues on the size and distribution of the quota increase could be resolved by the time of the Committee's next meeting in April 1983."

2. In view of the advance in the timing of the next meeting of the Interim Committee to early February 1983, and also taking into account the views expressed by the Interim Committee on the Eighth General Review of Quotas at its last meeting, the Executive Board has given urgent consideration to the main issues relating to the Eighth General Review of Quotas.

3. The Executive Board has discussed the Eighth General Review of Quotas in the light of the principle that quotas must provide the primary source for the Fund's financing. In this connection it has considered (i) the size of the overall increase in quotas; (ii) the distribution of the overall increase, including the position of countries with very small quotas in the Fund; and (iii) the mode of payment

for the increase in quotas. The range of views of Executive Directors on these main issues has greatly narrowed since the last meeting of the Committee. As outlined below, some differences remain among the Executive Directors. The principal elements of an agreement are now available for the Interim Committee to resolve the remaining issues and provide an early conclusion of the Eighth General Review.

II. Size of the Overall Increase

4. The Executive Directors have noted the view of the Interim Committee that the overall increase in quotas should be of a size that would enable the Fund to deal effectively with the problems of financing and adjustment that are within its competence and are likely to be encountered in the 1980s. The Executive Directors believe that the increase in quotas should enable the Fund to accommodate the likely needs for Fund resources in the 1980s, and that borrowing by the Fund, which should not be a regular feature of the Fund's operations, may be resorted to in exceptional circumstances, including borrowing by the Fund under its standing arrangements such as the General Arrangements to Borrow. Many Directors believe that the larger the size of the overall increase in quotas, the easier it will be to resolve some of the issues relating to the distribution of quotas; accordingly, they stress the importance of considering the issues of size and distribution in conjunction.

5. In their discussion on the likely need by members for Fund resources during the 1980s, most Directors are of the view that the need for Fund support of members' balance of payments adjustment programs cannot be expected to diminish in the years ahead, especially in the light of uncertainties and difficulties in the financial system that are, inter alia, associated with the servicing of international debt and related capital flows. These Directors believe that the increase in quotas under the Eighth General Review needs to be sufficiently large for the Fund to finance an appropriate level of access to its resources to promote adjustment. Some Directors hold the view that, following the exceptionally widespread adjustment efforts currently being supported by the Fund, payments imbalances that would require conditional financing by the Fund can be expected to moderate later in the decade.

6. In the light of these considerations, Directors' views on the size of the overall increase, which, in a spirit of compromise, have narrowed considerably since the last meeting of the Committee, may be summarized as follows:

(i) Most Directors believe that an approximate doubling of the Fund's quotas, from the present total of SDR 61.1 billion to

SDR 125 billion, would be appropriate. Some of these Directors are of the view that more than a doubling of present quotas is needed. All of them could accept an overall size of the Fund of SDR 100 billion as a minimum.

(ii) Other Directors have indicated that they could support an overall size of the Fund that lies within the range of SDR 85-100 billion, and some of these Directors believe that an increase in quotas of 50 per cent to the order of SDR 90 billion is a minimum;

(iii) In the course of discussion, almost all Directors have indicated that an increase in Fund quotas to SDR 100 billion would be acceptable.

7. A number of Directors believe that if the total of Fund quotas is less than SDR 125 billion, the interval between the completion of this Review and the start of the next (Ninth) General Review of Quotas should be shortened from the maximum period of five years. The view is also put forward that the acceleration in the timetable for completing the Eighth General Review, with a view to having the new quotas come into effect in late 1983 or early 1984, rather than late 1985, will have the result that the start of the period for the next review of quotas would be effectively advanced without a reduction in the five-year period between quota reviews.

III. Distribution of Overall Increase

8. In their discussion of the distribution of the overall increase in quotas, the Executive Directors have been guided by the Interim Committee which "noting that the present quotas of a significant number of members do not reflect their relative positions in the world economy...reaffirmed its view that the occasion of an enlargement of the Fund under the Eighth General Review should be used to bring the quotas of these members more in line with their relative positions, taking account of the case for maintaining a proper balance between the different groups of countries." Directors are also of the view that the distribution of the increase in quotas should not result in abrupt changes in quota shares of individual members and that all members should receive a meaningful increase in quotas. Furthermore, all Directors agree that the method used to distribute the increase in quotas should be one which applies uniformly to all members.

9. The quota calculations used for the purposes of this Review have been based on the revised quota formulas agreed by the Executive Board in August 1982. In its last Report to the Interim Committee on the Eighth General Review, the Executive Board noted that, "Whilst accepting the agreed quota calculations as reasonable indicators of the relative economic positions of countries in the world economy,

some Executive Directors are of the view that they do not provide a wholly satisfactory measure of relative economic positions. It is understood that the changes that have been made do not preclude further appropriate changes in connection with future reviews."

10. The Executive Board considered different methods that could be used to distribute the increase in quotas, taking into account the various aims noted in paragraph 8 above. After long deliberation, the Executive Board agreed that the element in the increase that is intended to better reflect the relative economic positions of member countries should be distributed in proportion to each member's share in the total of calculated quotas, and the element that is intended to assure a meaningful increase in quotas for each member, and to avoid abrupt changes in quota shares, should be distributed in proportion to each member's present quota.

11. The Executive Directors have not reached a consensus on the proportion of a given overall quota increase that should be devoted to effecting selective increases in quotas and the proportion that should be devoted to the equiproportional increase. The Tables appended to this report show alternative illustrative distributions between selective and equiproportional increases for four sizes of Fund--viz. SDR 85 billion, SDR 90 billion, SDR 100 billion, and SDR 125 billion. 1/

12. A number of Executive Directors stress that in view of the large and growing differences for a significant number of members between their shares in present quotas and in calculated quotas, and in view of what they consider to be the limited degree of adjustment under this method, it would be appropriate to distribute the entire increase in quotas in the form of selective adjustments. Each member would receive some increase in quotas under this method. On the other hand, a number of Directors believe that a significant part, of the order of three quarters, of the overall increase in quotas should be distributed as an equiproportional increase in quotas. A few other Directors favor, or can support, an equiproportional increase ranging between 50 to 75 per cent of the overall increase in quotas. These Directors stress the need to avoid abrupt changes in the quota shares of members and wish to ensure that each member receives a meaningful increase in its quota. These Directors recall that in the last communique of the

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1/ The Tables also show for each calculation the extent to which quota shares are adjusted toward shares in calculated quotas (the adjustment coefficient) and the distribution of shares in the Fund between the major groups of countries, which have been classified as in International Financial Statistics. (The IFS classification is used for presentational purposes only and it is not intended to have operational significance for the purposes of the General Review of Quotas.)

For ease of reference, the individual quota calculations that are summarized in the Appendix are shown in a separate document which is circulated concurrently.

Interim Committee it was stated that in bringing quotas more in line with relative economic positions, account should be taken of "the case for maintaining a proper balance between the different groups of countries." They noted that under all alternative illustrative calculations in the Tables attached to this report, the share of the non-oil developing countries, taken as a group, declines and they believe that a large equiproportional component would help to minimize the deterioration in the relative position of this group of countries. On the other hand, many Directors continue to feel that quota increases should be based on members' individual positions and not on the positions of groups of members. Between the views of those Directors who hold that the entire increase in quotas should be devoted to effecting selective increases and those who feel that a significant part of the increase should be distributed in the form of an equiproportional increase, many Directors have indicated that they favor, or can accept, in the light of the Executive Board discussion, an equiproportional element of 50 per cent or a lower figure, going for some to 20 per cent of the overall increase, depending on the size of the Fund.

13. The Executive Board has also considered the position of the very small quota members--i.e., those with quotas that at present are less than SDR 10 million, and who account for only about 0.1 per cent of total quotas. Many Directors feel that the special economic problems of these countries, including very limited access to capital markets, narrow productive and export base, and transportation difficulties, are not, and possibly cannot be, adequately comprehended by the quota formulas, and that a case exists for some special adjustment of their quotas, after taking account of any increases that might be agreed under the Eighth General Review. Adjustments, which would be meaningful from the point of view of the small countries concerned, would be relatively very small in aggregate (perhaps no more than SDR 20 million, depending on the precise method of adjustment chosen). They could be based on a single minimum quota, or rounding-up of quotas to say, a maximum level in each of a number of classes (e.g., SDR 5, 7.5 and 10 million), or a straight percentage increase (based either on present or new quotas); other methods could also be used. But against this, most other Directors hold the view that it is important to maintain uniformity of treatment of members in distributing increases in quotas. These Directors do not believe that the small SDR cost of such special adjustments is a relevant consideration, and they do not consider that the case has been made out that the economic problems of these countries are unique. Therefore, these Directors do not favor a special adjustment in the quotas of the members referred to above. Some of these Directors also point out that a special adjustment in very small quotas could result in these members satisfying their needs for Fund resources through use of facilities which do not involve upper tranche conditionality. A few Directors thought it appropriate to examine the economic problems of small countries further in the light of the increases in quotas that are agreed under the Eighth General Review.

Some Executive Directors put forward the view that the issue of a possible increase in basic votes, which would need an amendment to the Articles, might be further examined.

IV. Payment for Increases in Quotas

14. The Executive Board has discussed the mode of payment for the increases in quotas. The Articles of Agreement provide that each member which consents to an increase in quota shall "pay to the Fund twenty-five per cent of the increase in special drawing rights, but the Board of Governors may prescribe that this payment may be made, on the same basis for all members, in whole or in part in the currencies of other members specified, with their concurrence, by the Fund, or in the member's own currency... The balance of the increase shall be paid by the member in its own currency."

15. Almost all Directors agree in principle that 25 per cent of the increase in quotas should be paid in reserve assets. Most of these Directors would prefer that the reserve asset payment be in SDRs. A reserve asset payment made in SDRs provides the greatest enhancement of the liquidity of the Fund, improves the Fund's income position when the rate of remuneration is lower than the SDR rate, as at present, and it also promotes the use of the SDR in Fund operations and transactions. However, approximately 20 per cent of the total SDRs allocated are presently held by the General Department of the Fund and approximately 60 per cent are held by the industrial countries. Furthermore, approximately 90 members do not have at present sufficient SDRs to pay to the Fund 25 per cent of an increase in quotas of the order presently discussed. In these circumstances, a relatively large number of members would need to buy SDRs, perhaps mainly from the Fund itself, to pay them to the Fund. Consequently, many Directors believe it may be appropriate to give members an option to pay 25 per cent of the increase in quotas in SDRs or in the currency of another member prescribed by the Fund, with the concurrence of the issuer. The granting of the option requires a decision of the Board of Governors taken by a 70 per cent majority of the total voting power.

16. Directors recognize that many members may face difficulties in making reserve asset payments and that some might need to borrow to make the payments to the Fund. Several Directors are thus of the view that members should have the option of paying the increased subscription wholly in their own currency. Others point out that under existing decisions a reserve asset payment to the Fund either creates a reserve tranche position for a member, or enlarges the paying member's existing reserve tranche, by an amount equal to the reserve asset payment. Thus, a reserve asset payment to the Fund results only in a change in the composition of a member's reserves, and does not represent a net drain on them. Furthermore, a member can draw on its reserve tranche

without challenge to its representation of balance of payments need. Directors also noted that in the event that members would experience difficulties in making the reserve asset payment because they do not hold sufficient official foreign assets (SDRs and foreign exchange), arrangements could be put in place to assist such members in making the payments to the Fund. In the light of the assurances that have been provided by the staff regarding the technical feasibility of such arrangements, Directors agree that members that engage in such arrangements and that need to do so could repay promptly the reserve assets used in payment of 25 per cent of the quota increase by drawing on their reserve tranches.

17. Many Directors also feel that the question of an allocation of SDRs in the fourth basic period should be addressed urgently. In this connection, whilst noting that a decision to allocate SDRs would facilitate a payment of 25 per cent of the quota increase in SDRs, these Directors consider that the decision on SDR allocations has to be examined on its own merits, which they believe are strong.

18. In the light of these considerations, those Directors who have expressed reservations on the payment of 25 per cent of the quota increase in reserve assets could also agree to such payments on the understanding that the Interim Committee would request the Executive Board to review the latest trends in world inflation and liquidity as a matter of urgency, with a view to facilitating consideration at the next meeting of the Interim Committee as to whether a new allocation of SDRs would find broad support.

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As noted at the beginning of this Report, the Interim Committee requested the Executive Board "to assess the adequacy of existing arrangements to deal with major strains in the international financial system." In its discussions devoted to this matter, the Executive Board considered, inter alia, that a major enlargement and extension of the Fund's standing borrowing arrangements (General Arrangements to Borrow) could be very useful in providing the Fund with access to additional resources to help it deal with an inadequacy of resources and with a threat to the stability of the international monetary system. The Executive Board stressed that a revision of the GAB should not adversely affect the appropriate increase in the size of the Fund, its decision making process and independence, and its nondiscriminatory and cooperative character.

Table 1. Alternative Illustrative Distributions of Quotas (Fund of SDR 85 Billion)

(In per cent)

	Present quota shares (1)	Illustrative apportionment of overall increase into equiproportional/selective increases							
		75/25 (2)	66.7/33.3 (3)	50/50 (4)	40/60 (5)	33.3/66.7 (6)	30/70 (7)	20/80 (8)	0/100 (9)
1. Overall increase		39.3	39.3	39.3	39.3	39.3	39.3	39.3	39.3
Of which:									
Equiproportional increase, per cent of present quota 1/		29.4 (30.4)	26.2 (27.4)	19.6 (21.5)	15.7 (18.0)	13.1 (15.6)	11.8 (14.5)	7.9 (10.9)	— (3.9)
Selective increase, per cent of present quota 2/		9.8	13.1	19.6	23.6	26.2	27.5	31.4	39.3
2. Adjustment coefficient 3/		7.[illegible]	[illegible].4	14.1	16.[illegible]	[illegible]	19.7	22.6	[illegible]
3. Distribution of shares (per cent of total)									
Industrial countries	61.3	61.7	61.8	62.0	62.2	62.3	62.3	62.5	62.8
Developing countries	38.7	38.3	38.2	38.0	37.8	37.7	37.7	37.5	37.2
Of which:									
Major oil-exporting countries	10.9	11.1	11.2	11.4	11.5	11.5	11.6	11.7	11.8
Non-oil developing countries	27.8	27.2	27.0	26.6	26.3	26.2	26.1	25.9	25.4

1/ Figures in parentheses show the smallest increase, which includes an equiproportional increase, allocated to the member with the lowest ratio of calculated to present quota.

2/ This is a weighted average for all members and is the ratio of total selective increases to total present quotas. Selective increases are allocated in absolute amounts in proportion to members' shares in calculated quotas.

3/ This figure is the percentage reduction of the difference between a member's share in present quotas and its share in calculated quotas. The adjustment coefficient is the same for each member and it measures the degree to which quota shares are adjusted to reflect members' relative economic positions as indicated by the calculated quotas.

Table 2. Alterna_e Illustrative Distributions of Quotas (Fund of SDR 90 Billion)

(In per cent)

	Present quota shares (1)	Illustrative apportionment of overall increase into equiproportional/selective increases 75/25 (2)	66.7/33.3 (3)	50/50 (4)	40/60 (5)	33.3/66.7 (6)	30/70 (7)	20/80 (8)	0/100 (9)
1. Overall increase		47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5
Of which:									
Equiproportional increase, per cent of present quota 1/		35.6 (36.7)	31.6 (33.2)	23.7 (26.0)	19.0 (21.8)	15.8 (18.3)	14.2 (17.5)	9.5 (13.2)	-- (4.6)
Selective increase, per cent of present quota 2/		11.9	15.8	23.7	28.5	31.6	33.2	38.0	47.5
2. Adjustment coefficient 3/		8.0	10.7	16.1	19.3	21.5	22.5	25.7	32.2
3. Distribution of shares (per cent of total)									
Industrial countries	61.3	61.7	61.9	62.1	62.3	62.4	62.5	62.7	63.0
Developing countries	38.7	38.3	38.1	37.9	37.7	37.6	37.5	37.3	37.0
Of which:									
Major oil-exporting countries	10.9	11.2	11.3	11.4	11.5	11.6	11.7	11.8	12.0
Non-oil developing countries	27.8	27.1	26.9	26.4	26.1	25.9	25.9	25.6	25.0

1/ Figures in parentheses show the smallest increase, which includes an equiproportional increase, allocated to the member with the lowest ratio of calculated to present quota.

2/ This is a weighted average for all members and is the ratio of total selective increases to total present quotas. Selective increases are allocated in absolute amounts in proportion to members' shares in calculated quotas.

3/ This figure is the percentage reduction of the difference between a member's share in present quotas and its share in calculated quotas. The adjustment coefficient is the same for each member and it measures the degree to which quota shares are adjusted to reflect members' relative economic positions as indicated by the calculated quotas.

Table 3. Alternative Illustrative Distributions of Quotas (Fund of SDR 100 Billion)

(In per cent)

	Present quota shares (1)	Illustrative apportionment of overall increase into equiproportional/selective increases							
		75/25 (2)	66.7/33.3 (3)	50/50 (4)	40/60 (5)	33.3/66.7 (6)	30/70 (7)	20/80 (8)	0/100 (9)
1. Overall increase		63.8	63.8	63.8	63.8	63.8	63.8	63.8	63.8
Of which:									
Equiproportional increase, per cent of present quota 1/		47.9 (49.4)	42.6 (44.6)	31.9 (35.0)	25.5 (29.3)	21.3 (25.4)	19.2 (23.5)	12.8 (17.7)	-- (6.2)
Selective increase, per cent of present quota 2/		16.0	21.3	31.9	38.3	42.6	44.7	51.1	63.8
2. Adjustment coefficient 3/		9.7	13.0	19.5	23.4	26.0	27.3	31.2	39.0
3. Distribution of shares (per cent of total)									
Industrial countries	61.3	61.8	62.0	62.3	62.5	62.7	62.7	63.0	63.4
Developing countries	38.7	38.2	38.0	37.7	37.5	37.3	37.3	37.0	36.6
Of which:									
Major oil-exporting countries	10.9	11.2	11.3	11.6	11.7	11.8	11.8	11.9	12.2
Non-oil developing countries	27.8	27.0	26.7	26.1	25.8	25.6	25.4	25.1	24.4

1/ Figures in parentheses show the smallest increase, which includes an equiproportional increase, allocated to the member with the lowest ratio of calculated to present quota.

2/ This is a weighted average for all members and is the ratio of total selective increases to total present quotas. Selective increases are allocated in absolute amounts in proportion to members' shares in calculated quotas.

3/ This figure is the percentage reduction of the difference between a member's share in present quotas and its share in calculated quotas. The adjustment coefficient is the same for each member and it measures the degree to which quota shares are adjusted to reflect members' relative economic positions as indicated by the calculated quotas.

Table 4. Alternative Illustrative Distributions of Quotas (Fund of SDR 125 Billion)

(In per cent)

	Present quota shares (1)	Illustrative apportionment of overall increase into equiproportional/selective increases: 75/25 (2)	66.7/33.3 (3)	50/50 (4)	40/60 (5)	33.3/66.7 (6)	30/70 (7)	20/80 (8)	0/100 (9)
1. Overall increase		104.8	104.8	104.8	104.8	104.8	104.8	104.8	104.8
Of which: Equiproportional increase, per cent of present quota 1/		78.6 ([illegible])	69.9 (73.3)	52.4 (57.5)	41.9 (48.0)	34.9 (41.7)	31.4 (38.6)	21.0 (29.1)	-- ([illegible])
Selective increase, per cent of present quota 2/		26.2	34.9	52.4	62.9	69.9	73.4	83.8	104.8
2. Adjustment coefficient 3/		[illegible]	17.1	25.6	30.7	34.1	35.8	40.9	51.2
3. Distribution of shares (per cent of total)									
Industrial countries	61.3	62.0	62.2	62.7	62.9	63.1	63.2	63.5	64.0
Developing countries	38.7	38.0	37.8	37.3	37.1	36.9	36.8	36.5	36.0
Of which: Major oil-exporting countries	10.9	11.3	11.5	11.8	11.9	12.0	12.1	12.3	12.6
Non-oil developing countries	27.8	26.7	26.3	25.6	25.2	24.9	24.7	24.3	23.4

1/ Figures in parentheses show the smallest increase, which includes an equiproportional increase, allocated to the member with the lowest ratio of calculated to present quota.

2/ This is a weighted average for all members and is the ratio of total selective increases to total present quotas. Selective increases are allocated in absolute amounts in proportion to members' shares in calculated quotas.

3/ This figure is the percentage reduction of the difference between a member's share in present quotas and its share in calculated quotas. The adjustment coefficient is the same for each member and it measures the degree to which quota shares are adjusted to reflect members' relative economic positions as indicated by the calculated quotas.

FROM: M A HALL
17 January 1983

CHANCELLOR

WASHINGTON : TALKING POINTS

You might like to read the attached on the plane to Washington. The chart on page 19 provides a splendid spread of talking points.

M A HALL

A Portrait of America

The latest census reveals a hidden revolution both at home and on the job—and tells more about Americans than ever before.

'Give your name and age and business.
Is your husband working now?
Do you rent or own the building? Did you ever milk a cow?
This is strictly confidential—are you underweight or fat?
Does your husband have a bunion? Are his arches good or flat?
Did you vote for Herbert Hoover? Are you dry or are you wet?
Did you ever use tobacco? Did you ever place a bet?
Did you once believe in "nicking"? Have you ever been divorced?
Did you kiss before you married? Should the laws still be enforced?
Are you saving any money? Do you ever pay your debt?
Are your husband's old red flannels in the wash or on him yet?'
—"The Census Taker," Scott Wiseman, 1940

Uncle Sam's armies of statisticians don't really ask questions about the cleanliness of the old man's flannels. But they do ask about the state of Americans' arches (2.6 million are flat or fallen), their addiction to tobacco (those who haven't quit smoke more than they used to) and their thrift (the savings rate is on the rise again). The statisticians can expound on life and its quality and on death and its causes. They can analyze sex and birth, divorce and income, crime and eating habits. From the compounds of the U.S. Bureau of the Census in Suitland, Md., to the loneliest outposts of the Federal Bureau of Investigation, the data gatherers assemble megaloads of intriguing information about the ways Americans live and how they are changing—information that is further refined by everyone from academicians to corporate officers. As a result, America enters the new year knowing more about itself than ever before.

The data are hardly perfect. In a study to be published this month, Queens College political scientist Andrew Hacker observes that the 1980 decennial census counted 1 million more women than men who are separated from their spouses—a statistical impossibility.* Some people, notably illegal immigrants, criminals and minorities in tough ghetto neighborhoods, deliberately duck Uncle Sam; others dissemble when his minions probe their lives. But as Hacker points out, "the decennial Census is the only overall count we have . . . it tells us more about ourselves than we could ever know without it." And it does more than that: its findings—along with those from a host of other local, state and federal agencies—determine how Americans define their problems, how they set national policy and how they plan for the future.

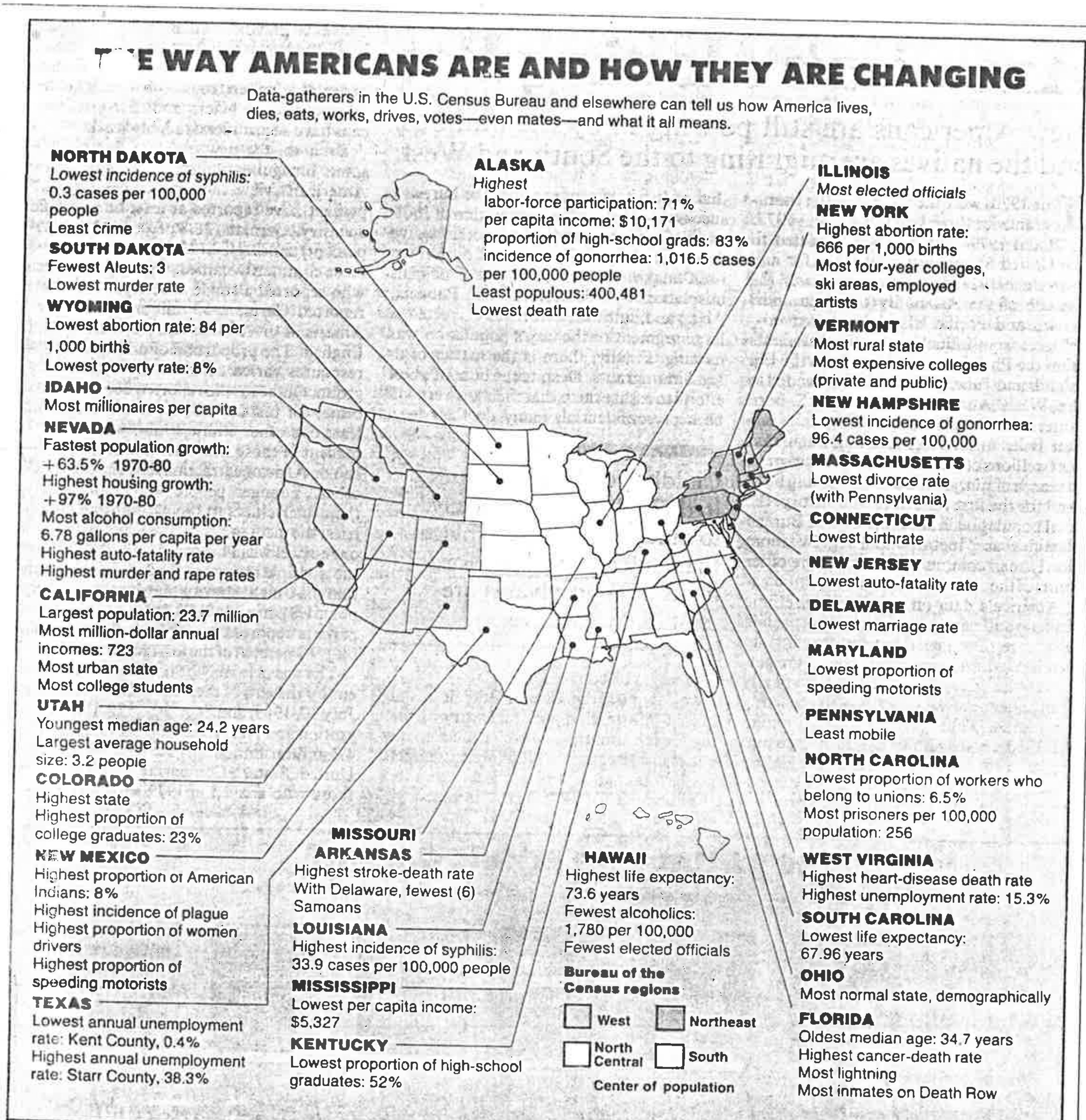

Joe McNally—Camera 5
Faces in the crowd: Are they better off?

Over the next three years, the Census Bureau will be digesting and updating the results of the 1980 count. Its experts are already reporting some important demographic realities the policymakers and planners have never faced before. Since the first national census in 1790, for example, when outriders combed the backwoods and infant cities to find 3,929,214 Americans (including 697,681 slaves), the U.S. population has ballooned to 232.6 million. For the first time, the center of population—located just off the Maryland shore in Chesapeake Bay in the first census—is now west of the Mississippi, about one mile west of De Soto City Hall in Jefferson County, Mo. Among the other macro-facts of the 1980s:

- For three decades in a row, population growth has been slowing—and in the 1970s it grew at the second-lowest rate in history.
- The baby-boom generation, like a pig swallowed by a python, has created a demographic bulge that affects everything from the housing market to social-security pay-

*"U/S: A Statistical Portrait of the American People." *281 pages. Viking. $23.95.*

NEWSWEEK, *as part of it's 50th Anniversary celebration, presents this 12-page special report on American life and many of the issues facing the United States. This package was written by Senior Editor Merrill Sheils, with reporting by Diane Weathers, Lucy Howard and Ron Givens.*



Christoph Blumrich, Marta Norman—NEWSWEEK

ments. And it is not conforming to recent patterns of American life: baby-boomers are marrying later (and divorcing more frequently), postponing childbirth and setting up smaller households.

■ The job market is changing dramatically—and so is the makeup of the work force. The participation of adult males is dropping, while that of women—particularly mothers of preschool and school-age children—has soared.

■ Life expectancy has reached its highest level ever: 73.8 years for the general population. The death rates from heart disease and stroke are on the way down. And the U.S. population is growing steadily older—a trend that will accelerate.

■ Teen-age sex is a fact of life, and unwed motherhood is on the rise. So is the number of POSSLQ's, the Census Bureau's acronym for a phenomenon that has baffled many a middle-aged parent: persons of the opposite sex sharing living quarters.

What does it all mean? Are Americans better or worse off? Are the changes under way merely evolutionary, or do they constitute, as some suggest, a "demographic revolution"? The raw statistics can provide only clues. But they provide fascinating insights into where America is and where it may be headed, whether "to servitude or freedom, knowledge or barbarism, prosperity or wretchedness," as Alexis de Tocqueville wondered more than a century ago. How Americans make use of what they know will have an effect on how it all turns out.

America's Melting Pot

New Americans are still pouring in by the millions, and the natives are migrating to the South and West.

The 1970s were the Decade of the Immigrant: for three years in a row—1977, 1978 and 1979—the numbers admitted to the United States surpassed those for any year since 1924. In particular, it was the Decade of the Asian. By the thousands, Asians and Pacific Islanders poured in—refugees from Indochina, medical students from the Philippines, families from the Fiji Islands and Taiwan. Most of them headed to the West. And so did many U.S.-born Americans. It was also the Decade of the Sun Belt, an interregional migration that sent millions of Northerners west and south in search of sun, jobs and lower heating bills. And for the first time in recent history, the total population in areas the Census Bureau classifies as "metropolitan" grew more slowly than communities beyond the outer limits of the suburban sprawl.

America's data on immigration, ethnic makeup and migration must be approached with care. For one thing, in an effort to develop more accurate readings on the patterns, the Census Bureau periodically changes some of its collection and reporting techniques. Thus, for example, although the 1980 census shows a 71.8 percent increase in the American Indian population since 1970—with native Americans exceeding the 1 million mark for the first time—that statistic says more about the bureau's success in enlisting the cooperation of Indian respondents than it does about native American fertility. For another, the bureau itself makes bloopers; for 1980, officials misplaced the boundaries for Phoenix, Ariz., and, until the error was corrected, a large segment of the city's population was missing. Finally, there is the matter of illegal immigrants. Despite the bureau's best efforts to assure them that their answers will be kept confidential, many do their level best not to be counted at all.

> Childless college graduates in their 20s are more likely to move from place to place than any other group. Residents of Pennsylvania are least likely to move.

In the past, the Census Bureau has acquired information about ancestry by asking for the country of birth of the respondent's mother or father. Now, in an attempt to get beyond the first or second generation, the bureau asks: "What is your ancestry?" Census officials admit that the rather vaguely worded question has produced mixed results. Polish- and Italian-Americans haven't had much trouble providing an answer, but many blacks and native Americans have been understandably stuck.

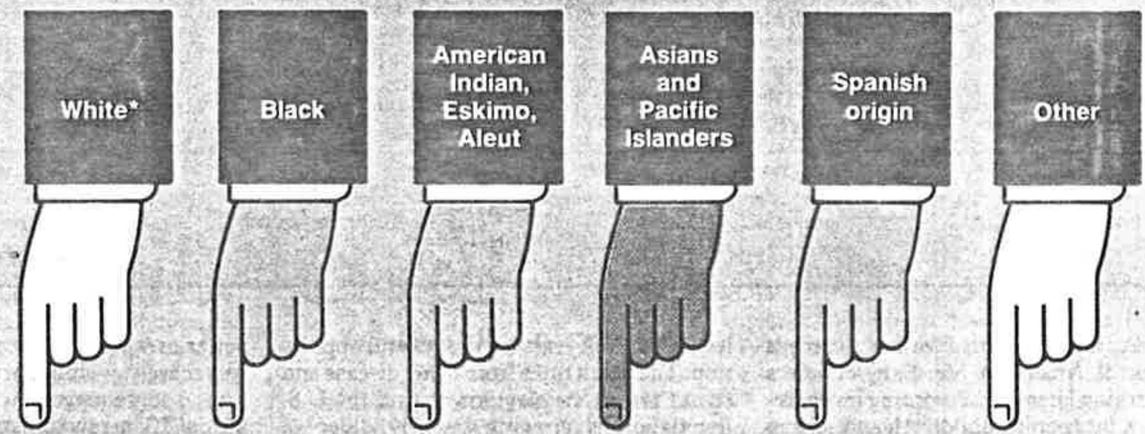
Even so, the new question has yielded some intriguing information about how Americans view their roots. Nearly 82.7 percent have reported at least one specific ancestry. German (28.8 percent), Irish (24 percent) and English (22.3 percent) were the most commonly named. Of the 54 percent who reported a single ancestry, 17 million reported German, 15 million listed Afro-American or African and 12 million said English. The proportion of multiple-origin responses varied considerably by ancestry group. Of those who reported Scottish forebears, for instance, 88.6 percent added at least one other ethnic strain, while only 7 percent of those who claimed Afro-American or African extraction also reported another. Younger people were more likely than their elders to report multiple ancestries: the median age of those who listed just one answer was 34.6, compared with 24.5 for the multiple reporters. And as if to confirm that the United States is the ultimate melting pot, 51.8 percent of U.S. natives with native parents reported multiple ancestry, while only 9.3 percent of the foreign-born did so.

The answers may be considerably different by the end of the next decade. Between July 30, 1969, and Sept. 30, 1979, the Immigration and Naturalization Service reports, 4.3 million immigrants were admitted to the United States. Comparing the origin of those who arrived in 1979 with those who

Charts by Christoph Blumrich with NEWSWEEK art staff

THE RACIAL AND ETHNIC ORIGINS

Asian-Americans are growing faster than any other single group—largely because of immigration.



	White*	Black	American Indian, Eskimo, Aleut	Asians and Pacific Islanders	Spanish origin	Other
1970	178,098,000	22,580,289	792,730	1,538,721	9,072,602	516,673
1980	188,340,790	26,488,218	1,418,195	3,500,636	14,608,673	6,756,986
Percent Increase	5.8	17.3	71.8	127.6	61.0	1,207.0

*Using 1970 classification procedures, which were changed for the 1980 census, would have produced these approximate totals: whites, 195.1 million; blacks, 26.6 million, and Asians and Pacific Islanders, 3.3 million.

Source: Bureau of the Census

came in the mid-1960s, INS perceives some remarkable differences. There were 46.4 percent [illegible]r immigrants from Europe, and there were 815.2 percent more Asians.

Between 1970 and 1980, the number of Asians and Pacific Islanders in the United States leaped from 1.5 million to 3.5 million. Koreans led the growth rate, increasing in number from 69,130 in 1970 to 354,529 in 1980—a rise of 412.8 percent. But other Asian groups also showed big gains. The Chinese population, with a growth of 85.3 percent, replaced the Japanese as the largest Asian group in the United States, with 806,027 members. Filipinos moved into second place, growing from 343,060 to 774,640 (up 125.8 percent). Although the Asian and Pacific-island groups became more geographically dispersed during the decade, they remain highly concentrated in the West: more than half of the Chinese live there, nearly three-quarters of the Filipinos and four of every five Japanese.

The West also claims the bulk of America's burgeoning Hispanic population, which grew by 61 percent during the 1970s—to 14.6 million. Demographers attribute the rise to a combination of immigration and high fertility rates among those already living in the United States. The largest single group of Hispanics was of Mexican origin (8.7 million or 59.8 percent of all Hispanics). Puerto Ricans follow,

> Between 1977 and 1978, huge increases in the numbers of Vietnamese and Mexican immigrants accounted for 95 percent of the total rise in immigration.

with 2 million—13.8 percent of the total—then Cubans, with 803,226 or 5.5 percent. The Mexican population is not only the biggest, but also the fastest growing: between 1970 and 1980, it almost doubled in size, growing by 92.8 percent. It has also begun to disperse from the Southwest: the proportion of Mexican-Americans who live there has fallen from 87 percent in 1970 to 83 percent in 1980. Puerto Ricans, too, are leaving their enclaves in New York; only 49 percent of them lived in New York State in 1980, compared with 64 percent in 1970. But the Cuban population is even more highly concentrated in Florida than it was 10 years ago. Nearly three out of every five Cubans live in the state now, compared with 46 percent in 1970.

The 1980 census asked, for the first time, if respondents spoke languages other than English at home. Fully 11 percent reported that they did, although the proportions varied widely from state to state: in Kentucky

A Portrait of America

and Tennessee, for example, only 1.8 percent spoke something other than English, while 38 percent in New Mexico did so. By far the most common foreign language is Spanish (fully 36 percent of Miami's population—and 40 percent of San Antonio's—speak Spanish at home), and older Hispanics are far more likely than those between the ages of 5 and 17 to say that they don't speak English well or at all.

Meanwhile, the net movement out of the Northeast and North Central regions and into the South and West continued through the 1970s—and blacks, who had maintained a different pattern of migration in the 1960s, joined the herd. During the decade, the South's population grew by 12.5 million or, to view it another way, the region gained an average of 3,432 new people per day. The West grew by 8.3 million—an average gain of 2,279 each day. Growth was sluggish throughout the North Central region: only two states, Minnesota and Wisconsin, increased their population by more than 6 percent. Two Northeastern states actually lost population. New York's fell by 3.8 percent and Rhode Island's by .3 percent.

But Vermont—America's "most rural" state by Census Bureau definitions—grew faster than the U.S. population, and therein lies a clue to one of the census's most interesting findings. According to Census Bureau demographers Larry Long and Diana DeAre, the 1970s saw "a surge of growth outside of incorporated places . . . an unprecedented shift of population toward small urban clusters and rural territory."

Within metropolitan areas, population grew by 10 percent during the 1970s; in nonmetropolitan territory, the rate was 17.1 percent. By contrast, during the 1960s metro growth was 2.4 times the nonmetropolitan rate, and in the 1950s, metropolitan increase outpaced other areas by nearly four to one. Long and DeAre say that the national deconcentration trend is not a function of interregional migration—say, from metropolitan areas in the Northeast to nonmetro areas in the West. The unincorporated areas in the Northeast themselves gained 22.6 percent—twice the national growth rate. Americans, it appears, are moving back to the country.

John T. Barr—Gamma-Liaison

English is an honored second language in the Los Angeles home of Arturo and Socorro Oviedo. The parents, of course, converse in Spanish. Away from home, their five children use English, although they find Spanish useful in keeping secrets from their Chinese or Filipino classmates. But conversations between generations casually cross the language barrier. "It seems the same to me to speak in English or Spanish," says the oldest, 15-year-old Maricela. Arturo, a painting contractor, came north from Guadalajara 18 years ago to make a nest egg to open a business back home, a dream that has receded ever farther into the future. He has retained his Mexican citizenship (although a legal resident of the United States), and frequently travels back across the border. Yet his assimilation can be judged by a series of birth certificates: Maricela and Arturo Jr., 11, his two oldest children, Sandra and Laura, 10 and 6, names which exist in both Spanish and English. And the four-year-old baby, whom they have named Erik.

Death of the Family?

As the baby-boom generation matures, it is developing a new set of patterns for home and family life.

The family in its old sense is disappearing from our land, and not only our free institutions are threatened, but the very existence of our society is endangered." That observation appeared in The Boston Quarterly Review in 1859. It could have been written last week: over the past decade, thanks in large part to the 80 million members of the baby-boom generation, America's approach to house and home has changed dramatically. "America is in the midst of a demographic revolution which involves profound changes in the way people act and think," say George and Eunice Grier, consultants to the Greater Washington Research Center.

The statistics speak for themselves. The average American household, for instance, is steadily dwindling in size: of the 83.5 million in existence in 1982, more than one in five consisted of one person living alone; at the same time, the proportion of households composed of six or more individuals has dropped from 10.6 percent of the total in 1970 to just over 5 percent today. Family households (related individuals living together) have grown by only 19 percent since 1970, while nonfamily households (made up of unrelated or single people) are up by 89 percent and now represent more than one-quarter of the total. Even the family households themselves have changed. The number of people who live in families headed by a man or woman without a spouse has soared from 21.7 million in 1970 to 35 million today, largely because of the rising divorce rate and the increasing incidence of out-of-wedlock births. One out of every eight children—and nearly half of all black youngsters—now lives in a single-parent home.

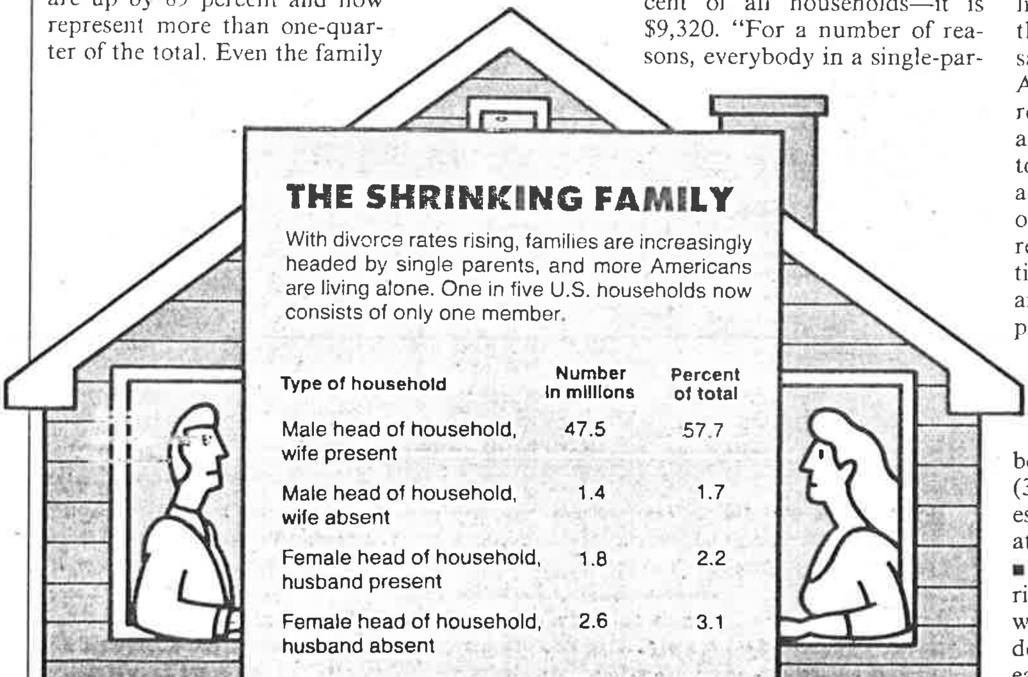
Hawaii has the smallest share of one- and two-person households (about 44 percent of the state's total) and Florida the largest (61 percent).

There is considerable cause for concern. For one thing, the composition of a household has a direct relationship to the household's economic health. The annual median income for a traditional family headed by a married couple, for instance, is $23,141, while for a female head of household with no spouse present—11.3 percent of all households—it is $9,320. "For a number of reasons, everybody in a single-parent household worries about money much more," says Harvard sociologist Robert Weiss. In addition, the trend toward deconcentration—fewer and fewer people living together in more and more households—may contribute to what Amitai Etzioni, founder and director of the Center for Policy Research, calls a "further weakening of national bonds that were not strong to begin with."

Then there is the question of what's happening to America's children. Setting aside questions of what strains economic worries, divorce, remarriage and other modern realities may have on young psyches, George Masnick, professor of behavioral science at Harvard, points to a longer-term problem for society as a whole. Because of later marriages, lower birthrates and the general aging of the population, he observes, an increasingly larger proportion of American households includes no children at all. "The voting, taxing constituency which should look out for children is shrinking," Masnick warns. "So when you have a bond issue for schools or a bill to raise money to improve playgrounds or anything that relates to kids, you get only one-quarter of the households with a stake in it."

Still, announcements of the family's death are drastically premature. Nine out of 10 people continue to live in households as family members, and 9 out of 10 young adults will marry—even if somewhat later than they did during the 1950s and 1960s. Even those who divorce will most likely remarry, men at an even greater rate than women. "Marriage is virtually universal and will remain so in our society," argues Arthur Norton of the Census Bureau. The real change, he suggests, is that "there is an awareness now that marriage doesn't have to have permanence if it isn't working out according to the desires and expectations of the people involved. It can be ended and re-entered." And there are some real bastions of traditional family life. Wyoming and Utah, for instance, have the lowest proportion of single-parent families (12.3 percent and 12.4 percent, respectively), and Utah, home of the strongly family-oriented Church of Jesus Christ of Latter-day Saints, boasts both the largest average household size (3.2 people per household) and the youngest median age (24.2) in the nation. A look at some of America's other living patterns:

■ **Marriage.** The median age for first marriage is now 24.8 for men and 22.3 for women, considerably older than that of a decade ago, but close to the medians in the early part of this century. Ten percent of young adults will never marry—a 100 percent increase over 1970's rate—but students of American history point out that that statistic, too, is not out of line with pre-World War II patterns. In addition, the majority of those who marry will have chil-



THE SHRINKING FAMILY

With divorce rates rising, families are increasingly headed by single parents, and more Americans are living alone. One in five U.S. households now consists of only one member.

Type of household	Number in millions	Percent of total
Male head of household, wife present	47.5	57.7
Male head of household, wife absent	1.4	1.7
Female head of household, husband present	1.8	2.2
Female head of household, husband absent	2.6	3.1
Single, never married	10.0	12.2
Divorced people	8.2	10.0
Widowed people	10.8	13.1

Source: Bureau of the Census

dren. "Childbearing and marriage are still linked," insists James McCarthy of Johns Hopkins University's department of population dynamics.

■ **Family Size.** But if marriage and childbearing are still linked, there has been a real shift in how much childbearing marriage entails. Families with three or more children under 18 have declined sharply in number since 1970—from 10.4 million to 6.9 million. The average family size for whites is now 3.2 persons. For blacks, it is 3.7. And for Hispanics, it is 3.9.

■ **Divorce.** The divorce rate—the number of divorces per 1,000 Americans—doubled to 5 between 1965 and 1976. Largely as a result, the number of one-parent households has increased by 100 percent since 1970—and the number of married couples with children has actually declined. Today there are 109 divorced people for every 1,000 married ones, and among blacks, the ratio is even higher: 233 divorcés per 1,000 married people. Nine out of every 10 one-parent families are maintained by Mom (and 48 percent of all black families with kids under 18 are headed by a mother alone). But over the past decade, the number maintained by single fathers has more than doubled, a trend many

Census officials report that there are two kinds of questions that are perennially controversial: those involving race and those asking about private plumbing.

experts predict will accelerate as child-custody laws are reformed.

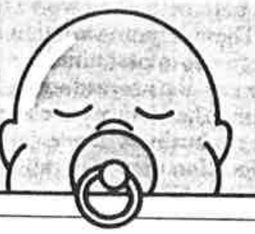
■ **POSSLQ's.** There are 1.9 million households in the nation—3 percent of the total—that are made up of "persons of the opposite sex sharing living quarters" without benefit of wedlock. Since 1970, their number has nearly quadrupled. Fifty-five percent of the partners in these households have never

TEEN-AGE MOTHERS

Total births are down, but births to unwed teen mothers are up alarmingly.

	Total births	Out-of-wedlock births
1970	656,460	199,900
1980	562,330	271,801

Source: National Center for Health Statistics



been married and 32 percent are divorced. Nearly two-thirds of them consist of men and women who are both under 35. More than 70 percent have no children. Although he has no statistical proof that there is growing social acceptance of cohabitation, Johns Hopkins sociologist Andrew Cherlin contends that "informal observation" and a number of court rulings on cohabiting partners' rights and obligations indicate increasing social tolerance. "Far from being a threat to the primacy of marriage in American family patterns," he maintains, "cohabitation is becoming more and more like the first stage of marriage."

■ **Living Alone.** The number of persons who live by themselves increased by 75 percent between 1970 and 1982. As of 1981, the number of people 65 and over who were living alone had jumped by 48 percent over the decade—from 5.1 million to 7.5 million. The number of those under 25 tripled—from 556,000 to 1.7 million. And the incidence among 25- to 34-year-olds quadrupled, from 893,000 to 3.5 million. More than three-fifths of those who live alone are women, but the number of men who do has increased by 105 percent to 7.3 million. The number of people who simply never married has risen by 115 percent, the number of divorcés by 150.8 percent and of widows and widowers by 36.1 percent. Of the Standard Metropolitan Statistical Areas (SMSA's), New York has the highest proportion—30.3 percent—of single-person households.

■ **Unwed Mothers.** Between 1970 and 1982, the number of one-parent families headed by never-married women rose by a startling 367 percent. The highest rate of out-of-wedlock births was among women between the ages of 20 and 24. But the number of illegitimate births among teen-agers jumped from 199,900 in 1970 to 271,801 in 1980—even as the number and rate of births among married teen-agers declined. The racial differences are striking: among white teen-agers, 33 percent of all births were illegitimate, while among black teens, 86 percent were out of wedlock. Experts attribute the increase to greater sexual activity among teen-agers, less social opprobrium against unwed mothers by society and—perhaps as a result—greater willingness to report out-of-wedlock births instead of disguising them. And in the case of some older women, the out-of-wedlock birth is a matter of deliberate choice.

But among teen-age mothers, there may be more disturbing reasons for the rising incidence of out-of-wedlock births. Dr. Kristin Moore, a social psychologist at the Urban Institute in Washington, observes that teen-agers with high aspirations are less likely to have children out of wedlock than are those with lesser expectations. Thus, she suggests, the absence of good schools and solid job prospects may help to explain the particularly high rate of births among poor unmarried young blacks.

Sadly, the climbing rate tends to perpetuate itself: while the father emerges from the experience relatively unscathed, the young mother is more likely to drop out of school, to have a somewhat larger family than usual and to remain a single parent for most of her life, since even her later marriages are more likely than others to end in divorce. For these reasons, her family is likely to be poor—a disproportionate number of teen-age mothers are on welfare—and the chances are higher that her

James D. Wilson—NEWSWEEK

One thing to be said for having a baby out of wedlock is that he'll never have to suffer through his parents' divorce. So Nancy Wright, a 32-year-old salesclerk from San Jose, Calif., was pleased when—after four miscarriages during her two failed marriages—a casual affair with a married man resulted in her getting pregnant. "We're better off just you and me," Wright coos at six-week-old Andrew—"not you, me and a man who will leave us." There were no shocked whispers when Andrew was born; the news boomed out over the loudspeakers at the department store where Wright works and where, she says, "everybody's been really supportive." She's not getting any support from Andrew's father, though, whom she didn't even tell about the birth. Nor does she plan to tell Andrew who his father is, unless he insists. "Maybe," she says with a laugh, "I'll pass him off as an Immaculate conception."

own daughters will repeat the same cycle. University of Pennsylvania sociologist Frank Furstenberg calls the situation "deplorable." "It demands a great deal of attention, a careful set of programs and concentrated effort," he argues. "What we have had instead is a great deal of rhetoric and public wringing of hands, but very little in the way of experimentation in how to deal with the problem."

As families and household composition have changed, so have the conditions of the home itself. Interregional migration during the 1970s forced a great deal of building, especially in the sun belt: despite two deep recessions, in fact, the nation's housing stock grew by an unprecedented 19.7 million units over the decade—more than the total housing inventory of Canada, Mexico, the United Kingdom, France or Italy. And despite nostalgic lamentations for the good old days, the quality of life in modern housing is a great improvement. In 1940, for example, 20 percent of all households had more than one person per room; today the average American home has two rooms per person.

Only 2.3 million units—2.7 percent of the total U.S. housing stock—lack private plumbing. Almost 93 percent have at least one telephone, 83 percent have central heating and over the past decade, the number of homes with air conditioning has nearly doubled to 47 million, or 55 percent of the total. But in the latest decennial census, the bureau stopped asking about television sets. The proportion of homes with TV's had reached 97.8 percent last time round, and any further growth simply didn't seem significant.

More than 1 in 10 homeowners report that they share their homes with mice. One-fourth of those with basements complain of water leaks.

Despite their concerns about divorce rates and unwed mothers, most students of American house and home seem fairly optimistic. Harvard's Masnick argues that what appear to be sweeping changes during the 1970s are actually a return to something more like normal. It was the 1950s and 1960s, with their earlier and higher rate of marriages and their extraordinary birthrates, that were unusual. "We must be careful not to assume that just because the older generation came first, their family patterns were more typical of 20th-century American family life," writes Cherlin of Johns Hopkins. "A close look at the historical record suggests that in some ways, the 1970s were more consistent with the long-term trends in family life."

Far from being worried by the tendency of baby-boomers to marry later in life, many experts hail it as a return to reason and good sense. "There was a time several decades ago when the alarm was about the high rate of early marriage," says Penn's Furstenberg. "Teen-age marriage by 18 or 19 was a public problem. Now, we've gotten what we wanted." But even though historically, people who marry later have had a lower rate of divorce and separation, few experts think the new generation will slow the breakup rate—in part, precisely because Americans take marriage so seriously. "The more you expect of marriage, the more you have divorce," Furstenberg maintains.

And some of the family experts see hopeful signals even in the more worrisome changes. Harvard's Weiss, for instance, suggests that to a large extent the growth in single-parent households is an expression of the American "commitment to self-determination." Similarly, older people who choose to live alone—apart from their grown children—are determined to maintain an independence that they might otherwise lose. Finally, says Weiss, many latchkey kids of single parents gain a head start on maturity: "There is something worthy of respect in a 12-year-old who can pick up his younger brothers and sisters, start supper, do a little housekeeping, then settle down until Mom gets home—and take pride in it. That's the American dilemma: self-reliance bought at the price of forgoing some experience of nurturing."

One way of interpreting the changes of the past 20 years, says James McCarthy of Johns Hopkins' department of population dynamics, "is that the family is going away." McCarthy doesn't buy that idea. "I think a more realistic way to interpret them is to say that a few new stages have been introduced into the family life cycle."

The bottom line, according to most students of American change, is that family life today is both better and worse than it used to be. "There is more variation in our lives than there was in past times," says Cherlin. "People are not proceeding in lock step." Lamenting the changes is useless. Getting on with the business of alleviating the pain and dislocation they may cause is the challenge of the 1980s.

Tim Kelly

Utah is famous for the Great Salt Lake and for being the headquarters of the Mormon church. And Kenneth and Tonya Riches of the Salt Lake City suburb of Murray do not find it at all unusual that they have six children after nine years of marriage: Mormons are not forbidden to practice birth control, but the church approves of large families. Riches, who sells office hardware, visited New York on business two years ago and was struck by how few children were on the streets; in Manhattan a four-bedroom apartment could swallow Riches's $26,000 salary whole. The Richeses tithe 10 percent of their income to the church and set aside the same amount for college, leaving just $200 a month for food, although eight-year-old Chad is not too far from the age when he could double that figure all by himself. But they remain optimistic, supported by their religion, which holds out the promise that the bond of marriage lasts for eternity, which is longer, even, than it will take to pay off three-month-old Tamara's college tuition.

The Work Revolution

More women are working, men are dropping out—and American workers are earning less real income.

Question: what's the most lethal kind of work you can do? (Answer: anything involving motor vehicles—especially construction, which reports 20 percent of the work-related fatalities even though it employs only 5 percent of American workers.) What's the safest? (Almost any service industry. The average stockbroker, for instance, just isn't in too much danger; even the SEC rarely resorts to capital punishment.) Nearly as many Americans walk to work as use public transportation, and one out of every five carless households is in New York state, where mass transit is most popular. Rochester, Minn., home of the Mayo Clinic, boasts the most doctors per 100,000 residents (1,511). And nearly half of the 4,414 Americans who reported 1980 incomes of $1 million or more lived in just three states—California, New York and Texas.

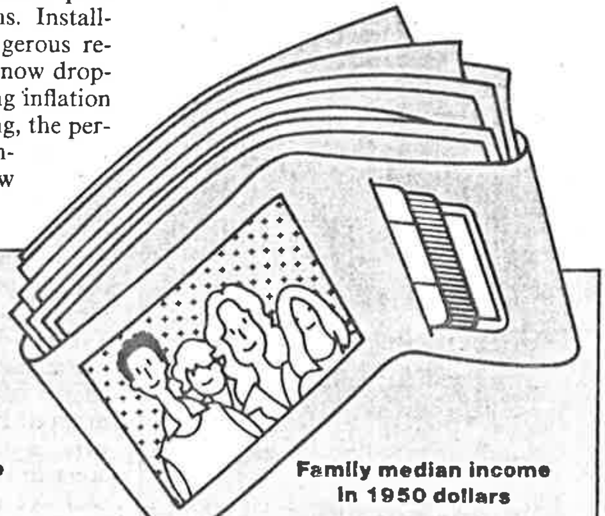
Like almost every other aspect of life in the United States, how Americans make a living, what they get for their work and how they spend it are changing dramatically. The influx of the baby-boomers has swelled the labor force at a much higher rate than the general population has grown: during the 1970s, the work force grew by 26 million, or 31.5 percent. The 1980 census was the first to report that slightly more than half of all women work outside the home; meanwhile, adult males have continued a decades-long dropout from the work force. Increasingly, those who are employed work in the service sector. More and more Americans are earning their living mending teeth, bodies and word processors, fiddling with computers and protecting the public from those who choose mugging, burglary and arson as their professions.

At the same time, however, the American dream seems to have frayed a bit about the pocketbook. Although nominal incomes have continued to rise, a decade of inflation has taken a fearful toll on America's purchasing power. The wage and salary gaps between women and men, blacks and whites, persist—and in some cases, have actually widened. The poor are still very much present: one out of seven Americans in the 1980s lives below the official poverty line. Old industries are dying. New ones demand different skills. Education and traditional family ties—two things the disadvantaged tend to lack—are becoming increasingly important to economic well-being. As a result of all these factors, says Arthur Norton of the Census Bureau's population division, the baby-boom group "faces tremendous obstacles. Their prognosis for 'success' is not as favorable as for those who will succeed them."

There are, of course, some bright spots. Noncash income, pension plans and assorted government benefits guarantee that almost no one has to go without the basics of life. In 1981, 46 percent of all households contained one or more people who were covered by a pension plan at work, and 59 percent had one or more members who were covered by a group health plan offered by employers or unions. Installment debt, which reached dangerous record highs in the late 1970s, is now dropping—along with the debilitating inflation rate. After several years of falling, the personal savings rate is finally inching upward again. And the New York Stock Exchange reports that Americans are investing in record numbers: a special study by the Big Board last year revealed that one out of every seven Americans was a corporate shareholder, with an average portfolio worth $5,450.

Among the most important developments in the American workplace:

■ **What They Do.** During the 1970s white-collar and nonhousehold-service workers accounted for 87 percent of all employment growth. The highest growth rates of all were in mining (up 81 percent), business repair services (up 71 percent) and entertainment and recreation services (up 49 percent). The number of Americans employed in professional services—law, medicine and finance, for instance—grew by 5.3 million; fully 46

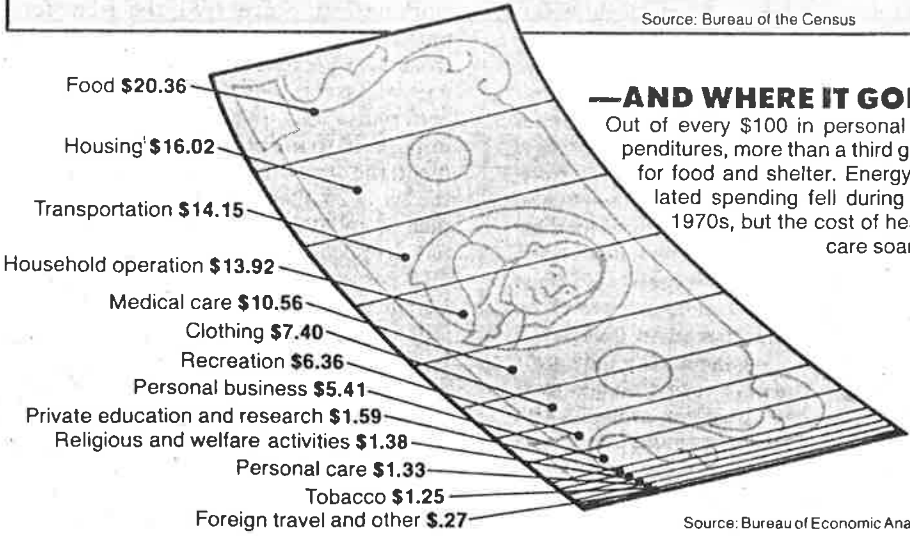


WHAT THEY EARN

Real income for all families dropped during the 1970s—and the earning gap between blacks and whites grew wider.

Family median income in current dollars				Family median income in 1950 dollars		
All families	White	Black and other		All families	White	Black and other
$ 3,319	$ 3,445	$ 1,869	**1950**	$ 3,319	$3,445	$1,869
4,421	4,605	2,549	**1955**	3,975	4,140	2,292
5,620	5,835	3,233	**1960**	4,568	4,743	2,628
6,957	7,251	3,994	**1965**	5,308	5,532	3,047
9,867	10,236	6,516	**1970**	6,117	6,346	4,040
13,719	14,268	9,321	**1975**	6,136	6,382	4,169
21,023	21,904	13,843	**1980**	6,142	6,399	4,044
22,388	23,517	14,598	**1981**	5,926	6,225	3,864

Source: Bureau of the Census



—AND WHERE IT GOES

Out of every $100 in personal expenditures, more than a third goes for food and shelter. Energy-related spending fell during the 1970s, but the cost of health care soared.

Source: Bureau of Economic Analysis

percent of the increase was attributable to th booming health-care field. Meanwhile, -collar and sales jobs rose only slightly (by about 9 percent), and the number of farm and household workers fell—by 12 percent and 29 percent respectively.

■ **Their Income.** All told, aggregate personal income in late 1982 came to $2.6 trillion. Between 1960 and 1970 real family median income rose by an average of $6,000, but during the inflation-ridden years between 1970 and 1981, it actually declined—by $723. Median incomes are substantially higher when both husband and wife are present in the family ($23,220, compared with $14,445 for a male householder with no wife) and even better if the wife works ($26,879). The gap between black and white incomes has widened in recent years, largely because the proportion of dual-income black families has steadily declined even as more white wives have taken jobs. And, according to the Bureau of Labor Statistics, women still earn only about 60 percent of male incomes. Americans over the age of 65 have the lowest median incomes, but during the 1970s, thanks in large part to inflation-pegged boosts in social-security benefits, their real incomes declined less than those of the general population.

James D. Wilson—NEWSWEEK

It was a modest milestone in woman's great march toward equality, but in a way just as telling as another digit in Sherry Lansing's salary: Molly Martin is the first woman maintenance electrician in the San Francisco Water Department. Her job is to test the equipment in the city's 18 pumping stations, at an hourly wage of $16.94. Like many journeywomen in the blue-collar trades, she has a college degree and is a refugee from a dead-end job. They are women who are tired of only being valued for their minds and would like to be appreciated for their bodies: bodies that can lift pipe or hoist bricks. Martin has met resistance from men who, she speculates, "aren't as proud of themselves when they see a woman doing the same thing they are." She has heard of men who bolster their egos by smashing women's thumbs with their hammers—one more sign, she says grimly, that "men still don't know how to treat women."

■ **How They Spend.** In 1980 Americans saved only 5.8 percent of their disposable personal income—a significant drop from the 8.6 percent they were saving in 1975. But since then, the rate has edged up—to 6.4 percent (about $130.2 billion) in 1981. The main lesson of the trends is probably that the average American is no fool: with interest rates at record highs, other investments offered much higher rates of return and savings accounts were simply unattractive. Americans also easily got the message of the soaring energy prices of the 1970s: spending on almost everything related to energy and transportation has dropped like a stone. The big winners in the spending sweepstakes seem to be household appliances—such as conveniences like pasta makers, food processors and vacuum cleaners.

■ **Who Is Working.** During the 1970s the baby boom hit the job market with a vengeance: the median age of American workers fell from 39 in 1970 to 34 in 1981. And among the boomers was an extraordinary influx of women (fully 67 percent of women between the ages of 18 and 34 are in the labor force). Today 46.7 million women—52 percent of the female population—are in the work force. At the same time, men are working less. Since 1951 the labor-force participation of adult males has declined from 87.3 percent to 77 percent. In large part, the trend seems to be attributable to better disability benefits and, even more important, to the popularity of early retirement: the drop-off of participation begins at the age of 25, then accelerates at 45. Among men 65 and older, labor-force participation has dropped from 44.6 percent in 1955 to 19.9 percent in 1981. But a hardy band of both men and women 75 years old and up is still on the job: 451,000 of them were members of the labor force in 1981, and they had an unemployment rate of just 2.8 percent.

■ **Who Is Unemployed.** Other Americans are not so lucky. Last week the Labor Department announced that the unemployment rate for December was 10.8 percent—a post-World War II record. Blue-collar workers have been hardest hit: 50 percent of all the jobless are from blue-collar trades, even though those trades employ only 31 percent of the work force. Minorities have also suffered disproportionately. In 1954 nearly 80 percent of black men over the age of 20 and 85 percent of white men were employed. In 1982 fewer than two-thirds of black men had jobs, compared with about 75 percent of whites. But the pain of unemployment, like that of inflation, is significantly alleviated by multiple incomes within a family. In 1958 fully 51 percent of all unemployed husbands were without other working family members. By 1981 only 33.2 percent reported no other paychecks coming home.

■ **The Female Factor.** Not only are women invading the workplace in unprecedented numbers, they are also taking different jobs. Between 1972 and 1982, for example, the proportion of women judges and lawyers increased from 3.8 percent to 14.1 percent. Women are also taking work once thought to be exclusively male—as security guards, welders, construction workers and telephone repairpersons. Still, nearly four out of five women workers remain in "pink collar" occupations such as clerical and

WHAT'S MY LINE?

Service jobs—especially in high-tech fields—grew sharply in the 1970s, while automation eliminated others.

On the Rise

Occupation	Percent increase
Computer operators	346.2
Teachers' aides	190.2
Social scientists	155.0
Health administrators	150.0
Roofers	139.7
Sales demonstrators	139.5
Real-estate agents	122.1
Bank tellers	113.3
Restaurant and bar managers	108.7
Receptionists	106.9

Out of Fashion

Occupation	Percent decrease
Tailors	61.2
Stenographers	50.0
Newspaper vendors	39.6
Barbers	35.3
Textile operatives	24.9
Garage workers	22.9
Telephone operators	22.5
Tool and die makers	12.9
File clerks	10.0
Sewers and stitchers	9.3

Source: "U/S: A Statistical Portrait of the American People," by Andrew Hacker

secretarial work. The greatest increase in working women is among married mothers with presc and school-age kids. Only 18.6 percent of mothers with children under six were in the work force in 1960 and only 30.3 percent in 1970; by 1981, nearly one out of every two had jobs outside the home. And nearly two-thirds of women with kids between 6 and 17 were working in 1981—up

In 1980, American families reported an annual aggregate income of nearly $1.7 trillion. One-fifth of the families—those with annual incomes of $34,535 or more—received 41.6 percent of the total. The bottom fifth, with incomes below $10,286, received just 5.1 percent.

from 49.2 percent in 1970. By last year, 32 million children, or 55 percent of those under 18, had mothers in the labor force.

Questions of Race. Over all, blacks and "other" workers now represent 11.6 percent of the employed people over 16—and 9.1 percent of white-collar workers. In 1972 minorities comprised 10.6 percent of all workers and 6.6 percent of white-collar employees. Like women, blacks have won jobs once closed to them: for the first time, for example, both nonwhites and women are showing up as professional pilots. But sales and certain blue-collar occupations remain tough to crack. And although blacks have increased their proportions in almost every other upscale occupational group, since 1976 they have lost ground in journalism. The proportion of black editors and reporters has declined from 6 percent to 4.9 percent. By contrast, women in 1981 attained an all-time high in those jobs: 50.2 percent of the total.

Rich Man, Poor Man. More than 30 million Americans now live below the poverty level (defined as an annual income of $9,287 for a family of four). For minorities, the situation is by far the bleakest: the white poverty rate is 11 percent, but for Hispanics it is 26.5 and for blacks, 34.2 percent. Once again, the importance of the family is evident in the statistics. For all Americans, the poverty rate is 14 percent, but for married-couple families, it is just 6.8 percent. A woman head of household with no husband present fares worst of all: among such women, the poverty rate runs at a startling 34.6 percent. Mississippi has the highest poverty rate (24.5 percent), Wyoming the lowest (8 percent). At the other end of the income spectrum are the 560,764 Americans who reported 1980 incomes of $100,000 and

A Portrait of America

above. The great majority (443,514) had adjusted gross incomes between $100,000 and $200,000 for the year, 100,369 made $200,000 to $500,000, 12,467 took in $500,000 to $1 million, and 4,414 reported incomes of $1 million or more.

Labor experts see both good news and bad in the data. On the plus side, says manpower expert Eli Ginzberg of Columbia University, the shift in employment from old goods-producing industries to service-sector jobs shows that the market is resilient, flexible and highly responsive to changing realities. And despite the current labor surplus, says Sar Levitan, director of George Washington University's Center for Social Policy Studies, American workers have more options than ever before. They are better educated, healthier and more mature by the time they enter the labor force.

But there are some trends that have the experts worried. Many men who are dropping out of the labor force are not leaving work to pursue the better life in retirement villages; a disproportionate number are black men who, at a young age, decide there is no place for them in the work force. Even more alarming, perhaps, is the sliding unemployment rate among black male teenagers. In 1954 almost 55 percent of them were employed; by 1982 only one in five was working. Too often, youngsters who can't find work turn into "discouraged workers" who simply stop trying. The only answer, says Bernard Anderson, an industrial economist who is director of social sciences at the Rockefeller Foundation, is federal intervention. "People can scream, holler and kick about make-work, dead-end jobs all they want, but the clear fact of the matter is that the vast majority of black teenagers who did find work between 1977 and 1980 did not find it in the private sector," says Anderson. "The majority of white teen-agers did."

To the list of worries, Sar Levitan adds the economic plight of families headed by women alone. "We aren't making adequate provisions for these women who are supporting kids on their own," he says. But the basic economic trends affect everyone, male and female, black and white, and economist Barry Bosworth, head of the Council on Wage and Price Controls under Jimmy Car-

John Cary

You have lived an American dream when you begin the year setting pressure gauges for the Caterpillar Tractor Co. in Peoria and end it building rocking chairs for your grandchildren. But James Polk, 49, is living in 1983 now. The family prosperity that paid for his brick home in East Peoria and permitted his early retirement last April disappeared quickly: by the end of summer, his son Steve, 26, lost his job as a forklift operator. His son Alan, 25, lost his welding job. His son-in-law Everett Frazier lost his job with a metal-craft company. His wife, Shirley, 46, is now the family breadwinner, working 60 hours a week as a psychiatric nurse at St. Francis Hospital and as a physical-rehabilitation consultant on the side. A family that used to plan Florida vacations and fishing trips together now stays home to can food and plot ways to keep the heat down. On Christmas Day Shirley put a turkey on the Polkses' table, a gift from her employer. "I won't let any of them go hungry," she says.

ter, [illegible] a senior fellow at the Brookings Ins[illegible]on, draws a clear lesson from them. "If we want to know why people are so discontent, these figures are a very vivid demonstration," he says. "They say, in economic terms, the average American worker is worse off today than he was a decade ago. What had been a long postwar history of rising real standards of living came to an end." When the long-awaited recovery from the current recession finally arrives, millions of Americans will be far better off. But it may be a decade or more before healthy new capital investments can spur productivity enough to renew the great expectations of the past.

Andrew Sacks

In the east-side neighborhood of Detroit where André Patrick lives with the fragments of a family—a grandmother, brother and cousin—any job would make a kid a celebrity. "Nobody I know has a job," he says glumly. Patrick himself—a 19-year-old high-school dropout serving two years' probation for an assault he says he did not commit—is not the best imaginable candidate to get one. Yet he has not been wholly defeated; he got an equivalency diploma with the help of the Urban League, and is studying to be a nurse. And he insists that some good may yet come out of the economic disaster that has engulfed his family, neighborhood and nation, if middle-class families humbled by the recession emerge with a better appreciation of the problems of the disadvantaged. Or, as he puts it, "The white people who voted for Ronald Reagan, he's kicking them in the ass now. They'll know better next time."

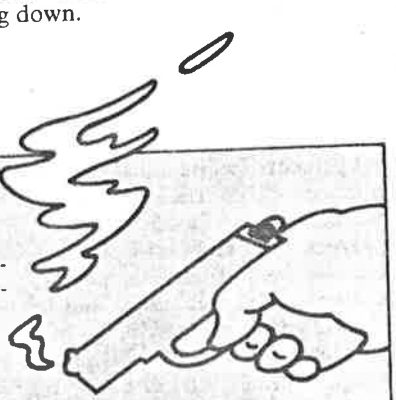
Crime and the Law

After a decade of growth, criminal activity may be headed down—but the prison population will grow.

Throughout the 1960s and into the early 1970s, both the incidence and the rate of crime soared. But the rate of increase began to level off in the mid-1970s—and for the first six months of 1982 the number of reported crimes actually dropped. The FBI's figures showed that violent crime was down by 3 percent across the nation, and that nonviolent crime had fallen by 6 percent.

According to many experts, the reason for the falloff is that the baby-boom generation is getting older. Statistically, crime is clearly linked to age: arrest rates for all kinds of crime peak with young males 16 to 18 years old, then start falling among older groups. (Victims of violent crime also tend to be young: the most likely candidate for murder, for instance, is a black male between 20 and 24.) Now, says Alfred Blumstein, professor of urban studies at Carnegie-Mellon University, "we are seeing a major change in the age structure of the population in the ages that matter most for crime." The tail end of the baby boom is nearly past the peak years of criminal activity. That, he says, suggests that in the years ahead America will experience a welcome drop in crimes of all kinds as the youngsters "get socialized" out of their incorrigible ways.

But the prison population, says Blumstein, will continue to climb. The reason: typically, courts do not lock up teen-agers except for the most heinous offenses. Thus, by the time a criminal has had several relatively minor convictions and is finally put away, he is often in his 20s. Blumstein predicts that as the last baby-boom offenders finally get their due, the prison population will peak—around 1990—and then start coming down.



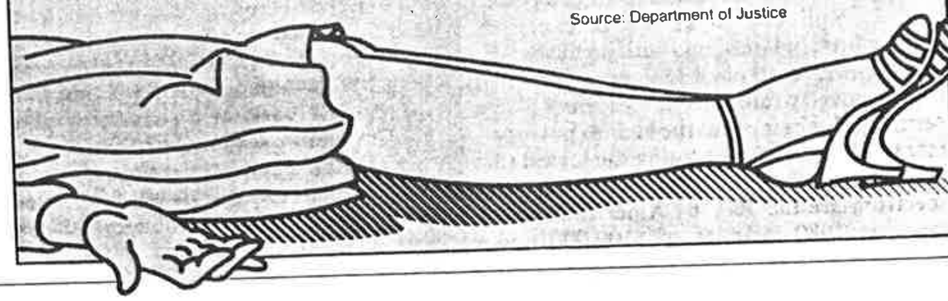
THE SAFER STREETS

Total violent crimes declined last year—in part because the baby-boom generation is finally outgrowing the crime-prone teen-age years.

Violent-crime rates per 100,000 population

	Murder	Rape	Robbery	Aggravated assault	Total
1971	8.6	20.5	188.0	178.8	395.9
1972	9.0	22.5	180.7	188.8	401.0
1973	9.4	24.5	183.1	200.5	417.5
1974	9.8	26.2	209.3	215.8	461.1
1975	9.6	26.3	218.2	227.4	481.5
1976	8.8	26.4	195.8	228.7	459.7
1977	8.8	29.1	187.1	241.5	466.5
1978	9.0	30.8	191.3	255.9	487.0
1979	9.7	34.5	212.1	279.1	535.4
1980	10.2	36.4	243.5	290.6	580.7
1981	9.8	35.6	250.6	280.9	576.9

Source: Department of Justice



A Portrait of America

Mario Ruiz

Evan Michael Jones Reese was born on Jan. 6 in New York City to baby-boom parents in their late 20s. He weighed in at a healthy 7 pounds, 10 ounces. And here is what the statisticians tell him about what to expect:

He will probably never have mumps and may well avoid the measles. Chicken pox is another matter; no point in worrying him now. He will probably be healthier than his parents—and quite possibly taller, as well—and although they are both college graduates, Evan may end up even better educated than they are. It will cost his family at least $135,000 to raise him to the age of 18, and no one even dares speculate about the cost of college after that. At least half of his contemporaries will have to live through their parents' divorces. When he grows up, Evan will almost certainly work in the service sector, and he will probably spend at least part of his life in the sun belt. And he can expect to live to at least 71—and possibly a good deal longer.

A Clouded Crystal Ball

All projections, by definition, are iffy—but the urge to make sense of what lies ahead is irresistible.

If past is prologue, then it ought to be possible to draw some modest conclusions about the future from the wealth of data about America's present. Will the crime rate continue to fall? Will single-person households—and the differing agendas of their inhabitants—actually swamp the traditional family? Will the United States evolve into a bilingual nation, with road signs, advertisements and electoral ballots printed in both English and Spanish?

All projections, of course, must be viewed with a healthy dose of skepticism. Nonetheless, the urge to make sense of what lies ahead is inescapable. After the 1980 census, the Census Bureau decided for the first time to venture some forecasts of its own for the decades to come. Working from what America already knows about itself, the bureau's experts and other demographers offer an irresistible, if clouded, crystal ball. Among their visions:

- According to the census projections, female life expectancy will increase from 78.3 years in 1981 to 81.3 in the year 2005. The life expectancy of American men will grow from 70.7 for babies born in 1981 to 73.3 years in 2005. And by the year 2050, women will have a life expectancy of 83.6 years and men of at least 75.1.
- Annual population growth will slow to almost nothing by 2050. In fact, the Census Bureau predicts, the rate of natural increase—net births against deaths—will be negative after 2035; only continuing immigration will keep it growing after that. The total population will be 268 million in 2000 and 309 million—an all-time high—in 2050. After that, it will start to decline. And the Census Bureau assumes America will never again experience the record yearly births of the postwar baby boom.
- The American population will grow steadily older. From 11.4 percent in 1981, the proportion of the population 65 and over will grow to 13.1 percent in 2000 and 21.7 percent in 2050. The percentage of the population that lives beyond the age of 85 will more than quintuple over the same period: from 1 percent in 1981 to 1.9 percent in 2000—and 5.2 percent in 2050. Meanwhile, the median age—30.3 in 1981—will rise to 36.3 by 2000 and 41.6 50 years later.
- More than 15 percent of all children under the age of five are now black. So it is not surprising, given the relatively high black fertility rate, that the Census demographers foresee a steady rise in the black proportion of the population. From 11.9 percent of the U.S. total in 1981, they predict the black percentage will grow to 13.4 percent in 2000 and 16.8 percent in 2050.

In the shorter term, the National Planning Association predicts that population growth in the 1980s will remain low—and that the population shift westward and southward will continue. Wyoming will be the big winner over the next decade, NPA suggests, with a growth rate of 28 percent. Texas should gain the most people—some 2.7 million. And of all the states, New York should grow the least. By 1990, NPA forecasts, the state's population will have increased by a bare .5 percent.

When it comes to the quality of life, most prognosticators are fairly cautious. Johns Hopkins sociologist Andrew Cherlin observes that "as we enter the 1980s, the pace of change appears to have slowed." For the next few decades, he predicts, there may be only modest swings in the marriage, birth and divorce rates—giving society time to adjust to the new patterns that have formed in recent years. "We are in a plateau in our family patterns that will likely last awhile," Cherlin maintains. Crime expert Alfred Blumstein, who foresees a drop in crime over the coming decade, predicts that the Northeast and Midwest, with stable but aging populations, will see the falloff first; for the South and Southwest, with their large proportions of younger people, the improvement will come less quickly.

Nothing is certain. Who, for example, could possibly have foreseen the outbreak of World War II—or the subsequent baby boom, with its wrenching effects on American life? And who can predict the next medical breakthrough—a cure for cancer, a reliable mechanical heart, a pill that arrests the aging process? By the decennial census of 1990, perhaps Americans will have perfected data gathering and analytical techniques enough to make wiser choices about their nation's course. Meanwhile, policymakers and planners must make the best decisions they can on the problems and possibilities already known about.

CONFIDENTIAL

FROM: T BURNS
DATE: 17 FEBRUARY 1983

CHANCELLOR

Lx v. w. This confirms my own impressions formed e.g. @ G.5 dinner: does J.G.L agree? I agree with $$ 20 125 – in theory, since the actual wider participants may not be so responsive

cc. Sir D Wass
Mr Littler
Mr Byatt
Mr Middleton
Mr Unwin
Mr Cassell
Mr Odling-Smee
Mr Sedgwick
Mr Evans
~~Mr Kerr~~
Mr Lavelle
Mr Bottrill
Mr Allen

DISCUSSIONS IN WASHINGTON: FEBRUARY 1983

1. During discussions in Washington last week I attempted to gain some insight into the following issues:-

i. the alternative interpretations of monetary policy and the likely effects of the recent bulge of the monetary aggregates

ii. the prospect for recovery of output and whether the good inflation performance is sustainable

iii. the prospects for action on the Budget deficit and the implications of the prospective large deficits

iv. US views on the "margin for manoeuvre" arguments directed towards those countries with lower inflation.

A list of the visits made is attached as an annex.

Monetary Policy

2. There are two distinct views about the recent behaviour of the monetary aggregates. The "monetarists" (for example Brunner, Meltzer, Sprinkel and some at the AEI) argue that a large part of the monetary

growth in the latter part of 1982 was a genuine monetary impulse. They think that it will have the usual effect of boosting nominal GDP. They argue that the recent sharp velocity decline is a reflection of recession and the scale of the monetary injection; that it will be reversed, as it always has been in the past leading to higher inflation. On this interpretation the recent rise in the long term interest rates is a reflection of apprehension about inflation prospects.

3. The "Fed" view which seems to be largely supported by Feldstein is that the monetary aggregates recently have been dominated by special factors reflecting institutional change and intermediation. The change in velocity is large and might be sustained. Disinflationary pressures are strong and it was right to take a risk with the monetary aggregates. It is argued that it was important that after the Fed allowed short term rates to fall long rates also fell so confirming the legitimacy of the move. This is what happened initially. Recently there has been some upward drift of long rates suggesting that possibly interest rate reductions have gone far enough for the moment.

4. There is little doubt that US monetary policy is in considerable disarray. The Fed have been moving to wider aggregates without success. I am inclined to accept a good part of the Fed argument which implies that velocity change last year resulted in US monetary policy being considerably tougher than intended. We have experienced similar problems with £M3 over the past 3 years.

5. The problem for the US authorities now is to find something to put in its place. In the UK we were able to take refuge in the "range of monetary indicators" presentation but in our case the narrow aggregates were growing slowly at that point and have remained either within or below the target ranges. The US are heading for trouble with all the aggregates. The UK monetary problems were also eased because of the clear progress that was being made on the budget deficit. In the US the position is still the reverse with the budget deficit worsening. Mr Middleton has pointed out the great risks involved in concentrating on wider aggregates at a time when fiscal policy is getting further out of hand.

6 Yesterday Volcker rebased and increased the targets but there can be no confidence that he will stick to them. They now have a difficult task of re-establishing some credibility in monetary policy. Their policy is now pinned on continuing success against inflation. If that remains under control they may be able to ride out the current confusion. But if it picks up, for example because of a sharp dollar depreciation it will be difficult to avert a further tightening of policy.

7. For the moment there seems to be some determination on the part of the Fed to avoid any significant increase in short term interest rates. They point to very high real interest rates at present, particularly on an after tax basis. At the same time they acknowledge that possibly they have been leading the market too rapidly towards lower short term rates.

8. For the moment the "monetarists" seemed to be gagged in public as the President has indicated that he is entirely content with Fed behaviour. But they may not remain silent and leaks indicating dissent are already emerging. It must be very difficult for those like Sprinkel who have these doubts about the conduct of monetary policy.

Output and inflation

9. These differences on monetary policy are reflected in views about recovery and inflation prospects.

10. It seems to be agreed that recovery is on the way. The differences of view relate largely to its timing and strength.

11. The optimistic group are talking of 5 or 6% growth through the year. This is based on an acceleration of monetary aggregates, a rising level of final demand and recent heavy destocking which is expected to be reversed or at least come to an end.

12. Those being more cautious point out that so far, apart from yesterday's industrial production figures, there is no hard evidence of recovery and optimistic expectations have had to be revised several times over the past six months. They acknowledge that the employment statistics point in the right direction but there are some ambiguities there also.

13. The group that is most worried about monetary growth are most optimistic on output but are also most concerned about inflation and inflationary expectations.

14. But there are some very optimistic inflation figures around. For example the Fed are looking for inflation in the 3-4% range. It is argued that although there has been some benefit this year from commodity prices, food prices and lower interest rates which will not be repeated there could be strong downward pressure continuing from lower energy prices and lower labour costs as earnings growth slows and productivity improves. Recently the US has been experiencing better than expected productivity figures in a way reminiscent of our own experience.

15. I was impressed by the strength of opinion about the imminent upturn and clearly there are some good arguments - particularly from lower interest rates and the recent scale of destocking. But we have seen in our own case the difficulty involved in sustaining pick up against the background of high real interest rates, poor profitability and cost competitiveness and weak overseas markets. Of course in the UK we have had the problem of world recession to cope with while domestic demand has been recovering. The US should not have as big a problem but the difficulties of the LDC debtor countries could provide an echo of that effect. On the same comparison the US could continue to make impressive progress against inflation.

16. From our point of view we must hope that Volcker is correct. A US recovery at about 4% a year combined with further downward pressure on inflation is a very convenient message. I would go part of the way with them but there is a significant risk of further interest rate and exchange rate instability in the US if the economy turns around too fast.

<u>Budget Deficit</u>

17. The Budget deficit remains a big talking point. Everyone I spoke to was clearly alarmed. The prospect is for a deficit of 6% of GDP; over time a larger proportion of this deficit is "structural" rather than "cyclical".

18. The worries are

i. high prospective Budget deficits could damage current activity by increasing real interest rates now

ii. high real interest rates damage investment and the balance between sectors

iii. it is likely to increase the real exchange rate putting pressure on mature industries and thus creating demands for increased protection.

what's new?

19. I sensed a strong determination to try to do something about the Budget deficit but no real consensus about the particular measures that should be taken. The Congressional Budget Office is looking for an end to the indexation of tax thresholds, some reduction of spending programmes (including defence) and higher indirect tax. (The introduction of a VAT, mentioned in some quarters, was considered unlikely as the collection system does not exist at the moment.)

20. It is important to keep the pressure on the US about their deficit. But once it becomes a matter of deciding between a list of options it becomes more difficult for outsiders to make an impact.

Margin for Manoeuvre

21. I spent some time with Feldstein discussing the pressure from some countries and international organisations for the US and UK, along with others, to take advantage of lower inflation to stimulate their domestic demand.

22. I argued that in terms of our own MTFS lower inflation was likely to leave room within the framework for higher output. But that was expected to emerge automatically by sticking to the existing guidelines and did not imply "reflationary" action by government. Having successfully reduced inflation this was not the time to reverse policies and attempt to achieve convergence by regressing towards the mean of inflation in the industrial countries.

23. Feldstein wholly agreed although he recognised the pressure at the Summit to be seen to be taking action. I argued that it was important to convince other countries of the way in which recovery was expected to emerge within the framework of these policies. A discussion of this kind could be helpful in improving understanding of the policies being pursued in both our countries.

T BURNS

ANNEX

VISIT TO WASHINGTON - FEBRUARY 1983

Sprinkel	(US Treasury)
Klein	(Wharton Econometrics)
Fellner, Stein and Penner	(American Enterprise Institute)
Pechman and Perry	(Brookings Institute)
Rivlin	(Congressional Budget Office)
Axilrod and Kichline	(Federal Reserve Bank)
Feldstein	(Council of Economic Advisers)

FROM: J O KERR
DATE: 18 February 1983

PWP

MR BURNS

cc Sir Douglas Wass
Mr Littler
Mr Byatt
Mr Middleton
Mr Unwin
Mr Cassell
Mr Odling-Smee
Mr Sedgwick
Mr Evans
Mr Lavelle
Mr Bottrill
Mr Allen

DISCUSSIONS WITH AMERICANS IN WASHINGTON LAST WEEK

The Chancellor was grateful for your minute of 17 February about your talks in Washington last week. His own impressions, particularly from the discussion at the G5 dinner on 9 February, were very much in line with yours: he would like to know whether Mr Littler's too were similar. And he would be grateful for the draft of a short minute to the Prime Minister.

2. The Chancellor agrees with your conclusion that it will be important to keep on pressing the Americans about the deficit, and that a Summit discussion of how recovery should emerge within the framework of existing guidelines, and without "reflationary" action by governments, could be helpful. His only concern is that some of the Summit participants may be less responsive in such a discussion than was Mr Feldstein when you went over the ground with him. Thus, while the Summit discussion could certainly, in theory, be helpful, there is a risk that it might in practice prove unhelpful.

JOK.

J O KERR

CONFIDENTIAL

Pwp

FROM: J.G.LITTLER
DATE: 21 FEBRUARY,1983

MR. KERR

cc Sir Douglas Wass
Mr. Burns
Mr. Byatt
Mr. Middleton
Mr. Unwin
Mr. Cassell
Mr. Odling-Smee
Mr. Sedgwick
Mr. Evans
Mr. Bottrill
Mr. R.I.G. Allen

M. attach TB's minute (Thurs) + more (Rcd)

DISCUSSIONS WITH AMERICANS IN WASHINGTON LAST WEEK

My own direct contacts with US opinion in Washington last week were confined to Treasury and Federal Reserve Bank officials. As I indicated at the end of my notes of the G.5 meeting, I had the same impression of a shift in expectations over the last couple of months in favour of a buoyant view on demand and activity in the US economy in 1983. I also had the impression that the FED were reckoning that the best immediate hope on the fiscal deficit was that Congress would go some way towards accepting the thrust of President Reagan's January statements, and that they would probably be leaning towards accommodating monetary policy.

2. Incidentally, on the second point raised in your minute of 18 February to Mr. Burns, I took the opportunity of giving to Mr. Tietmeyer privately a copy of the passage we had worked out for ourselves on recovery without "reflationary" action by governments (part of which was later used in the IMF Communique). Not surprisingly, Tietmeyer was very pleased with it. But then we would not expect Germany to be among the troublesome Summit participants on this issue!

Good

(J. G. LITTLER)

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FROM
OECD PARIS TELEX 620160 PARIS

TO
J.G. LITTLER, ESQ., C.B.
SECOND PERMANENT SECRETARY
H.M. TREASURY
LONDON

SECOND PERM SECY OFFICE
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FROM	
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	Mr Lavelle
	Mr Carey
	Mr Bothwell ✓
	Mr Hall
	Mr Atkinson

GROUP OF TEN

CHAIRMAN OF THE
DEPUTIES

CONFIDENTIAL

JANUARY 31, 1983

NOTE FROM THE CHAIRMAN OF THE DEPUTIES
OF THE GROUP OF TEN

THIS IS TO INFORM YOU THAT THE NEXT MEETING OF THE DEPUTIES OF THE GROUP OF TEN WILL BE HELD ON WEDNESDAY, FEBRUARY 9, 1983, AT THE IMF HEADQUARTERS IN WASHINGTON, IN THE EXECUTIVE BOARD ROOM ON THE 12TH FLOOR, BEGINNING AT 7:30 P.M. THE MEETING WILL BE DEVOTED TO AN EXCHANGE OF VIEWS IN PREPARATION FOR THE MEETING OF OUR MINISTERS AND GOVERNORS THE FOLLOWING DAY.

KIND REGARDS.

LAMBERTO DINI

MR. ATKINSON
DEVELOPECONOMIE

262405 TRSY G
OCDE B PARIST

CONFIDENTIAL

FROM: J. G. LITTLER
DATE: 31 JANUARY, 1983

MR. LAVELLE

cc Mr. Bottrill
Mr. Atkinson

SAUDI ARABIA AND THE GAB

The planned further meeting to explore this was held in London on 28 January, between a Saudi team led by the Governor of SAMA and Mr. Nimatallah, and Lamberto Dini and his Assistant, Messrs. Habermeier and Nicoletopoulos of the IMF and myself.

There was no negotiation. The Saudis explained that their Finance Minister, who had been on holiday, had not considered the matter, and they wanted only to go over possibilities and implications on the widest possible basis, ranging from a very close association verging on full membership to a veryloose one. There was a good deal of discussion of the background, history and development of the original GAB and the new extension, and of the nature of GAB relations with the IMF. We then went through the headings of "close association" guided in the main by the text which had been sent out by the IMF, which you have seen. At various points we discussed the elements which would cease to be necessary at different levels ofloosening of the association (see also below).

We were asked if we could give an indication of the kind of letter which the Chairman of the G.10 might send if there were a pretty close association. We agreed to draft this to give to the Saudis by Friday night, and did so. A copy of the result is attached

Two comments:

- the inclusion of words about entitlement to take part in the decision-making process, in particular participation in voting, stemmed from Dini's presentation at the meeting, which took me and Habermeier a little aback. Indeed it was our immediate qualifying comments which led him hastily to say that he was offering this only on a personal basis, although as something which logically he would feel obliged to recommend for a "very close association". I put it to Dini afterwards that I thought there would be several G110 countries who would want to think very carefully indeed, and probably conclude negatively, on voting participation, and his letter to the Governor mutedly reflects this.

- We did make clear, as does part of the attached draft, that very close association would involve acceptance of binding obligation, with no possibility of opting out. I remain convinced from the very reserved comments made during our meeting by the Saudis that this is likely to be an insuperable objection for them. I tried to indicate at various points that an arrangement which was less close, and less binding, but still fairly intimate, could still give Saudi Arabia participation in useful G.10 discussion, i.e. much of the draft letter apart from the two sentences in square brackets would remain valid in those circumstances. Dini seemed to think that other G.10 members would object strongly, although not Italy, but I think he is wrong.

There is no immediate action for us. Dini will communicate with other members of the Group of Ten. I will tell John Anson where we stand, but not send copies of the attached documents (he can ask the IMF Staff to show him if he wants). I will show this minute and enclosure to Mr. Kerr, but I think we need not trouble the Chancellor.

(J. G. LITTLER)

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BANK OF ITALY UK REPRESENTATIVE OFFICE

Telephone 01-606 4201/5
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Lamberto Dini
Chairman of
The Deputies of
The Group of Ten

39, KING STREET
LONDON EC2 8JJ

London, 28 January 1983

Dear Mr Governor,

As agreed during our most useful meeting of today, I am enclosing a draft of a letter on the relationship that could be established between the G-10 countries and Saudi Arabia in connection with a lending agreement between the Fund and Saudi Arabia that would be in accordance with the memorandum that the Managing Director of the Fund has transmitted to Minister Abalkhail and yourself on January 25 and which we discussed in some detail this morning.

Paragraph 1 of this draft letter contains two sentences which are in square brackets. As I had occasion to explain, the reason for this is that the G-10 Ministers and Governors have not yet considered the matter of participation in a voting procedure by a country associated with the GAB. However, these sentences have been included in the draft letter because it seems to me that the close association envisaged in the above-mentioned memorandum would logically call for participation of Saudi Arabia in the decision-making process on activation, and I would therefore be prepared to recommend to the GAB participants that they accept them.

During our meeting we also discussed the possibility of a different form of association which would not be as close as the one described in the above-mentioned memorandum from the Managing Director. In the case of such a different association, the draft letter concerning the relationship between Saudi Arabia and the GAB participants would have to be reviewed and appropriately adjusted.

I may add the kind of amendments that would be made to the existing GAB decision depend on the form of association that will be chosen.

With kindest regards,

Sincerely yours

L. DINI

DRAFT

Dear Mr Minister

As you are aware, the Finance Ministers and the Central Bank Governors of the countries participating in the GAB have recently decided to support a revision of the GAB that would enlarge the amount of their credit arrangements and would make GAB resources available also to other members of the Fund that are not GAB participants.

The GAB countries recognise that they and Saudi Arabia share an interest in fostering and preserving the stability of the international monetary system, and that Saudi Arabia for many years has been playing a crucial role in providing financial support to the Fund.

The GAB countries take note with satisfaction that a lending agreement between the Fund and Saudi Arabia is to be concluded on terms and conditions comparable to those of the GAB. In this connection they believe that it would be appropriate to strengthen the co-operation which is being developed between them and Saudi Arabia. Accordingly they have decided to propose the following understandings regarding consultation and the exchange of information with Saudi Arabia, which they have authorised me to transmit to you on their behalf.

1. Saudi Arabia will be included in the consultations among GAB participants regarding proposals of the Managing Director of

the Fund for calls under the GAB and will be invited to send representatives to take part in meetings that may be held by the GAB participants to consider such proposals. /‾Representatives of Saudi Arabia attending any such meetings will be entitled to take part in the decision-making process, including any voting that may take place, as if Saudi Arabia were a GAB participant. For this purpose, a proposal of the Managing Director for calls under the lending agreement with Saudi Arabia referred to above shall be treated as if it were a proposal to a GAB participant, and Saudi Arabia will be bound by the decision reached as if it were a participant_7.

2. Saudi Arabia will also be invited to send representatives to attend meetings of the GAB participants called to consider other matters that may arise under the GAB Decision. In addition it will be invited, as may be agreed, to send representatives to other meetings to discuss aspects of the functioning of the international monetary system that are of common interest to the GAB participants and Saudi Arabia.

3. In any event, Saudi Arabia will be kept informed by the Chairman of the Ministers and Governors of the GAB participants or by the Chairman of their Deputies, as the case may be, of other relevant deliberations of the GAB participants.

4. These understandings shall apply as long as the undertaking of Saudi Arabia to make resources available to the Fund under the lending agreement referred to above is in effect.

I shall appreciate a reply confirming that the understandings set forth in this letter are acceptable to Saudi Arabia.

INTERIM COMMITTEE

Group of Twenty Four: Background Brief

1. Since the G24 'programme of immediate action' was published in 1979, there have been a number of changes in Bank and Fund along the lines of the recommendations. Their precise concern at this Interim Committee will only become clear when the G24 communique is published. However, it is unlikely that the items will differ much from these set out in September 1982 communique.

2. Conditionality G24 deplored the hardening of conditionality evident, for example, in the resort to preconditions.

UK view: We agree that Fund conditionality has been applied **firmly** over the last two years but we judge the overall degree is about right. The Fund does take account of political and social priorities but this cannot absolve countries in balance of payments problems from adjusting.

3. Quotas G24 urged a doubling of quotas, with a large element of equiproportional increases. The voting power of ldc's should be increased by giving them 45% of quotas plus larger basic votes. **UK view** Our general view on the quota Review is set out elsewhere but we have all along stressed that, if quotas were more fairly to reflect members' positions on the world economy, there cannot be any predetermined voting blocs. It is not possible to say that no ldc's share in quotas should be allowed to fall. In particular, if ldcs received 45% of quotas, their voting strength (if augmented by greater basic vote, would come to almost 50%. Their position in the world economy does not justify this.

4. SDR allocation/aid link G24 called for both allocations and the establishment of the link between SDRs and development finance.

UK view: We agree that it is now right to study the question of allocations but remain firmly apposed to the aid link, which would blur the distinction between aid and IMF activities. It is not the role of the Fund to become source for endlessly transferring

resources. Moreover the aid link would act to undermine confidence in the SDR as a reserve asset.

5. CFF G24 sought an expansion of the Compensatory Financing Facility.

UK view: Over the last year or so we have sought with some success to make the test of cooperation for CFF drawings above 50% more rigorous. The ldcs are always seeking to liberalize the CFF to alter the balance between high- and low conditionality finance. We do not believe there is a case for this and indeed the access limits of the CFF may need to be reviewed at a later stage in the Review.

6. Small islands G24 called for slacker conditionality for small islands and poor landlocked countries. UK view: This demand has also been reflected in the pressure for minimum quotas in the Review. We are not convinced that in particular the problems of the small islands are so different from larger ldcs that they merit minimum quotas or special conditionality.

7. International Monetary Reform. G24 argued for a fundamental reform of the international monetary system as an essential aid to world economy.

UK view: the present difficult situation is not the time to uproot the tested international structure which has served us well. The agreement on the GAB and the acceleration of the Quota Review underline the fact that existing institutions are showing themselves capable of adapting.

8. UNCTAD G24 wish to take up many of these monetary issues in the forum of UNCTAD VI.
UK view: Although we cannot stop UNCTAD considering financial questions, it is important that UNCTAD goes not give the impression that it is entitled to give remits to the IFIs. UNCTAD may want to look at allocations and the CFF in particular. These are, however, properly matters for the Fund which in the final analysis has the responsibility.

9. <u>GATT</u> Executive directors, including ldcs, have acknowledged the prime role of the GATT as the guardian of the international trading system and have expressed a desire to see closer Fund/Bank collaboration. Moreover, it has been agreed that, in conducting Article IV consultations with larger members, the staff will include analysis of trade policy with overall appraisal. This approach is being applied to consultations undertaken since the beginning of the year.

10. <u>Development Committee.</u> In all of this there is nothing very new. The ldcs may well try to use some of these points as negotiating counters in the Quota Review. They might also try to urge the calling of an April Development Committee. At this stage, however, we doubt whether there is sufficient new business to justify a separate spring meeting of the Development Committee.

INTERIM COMMITTEE

FUND LIQUIDITY: BACKGROUND BRIEF

Points

1. Although the Fund has both unused ordinary resources and credit lines for the very immediate future, more will be needed in the period before the Eighth Quota Review is implemented (and the new GAB borrowing arrangements put in place).

2. Therefore the Fund should finalise arrangements soon for a third SAMA tranche of SDR 4 billion. This should be enought to provide the Fund with adequate resources provided the Quota Review is ratified by mid 1984.

3. However the Fund should continue to explore similar medium term borrowing from others who have not so far lent enlarged Access resources. We recognise that prospects here are not good. We would support market borrowing only if borrowing from official sources were inadequate.

Background

4. Since Toronto concern has grown about the Fund's immediately available resources before the Eighth Quota Review is put in place. The Fund currently has just over SDR 10.1 billion of uncommitted ordinary resources which should be adequate for the next 18 months. However it has now only SDR 1.7 billion of uncommitted borrowed resources to finance Enlarged Access programmes. Brazil (SDR 2.8 billion) will more than absorb this. Without the third SAMA tranche the staff estimate a commitment gap of SDR 3.5 billion by April. For 1983-84 their estimates of commitments of borrowed resources for members with quotas of less than SDR 800 million is SDR 3.4 billion (including, for example, Egypt, Pakistan, Zaire, Philippines, Portugal and Turkey). This would raise the commitment gap to SDR 7 billion. Some of these commitments may not materialise but a number of the OPEC high absorbers (Nigeria, Indonesia) are potential borrowers as well. Further commitments to

members with quotas over SDR 800 million cannot be precluded eg Venezula looks likely to come into the Fund. The entry of these OPEC countries will not have an immediately offsetting effect on Fund liquidity since most non-oil ldcs already have programmes.

5. This makes it particularly urgent to secure the third SAMA tranche of SDR 4 billion. (In 1981 the Saudis indicated their intention to consider a further commitment for the third year if their balance of payments and reserve position permitted). During his visit to Saudi Arabia with the Chancellor (7-9 January) the MD intended to discuss the third tranche with the Saudis. No definite conclusion was reached - the Saudis gave the impression that for them the main question was enhanced resources for the Fund (whether by the third tranche or parallel Saudi lending alongside the new GAB appeared a secondary question). Habermeier (Fund Treasurer) with Dini met the Saudis in London on 28 January to continue the contacts on GAB matters and will no doubt have sounded them out further on the third tranche. There is a good chance of securing the third tranche in the coming months.

6. The Fund estimate that with the Fund tranche they should be able to carry on until the Quota Review is ratified. However we have also been encouraging the Managing Director to approach other non-G10 potential leaders, such as Kuwait (SDR 2 billion) and the Emirates (SDR 1 billion) neither of which contributed under the Enlarged Access policy. The Kuwaitis have given a definite 'no' (their domestic financial system and stock market are in some disarray). The Fund are 'not optimistic' about the UAE either.

7. Therefore we cannot rule out a further approach to the G10 countries (i.e Germany, Japan and ourselves) for loans to tide the Fund over until the proposed new implementation date of mid-1984 for the Eighth Quota Review although the Fund may be reluctant to do this given the recent GAB decision. We understand that the Germans might be willing to lend but we do not want to ease the pressure on the Saudis or other non-G10 lenders at this stage. Therefore the less said about this the better. In particular we want to avoid giving the impression that the UK would agreed to lend more than the forecast SDR 150mn already committed.

8. The staff's estimates may be pessimistic as programmes breakdowns will reduce the need for borrowed funds. We might be able to live with an uncovered commitments gap during late 83 - early 84 provided that the Fund is fully ready to go to the market if the GAB/quota increase is delayed. In the event that the Fund had a major inadequacy of resources because of a shortfall from official sources, we would support direct market borrowing. If the Fund does go to the markets, it should do so from a position of strength well ahead of any immediate financing need.

REAPPOINTMENT OF LAROSIERE: STATE OF PLAY

Larosiere's term expires in June. The formal procedure for re-appointment is a matter for the Executive Board, in particular the longest serving ED (currently Kafka of Brazil).

2. Delors told Larosiere in Paris that G5 had agreed to his reappointment. Kafka has now sent a memorandum to all EDs saying that a number of EDs have been able to manifest their formal agreement to the MD's reselection, and among others all those who have reacted substantially have indicated likely support from their constituencies. It says there is no other candidate.

3. Kafka has suggested that each member of the Interim Committee should give his ED bilaterally the reaction of his constituency. Shortly after the Interim Committee Kafka will ask for the formal reaction of each ED. He will then consult with Larosiere and start work on the formulation of a contract containing terms and conditions of service for the next five years. The agreement of the salary tends to be a delicate matter and needs to be co-ordinated with the World Bank as in the past the two institutions have kept in step. When the contract has been agreed, the formal procedures are that the Executive Board takes the decision to reappoint. The salary and terms and conditions are then sent to the whole Board of Governors for approval by postal vote.

EFFECTS OF AN OIL PRICE FALL ON THE WORLD ECONOMY

Work is proceeding on the impact of a sharp fall in the oil price on the world economy but preliminary results are available. The Chancellor will have seen the report of the effect of a fall in price to $25 on both the world and the UK economies under cover of Mr Middleton's note of 4 February.

2. The January forecast assumes that the average OPEC oil price falls to about $30 a barrel early this year compared to $32½ at the end of 1982. We have also looked at $25 and $20 a barrel. The forecasts and simulations also assume that the dollar depreciates by about 10 per cent during the year. This would be equivalent to a further reduction of about $2 a barrel for the world as a whole.

3. Our work tends to support the OECD's results that a 10 per cent fall, $3 or so, would raise activity in the OECD by rather over half a per cent in about two years. This assumes that other energy prices fall in line with oil prices and that OECD governments maintain their monetary and fiscal policies in nominal terms so that as inflation falls real activity increases.

Major 7 Economies		January Forecast	$25 oil price	$20 oil price
Inflation	- 1983	5¼	4¾	4¼
	1984	5¾	5½	5
Growth	- 1983	1¼	1¾	2¼
	1984	3½	3¾	4¼

4. It has been argued recently that the disruptive impact of any large change in oil prices could outweigh the beneficial impact of their being lower. This would be because of problems caused to the international financial system by the adverse effects on some developing countries, because any large shift of income tends to cause retrenchment from those who lose income - in this case OPEC - before any expansion from those who gain, and because some of the adjustments firms had made in response to the rise in prices since 1979 will no longer be efficient and may need to be reversed.

5. We are still considering these effects but we are inclined to think that, while they assume that a fall in oil prices would not be as beneficial as a rise was harmful, they are not likely to make the benefits negligible. The table above incorporates some allowance for the operation of these factors.

6. Most 'problem' debtor countries, eg Brazil, Chile, Argentina, Poland, Romania, are net oil importers and would therefore benefit from a fall in the oil price. The notable exception is Mexico which, as a major net oil exporter, would suffer a considerable deterioration in its current account balance. Mexico is already undercutting OPEC so a small fall in the price would cause comparatively few problems, and any reduction in interest rates with lower inflation would be of considerable benefit. A large price fall to $20, however, would worsen the current account by $4-5 billion a year but Brazil would benefit to at least the same extent.

7. Several OPEC countries would be in considerable difficulties. Venezuela and Indonesia have a fair amount of outstanding debt and would lose a great deal of revenue. Some other countries, notably Nigeria, would be forced to reduce imports even more sharply than is already necessary and would suffer hardship. Most developing countries on the other hand, would benefit from the oil price fall from an expansion of OECD imports and from a slight reduction in interest rates. Activity in the world economy as a whole would be higher, but there would need to be considerable redirection of lending and trade flows with consequences that are difficult to predict.

8. We are still examining policy implications for the OECD and the UK. The policy implications for OECD countries from a price fall are mixed. If there is a large price fall steps may need to be taken to ensure that the worsening of oil exporters' financial positions can be accommodated by the banking system. Also, if the fall is large, it could be argued that energy taxes may need to be raised to encourage conservation so that increased demand does not cause another oil price hike in the middle of this decade. An increase in energy taxes, however, or any measure which stops energy prices in OECD countries falling with the oil

price, lessens the beneficial impact on OECD economies considerably and would cause problems for oil companies. Such a rise could, however, perhaps be combined with a compensating move towards reductions in other taxes. The UK as an oil producer is a special case. We have little indication yet how other major countries are considering reacting to these issues.

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Instructions for completion of Dummy Card

Use black or blue pen to complete form.

Use the card for one piece or for each extract removed from a different place within a piece.

Enter the department and series,
eg. HO 405, J 82.

Enter the piece and item references, .
eg. 28, 1079, 84/1, 107/3

Enter extract details if it is an extract rather than a whole piece.
This should be an indication of what the extract is,
eg. Folio 28, Indictment 840079, E107, Letter dated 22/11/1995.
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FROM: A R H BOTTRILL
DATE: 2 FEBRUARY 1983

CHANCELLOR

cc Sir D Wass
Mr Littler
Mr Burns
Mr Unwin
Mr Lavelle
Mr Odling-Smee
Mr Hall
Mr Atkinson
Mr Graham

PS/Governor (B/E)
Mr Anson (UKDEL/IMF)

IMF INTERIM COMMITTEE - WASHINGTON, 10-11 FEBRUARY

You will be chairing the IMF Interim Committee meeting in Washington on 10-11 February. This will be preceded by a G5 working dinner and by a G10 Ministers' meeting.

2. You are to have bilateral meetings with the Managing Director and with Ministers from India, China, Australia and the Anglophone African countries before the Interim Committee itself. You, together with Secretary Regan and the Managing Director, are to have a session with US Congressmen. [The three of you will also see President Reagan after the meeting].

... 3. The full list of briefs is at Flag A. The latest version of
...2 the programme is at Flag B. A general speaking note is at Flag C. Mr Hall is providing separately a list of media arrangements.

4. The main business of the meetings will of course be the IMF quota increase, and the essential objective will be to secure a satisfactory agreement on this. There will undoubtedly be a continuing undercurrent of concern about the timing and extent of recovery in the world economy. The opportunities for major policy discussion will be limited but there is perhaps some important groundwork to be put in hand in preparation for the OECD Ministers' meeting and the Williamsburg Summit in the spring.

5. There are a number of other issues that are likely to come up in the three days. In terms of Fund business, these include the question of an SDR allocation, and the relationship between the Fund and the commercial banks. More generally, they include the US budget deficit and the problems of major debtors.

6. The rest of this steering brief covers the handling of the Interim Committee meeting itself, the preliminary discussions before it (including G5) and the possible follow-up with the Press [and possibly President Reagan].

Tactics for the Interim Committee

7. The central objective is to reach agreement, if possible on Thursday, on the size of the Fund and the extent of equiproportional distribution.

8. On the size of the Fund our approach to Governors envisaged that a settlement would be reached within the range SDR 85-100 billion. The prime determinant of the final figure is the view of the US. It is unlikely that they will stick to their minimum figure of SDR 85 billion or concede an increase in excess of 50 per cent. Given the US blocking vote, others in the last resort will have to come in line.

9. As regards distribution the approach to Governors quoted middle range of 25-40 per cent for the share of the quota increase to be allocated equiproportionally. A figure within this range is perhaps the largest which will preserve the appearance of a steady progression towards calculated quotas and keep the Japanese within the camp. Logically the larger the increase in the size of the Fund, the larger ~~smaller~~ the size of the equiproportional element compatible with ~~necessary to produce~~ a given degree of progress to calculated quotas. Against this, however, the majority of LDCs favour a substantial equiproportional element both to protect their quota size and their voting power. This probably points to a compromise in the centre of any given range but with a disposition to take the upper end if the figure negotiated for Fund size is thought to be "small" on the grounds of securing LDC support for the package as a whole.

There are a number of issues allied to the central areas for decision whose outcome will be of interest, usually to developing countries. Among these "douceurs" only the question of access seems potentiallya source of problem for the central decisions.

i. Access to Fund resources. This is not mentioned in the report from the Executive Board but seems certain to come up in debate. The neutral and appropriate solution would be to remit the matter to the Executive Board. An admission in the communique that enlarged access would need to continue at least through the Eighth Quota Review would in principle amount to some bow to developing countries' wishes. An admission that the level would not be reduced in cash terms at least initially (or might even be somewhat increased) would extend the concession. But since the tactical preference would be to leave the matter for later resolution, it would be counter-productive to introduce it into the discussion of central issues, although a defensive line as above will be needed if others introduce it.

ii. Review of SDR allocation. A form of words has already been agreed in the Executive Board Report and could be used in the communique. Some debate upon this may prove necessary at the time of discussion of the communique. But this would be after decisions on the main issues have been taken.

iii. A special increase for very small countries. There is no logical case for this. It cuts across the principle of uniformity. A possible variant would be a general agreement to round up all quotas to the nearest SDR 0.5 million rather than the normal SDR o.1 million. This would be of general interest while having some disproportionate benefit for small countries. Once again this move could not operate as a serious influence on the major decisions but might be used to make a "low" settlement more acceptable.

iv. Bringing forward the next Review. There might be a case for committing the Committee to the introduction of the Ninth Review on 1 January 1989 if the decision to try to implement the Eighth Review by end-1983 came into question. But this would be a matter of housekeeping or possibly presentational interest rather than of direct influence on decisions.

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11. The decision to roll all the items of the agenda into one, and so maintain a brisk momentum, is intended to demonstrate from the start that matters are being kept under a tight rein. The Chancellor will want to keep colleagues' attention firmly on the central issues. It may be possible to sidetrack any diversions by offering to cover them under 'Any other business' or in the communique, but this technique needs to be used sparingly and certainly not for anything which might unravel the central decisions later. In general, precedent suggests that use needs to be made of meal times to ease the decision process.

12. It seems desirable to provide time after the conclusion of the main speeches by Governors for one of two broad tactics. If, despite earlier soundings, the content of the speeches of one or two members so indicates, it may be necessary to ask them to attend upon you during a brief adjournment. It might well be helpful to announce at the outset that a period of adjournment would follow the ending of the main interventions and that a shorter round-up would be undertaken before dinner.

13. After the intermission you might wish to indicate that the tenor of the discussion had led you to suppose that the weight of opinion favoured a settlement in the region SDR 90-95 billion and an equiproportional element in the region of 30-35 per cent. It might be helpful to have the staff circulate tables on this basis at this stage. It might be useful also to pick up references to the SDR review, and possibly to the concern expressed for small countries. Some reference to other items figuring in the list of "douceurs" above might also be judged helpful. It might be helpful to select some points for the communique. It could be proposed that discussion could then proceed over dinner.

14. At dinner it would seem preferable to concentrate on a single decision, that of the size of increase. There would be a case for concentrating effort on the top end of the range. If, against expectation, the US prove prepared to concede SDR 95 billion, it might be simplest to propose a distribution percentage of 33½ per cent, the mid-point of the range. If the US are only prepared to go as high as (say) a 50 per cent increase (SDR 92 billion) the best course might be to propose an equiproportional element of 35 per cent, which would add to worries of Japan, but would help to console ldcs.

15. The morning of Friday, 11 February is likely to be occupied with the communique and may provide the opportunity for a modest discussion on the world economic outlook, as well as tying up loose ends.

Preparatory meetings

16. The discussions with Mr Houtven and the Managing Director on Wednesday morning will provide an opportunity to consider some of the Interim Committee tactics in more detail, including the optimum positioning of statements by the US and any reliable intervener (such as Mr Littler for the UK). The EC statement which will be delivered by Germany (Stoltenberg probably) might be a useful early contribution if we can secure at Ecofin on Monday that it is reasonably close to the compromise outcome which we think negotiable. Other Washington meetings are discussed below.

India

17. We expect Mr Mukherjee* to attend. We asked our High Commissioner in Delhi to sound out the Indians before the Interim Committee date was announced, and they supported bringing it forward. They should now be persuaded to make it a success. They have a key role as leading LDC. They would prefer a larger Fund, but could probably accept a settlement between SDR 90-100 billion. They want to protect their quota and therefore favour a large equiproportional element in any increase. They need to be persuaded of the importance of a significant selective element if quotas are to reflect more nearly relative economic positions. They have not mentioned access, but if they do they will need to be offered at least a review in the Executive Board. They are one of the countries most likely to argue for a guarantee of no reduction in nominal access or even a modest increase. See briefs at Flag on India on quotas including access.

China

18. We expect Shang Ming, Adviser at Vice President level of the People's Bank, to attend. The Chinese would prefer a large quota increase but would probably accept SDR 90-100 billion. Their request to see the Chancellor, however, probably stems from their fear of being overtaken by the Netherlands for ninth place. They may have been unduly influenced by neighbouring Japan which has been arguing for a quota increase close to SDR 100 billion with a large selective element - a combination which would make the Chinese fears real. A quota increase at the lower end of the SDR 90-100 billion range, coupled with a limited selective element should just enable the Chinese to hold their position, but it will be close and cannot be guaranteed. A brief with illustrative figures is at Flag .

* Mr Anson has just reported the contrary. It may be the new Indian Central Bank Governor.

Ang ophone Africa

19. We expect Mr Chidzero, Zimbabwe's Finance Minister, to attend. His constituency includes Nigeria and the Sudan. They want a quota increase to at least SDR 100 billion to secure adequate resources for their likely needs. If India and China accept an outcome below SDR 100 billion, the Africans cannot hold out alone. They will want, however, to preserve their share, as far as possible, particularly for fear that their constituency's viability will be threatened. Any adjustment to constituencies will take place in the context of the next biennial election of Executive Directors in 1984 when groups of countries will be trying to garner enough votes to keep their right to elect a Director. We think it desirable to maintain two African constituencies but have no formal say in this.

Australia

20.

G5 ɜeting

21. Mr Regan has arranged a short meeting for Ministers, Deputies and Governors, followed by drinks and dinner. He has suggested discussion should focus on GAB developments since the Paris G10 meeting, the Quota Review and, if necessary, problem countries
... (Telex attached at Flag). We have suggested that Ministers may also need to discuss the follow-up to the Versailles initiative on policy convergence. The results of this could be relayed to the Managing Director when he joins you briefly for drinks.

... 22. A full brief on the GAB is attached at Flag , this suggests that the main outstanding issue is the form of any Saudi participation in the GAB. The Saudis appear eager for a close relationship with the GAB and for involvement in other G10 discussions. Their expectations have been raised that these will be granted. There is perhaps little that either G5 or G10 Ministers can do at this stage to disappoint these expectations too bluntly without the risk of souring the Saudi relations with both the industrial countries and the Fund. The best that we can now aim for is to put the relationship on as prudent a basis as possible.

23. On the Quota Review, G5 positions have not altered significantly since Kronberg. On size, we should take the opportunity to join other G5 members in pressing the United States to be ready to compromise on a quota increase of at least 50 per cent (ie to SDR 92 billion). We and the Germans would be content with this. The French and Japanese would prefer an outcome closer to SDR 100 billion.

24. On distribution, the ranking of G5 countries seems unlikely to change with any of the most likely outcomes on the size of quota increase and its division between equiproportional and selective increases. Germany would only overtake the UK for second place with a Fund size of SDR 100 billion and no equiproportional element. Similarly, Japan would only over-take France for fourth place with a quota increase to at least SDR 95 billion with no equiproportional element.

25. The G5 ranking, therefore, may for all practical purposes be regarded as settled. We should use the G5 meeting to persuade colleagues to narrow their views on the split between the equi-proportional and selective elements in the quota increase. The US, the Germans and ourselves favour limiting the equiproportional element to less than 50 per cent. We are looking perhaps to 30-40 per cent. The French have argued for more than 50 per cent to be allocated equiproportionally. The Japanese have argued for only about 20 per cent. We should press on the French the need for a significant selective element and on the Japanese the need to move closer to a range of figures which may be negotiable with developing countries.

26. [On problem countries, there is no need for urgent G5 discussions at present. A brief is at Flag 7.]

27. On the Versailles follow-up and the general state of the world economy, we are anxious that the ground should be properly prepared for Williamsburg. We are still committed to an overall prudent approach to the management of the economic recovery. We are aware, however, of a need for continued efforts to improve policy co-ordination between major countries. This stems from the need still to reduce the volatility of exchange rates as well as the need to ensure that each country plays its part in sustaining the recovery. These are often related.

28. In the case of the first, greater certainty about the course of US monetary and fiscal policies would be particularly helpful. In that of the second, it will be important that unduly restrictive policies in countries with good inflation, budgetary and external performance (eg Japan) do not hinder recovery. Expectations of better co-ordination are being increased, eg by Mr Sprinkel's inadim-advertent musings aloud in Paris, by M Delors' own call for concerted action, by the Scandinavians' initiative in the OECD and by such outside commentators as the Institute for International Economics in Washington.

26. We do not share the view of those arguing for concerted reflation, but we do believe the OECD Ministers' meeting and the Williamsburg Summit will have to address these issues. The OECD Secretariat is already doing a lot of technical work in this area. In the G5 context, there would seem value in having before Williamsburg a further Ministers' meeting for which the IMF Managing Director should be asked to produce a paper setting out clearly his views on the overall thrust of policies and the scope for a better balance between countries. A detailed brief is at Flag .

Chancellor

The following were at Brit-US Parliamentary Group dinner on 13 Nov;-

Mathias

Percy

Pell

[illegible]

Downer

Which of these did I meet at Brit.US Parly Group dinner at Goodwood?
(Ask Group secretary ~~[illegible]~~ – not C.. MP, who's got – if in doubt)

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TO IMMEDIATE F C O
TELEGRAM NUMBER 69 OF 3 FEBRUARY

I M F INTERIM COMMITTEE
LUNCH WITH CONGRESSMEN

1. AS REQUESTED IN TELCON BOTTRILL/MS RYAN, FOLLOWING IS THE LIST OF SENATORS AND CONGRESSMEN INVITED TO LUNCH ON WEDNESDAY FEBRUARY 9 TO MEET THE CHANCELLOR AND MANAGING DIRECTOR:

SENATE

MATHIAS (R) CHAIRMAN OF THE SUB-COMMITTEE ON INTERNATIONAL ECONOMIC POLICY OF THE FOREIGN RELATIONS COMMITTEE

HEINZ (R) CHAIRMAN OF THE SUB-COMMITTEE OF THE BANKING COMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY

PROXMIRE (D) RANKING MINORITY MEMBER ON THE BANKING COMMITTEE

KASTEN (R) CHAIRMAN OF THE FOREIGN OPERATIONS SUB-COMMITTEE OF THE APPROPRIATIONS COMMITTEE

JEPSEN (R) CHAIRMAN OF THE JOINT ECONOMIC COMMITTEE

PERCY (R) CHAIRMAN OF THE FOREIGN RELATIONS COMMITTEE

PELL (D) RANKING MINORITY MEMBER ON THE FOREIGN RELATIONS COMMITTEE OF INTERNATIONAL ECONOMIC POLICY

DODD (D) RANKING MINORITY ON THE SUB-COMMITTEE OF THE FOREIGN RELATIONS COMMITTEE

GARN (R) CHAIRMAN OF THE BANKING COMMITTEE

HATFIELD (D) RANKING MINORITY MEMBER ON THE SENATE APPROPRIATIONS COMMITTEE

STENNIS (R) CHAIRMAN OF THE SENATE APPROPRIATIONS COMMITTEE

INOUYE (D) RANKING MINORITY MEMBER ON THE SUB-COMMITTEE OF THE APPROPRIATIONS COMMITTEE ON FOREIGN OPERATIONS

HOUSE

NEIL (D) CHAIRMAN OF THE HOUSE BANKING SUB-COMMITTEE ON INTERNATIONAL TRADE, INVESTMENT AND MONETARY POLICY

/ LEACH (R)

LEACH (R) RANKING MINORITY MEMBER OF ABOVE SUB-COMMITTEE

KEMP (R) RANKING MEMBER OF THE APPROPRIATIONS SUB-COMMITTEE ON FOREIGN OPERATIONS

LONG (D) CHAIRMAN OF THE APPROPRIATIONS SUB-COMMITTEE ON FOREIGN OPERATIONS

HAMILTON (D) VICE CHAIRMAN OF THE JOINT ECONOMIC COMMITTEE

ST GERMAIN (D) CHAIRMAN OF THE BANKING COMMITTEE

WHITTEN (D) CHAIRMAN OF THE APPROPRIATIONS COMMITTEE

CONTE (R) RANKING MEMBER OF THE APPROPRIATIONS COMMITTEE

WYLIE (R) RANKING MEMBER OF THE BANKING COMMITTEE.

2. F C O PLEASE ADVANCE TO PS/CHANCELLOR OF THE EXCHEQUER, LITTLER AND BOTRILL (TREASURY)

ANSON

ADVANCED AS REQUESTED

MONETARY
ERD

CONFIDENTIAL

GRS 600
CONFIDENTIAL
DESKBY BOTH 070900Z
FM WASHINGTON 042255Z FEB 83
TO IMMEDIATE FCO
TELEGRAM NUMBER 298 OF 4 FEBRUARY
AND TO IMMEDIATE UKREP BRUSSELS

2

IMF INTERIM COMMITTEE

1 I CALLED ON SECRETARY REGAN THIS AFTERNOON AND DELIVERED THE PERSONAL MESSAGE FROM THE CHANCELLOR OF THE EXCHEQUER WHICH WAS SENT HERE BY TELEX ON WEDNESDAY AND CONFIRMED BY TELEPHONE BY THE TREASURY YESTERDAY MORNING.

2. REGAN WAS GRATEFUL FOR THIS MESSAGE AND SAID THAT HE AGREED WITH PARAGRAPHS 1-3. HE WAS HAPPY TO HAVE THE CHANCELLOR'S VIEWS ON PARAGRAPH 4 (IMPORTANCE OF ADEQUATE INCREASE IN QUOTAS, AND MEETING WITH CONGRESSIONAL LEADERS). HE WAS GRATEFUL FOR THE REMARKS IN PARAGRAPH 5 ABOUT THE BUDGET PROPOSALS RECENTLY ANNOUNCED BY THE ADMINISTRATION. HE SAID THAT HE WOULD LET THE CHANCELLOR KNOW ON PARAGRAPH 6 WHICH SUGGESTED THAT HE, THE CHANCELLOR AND THE MANAGING DIRECTOR MIGHT MEET PRESIDENT REAGAN AFTER THE INTERIM COMMITTEE. THE SAME THOUGHT HAD OCCURRED TO REGAN INDEPENDENTLY, BUT IT WOULD OBVIOUSLY DEPEND ON THE PRESIDENT'S SCHEDULE, ESPECIALLY AS IT WOULD BE A FRIDAY AFTERNOON.

3. REGAN ADDED THAT HE WAS GLAD ARRANGEMENTS HAD BEEN MADE FOR HIM TO MEET THE CHANCELLOR BEFORE THE INTERIM COMMITTEE. HE WAS HOPING THAT THIS WOULD BE A ONE-ON-ONE MEETING, AT WHICH HE COULD MENTION SOME OF THE IDEAS HE INTENDED TO BRING UP AT THE G5 DINNER. IN ADDITION TO EXCHANGING VIEWS ON THE IMF QUOTAS AND THE GAB, HE WANTED TO DISCUSS THE CURRENT OIL CRISIS, AND HOW WE WOULD PERFORM IF THE POSITION GOT MORE DIFFICULT. IF THE PRICE WAS TO FALL FURTHER, HE HOPED THAT THIS WOULD NOT HAPPEN PRECIPITOUSLY, BUT THE MARKET MIGHT NOT SEE IT THAT WAY. HE WAS INTERESTED AT THE WAY IN WHICH, FOR EXAMPLE, THE RUSSIANS AND THE EGYPTIANS HAD DROPPED THEIR PRICES SO QUICKLY. POLITICAL LEADERS WOULD BE LOOKING TO FINANCE MINISTERS FOR SOLUTIONS, AND HE WOULD RATHER HAVE A GAME PLAN THAN IMPROVISE.

4. ON THE PROSPECTS FOR THE BUDGET, REGAN OBSERVED THAT THE ECONOMIC PROJECTIONS WHICH HAD BEEN DEVISED TO AVOID ANY CRITICISM OF OVER-OPTIMISM HAD, IN HIS VIEW, ERRED ON THE SIDE OF OVER-PESSIMISM. FELDSTEIN WAS ALREADY INCLINING TO TAKE A SIGNIFICANTLY LESS PESSIMISTIC VIEW, IN WHICH CASE THE PROJECTED DEFICIT MIGHT BE CONSIDERABLY LOWER.

5. ON THE LUNCH WITH CONGRESSIONAL LEADERS, HE MENTIONED THAT THIS WAS PART OF A LARGER CAMPAIGN, ESSENTIALLY TO GET THEM TO RECOGNISE THAT THERE WAS A DIFFERENCE BETWEEN THE IMF, AND BODIES LIKE IDA AND AID.

CONFIDENTIAL /6.

Hu! So maybe we should not go overboard on IDA this time!

6. AS REQUESTED IN TELECON LITTLER/ANSON, WE HAVE SEPARATELY ASKED THE U S TREASURY FOR SOME NOTES ABOUT THE KIND OF POINTS WHICH THE CONGRESSIONAL LEADERS HAVE ALREADY RAISED IN PREVIOUS DISCUSSIONS WITH THE U S TREASURY. THESE WILL BE AVAILABLE WHEN THE CHANCELLOR ARRIVES. THE KEY POINTS, APART FROM THE ONE MENTIONED BY REGAN ARE: ANTIPATHY TO THE BANKS (WHY SHOULD WE BAIL THEM OUT?): GENERAL ANTIPATHY TO LDC'S: AND OBJECTIONS TO GIVING MONEY EITHER TO INTERNATIONAL INSTITUTIONS OR TO LDC'S WHEN THERE ARE PRESSING NEEDS AT HOME.

7. FCO PLEASE ADVANCE TO BOTTRILL (TREASURY), WHO MAY WISH TO PUT IN HAND BRIEFING FOR THE CHANCELLOR ON THE ENERGY MATTERS IN PARAGRAPH 3 ABOVE IF THIS IS NOT ALREADY COVERED BY EXISTING BRIEFING MATERIAL. UKREP BRUSSELS PLEASE PASS TO CHANCELLOR AND LITTLER, ATTENDING THE ECOFIN MEETING.

WRIGHT

MONETARY
ERD

(ADVANCED AS REQUESTED)

FROM: A R H BOTTRILL
DATE: 4 FEBRUARY 1983

CHANCELLOR

cc Sir D Wass
Mr Littler
Mr Burns
Mr Unwin
Mr Lavelle
Mr Odling-Smee
Mr Hall
Mr Atkinson
Mr Graham

PS/Governor (B/E)
Mr Anson (UKDEL/IMF)

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Tactics for the Interim Committee

7. The central objective is to reach agreement, if possible on Thursday, on the size of the increase in quotas, and its distribution. It is probably easiest to decide these in two stages, although the issues are inter-related. Briefly, the larger the quota increase the greater is the change in members' shares for a given split between the equiproportional and selective elements of the increase. A brief is at Flag D.

8. On the size of the Fund our approach to Governors envisaged a settlement within the range SDR 85-100 billion. The prime determinant is the US view. It is unlikely that they will stick to their minimum of SDR 85 billion or concede an increase much if anything in excess of 50 per cent. Given the US blocking vote, others in the last resort will have to come in line - which probably implies a settlement in the SDR 90-95 billion range. This will leave LDCs disappointed about the resources likely to be available to the Fund and about the level of their own quotas - although it typically reduces the erosion of their share for any given distribution method. At the same time, a low quota size will leave the Japanese concerned about their ability to secure a larger portion of the smaller cake. These issues will be reflected in the discussion of distribution.

9. On distribution the approach to Governors quoted a middle range of 25-40 per cent for the share of the quota increase to be allocated equiproportionally. The Japanese would prefer a figure at the very bottom of this range or below, and some LDCs would prefer a figure of 50 per cent or more. Most of the industrials, however, would be content with a settlement in this area. The Fund have suggested that in your opening statement you should leave the range at 20-50 per cent. The initial objective should be to narrow this to 25-40 per cent and then compromise between LDCs and Japan.

10. There are a number of issues allied to the central areas for decision whose outcome will be of interest, usually to developing countries. Among these "douceurs" only the question of access seems potentiallya source of problem for the central decisions.

i. Access to Fund resources. This is not mentioned in the report from the Executive Board but seems certain to come up in debate. The neutral and appropriate solution would be to remit the matter to the Executive Board. An admission in the communique that enlarged access would need to continue at least through the Eighth Quota Review would in principle amount to some bow to developing countries' wishes. An admission that the level would not be reduced in cash terms at least initially (or might even be somewhat increased) would extend the concession. But since the tactical preference would be to leave the matter for later resolution, it would be counter-productive to introduce it into the discussion of central issues, although a defensive line as above will be needed if others introduce it.

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15. The morning of Friday, 11 February is likely to be occupied with the communique and may provide the opportunity for a modest discussion on the world economic outlook, as well as tying up loose ends.

Preparatory meetings

16. The discussions with Mr Houtven and the Managing Director on Wednesday morning will provide an opportunity to consider some of the Interim Committee tactics in more detail, including the optimum positioning of statements by the US and any reliable intervener (such as Mr Littler for the UK). The EC statement which will be delivered by Germany (Stoltenberg probably) might be a useful early contribution if we can secure at Ecofin on Monday that it is reasonably close to the compromise outcome which we think negotiable. Other Washington meetings are discussed below. Annotated country interests are at Flag F.

India

17. We expect Mr Mukherjee to attend. We asked our High Commissioner in Delhi to sound out the Indians before the Interim Committee date was announced, and they supported bringing it forward. They should now be persuaded to make it a success. They have a key role as leading LDC. They would prefer a larger Fund, but could probably accept a settlement between SDR 90-100 billion. They want to protect their quota and therefore favour a large equiproportional element in any increase. They need to be persuaded of the importance of a significant selective element if quotas are to reflect more nearly relative economic positions. They have not mentioned access, but if they do they will need to be offered at least a review in the Executive Board. They are one of the countries most likely to argue for a guarantee of no reduction in nominal access or even a modest increase. See
...2 briefs at Flag G on India and at Flag D on quotas.

China

18. We expect Shang Ming, Adviser at Vice President level of the People's Bank, to attend. The Chinese would prefer a large quota increase but would probably accept SDR 90-100 billion. Their request to see the Chancellor, however, probably stems from their fear of being overtaken by the Netherlands for ninth place. They may have been unduly influenced by neighbouring Japan which has been arguing for a quota increase close to SDR 100 billion with a large selective element - a combination which would make the Chinese fears real. A quota increase at the lower end of the SDR 90-100 billion range, coupled with a limited selective element should just enable the Chinese to hold their position, but it will be close and cannot be guaranteed.
... A brief with illustrative figures is at Flag H.

Anglophone Africa

19. We expect Mr Chidzero, Zimbabwe's Finance Minister, to attend. His constituency includes Nigeria and the Sudan. They want a quota increase to at least SDR 100 billion to secure adequate resources for their likely needs. If India and China accept an outcome below SDR 100 billion, the Africans cannot hold out alone. They will want, however, to preserve their share, as far as possible, particularly for fear that their constituency's viability will be threatened. Any adjustment to constituencies will take place in the context of the next biennial election of Executive Directors in 1984 when groups of countries will be trying to garner enough votes to keep their right to elect a Director. We think it desirable to maintain two African constituencies but have no formal say in this.

Australia

20. We expect Mr Howard, the Treasurer, to attend. Our reason for seeing him is partly Commonwealth courtesy but also because his constituency includes several small islands (Seychelles, Solomons, Vanuatu and Western Samoa). The Solomons in particular has argued for special treatment for small members. It is important that the issue is settled at the Interim Committee, otherwise it could both delay implementation of the Quota Review and risk others seeking special treatment. One solution might be to round up all quotas to the nearest SDR 0.5 million suggested above. Does Mr Howard have a better one? Australia's position on the Quota Review as a whole is close to our own and flexible. Their Executive Director has kept them in touch with GAB discussions but they have voiced no desire to join. It would be complicated to incorporate them at this late stage, and could make the Saudi negotiations even trickier. Nevertheless, Australia could become a parallel creditor. If interested they should take it up with the Managing Director. Brief at Flag K.

G5 Meeting

21. Mr Regan has arranged a short meeting for Ministers, Deputies and Governors, followed by drinks and dinner. He has suggested discussion should focus the GAB, the Quota Review and, if necessary, problem countries (telex attached at Flag L). We have suggested that Ministers may also need to discuss the follow-up to the Versailles initiative on policy convergence. The results of this could be relayed to the Managing Director when he joins you briefly for drinks.

22. On the GAB, the Executive Board has now discussed the final form of the necessary decision for the G10 participants (and Switzerland). An umbrella enabling clause has been included to allow for various arrangements with parallel creditors. This should allow more time for discussions with the Saudis. Mr Littler's record of the recent London talks is at Flag Q. We should be prepared perhaps to accept Saudi participation at the second window for lending to the Fund with voting rights, but not be ready to admit them to the first window for lending to individual GAB participants unless they are prepared to forgo any right to opt out. Occasional Saudi attendance at G10 meetings by invitation should cause us no difficulty. What do other G5 think? It is important to remember that the Saudis have expectations of a close relationship. Any reluctance now by G5/G10 would need to be made clear to them so that any communique language is not based on a misunderstanding.

23. On the Quota Review, G5 positions have not altered significantly since Kronberg. On size, we should take the opportunity to join other G5 members in pressing the United States to be ready to compromise on a quota increase of at least 50 per cent (ie to SDR 92 billion). We and the Germans would be content with this. The French and Japanese would prefer closer to SDR 100 billion.

24. On distribution, the ranking of G5 countries seems unlikely to change with any of the most likely outcomes on the size of quota increase and its division between equiproportional and selective increases. Germany would only overtake the UK for second place with a Fund size of SDR 100 billion and no equiproportional element. Similarly, Japan would only overtake France for fourth place with a quota increase to at least SDR 95 billion with no equiproportional element.

25. The G5 ranking, therefore, may for all practical purposes be regarded as settled. We should use the G5 meeting to persuade colleagues to narrow their views on the split between the equiproportional and selective elements in the quota increase. The US, the Germans and ourselves favour limiting the equiproportional element to less than 50 per cent. We are looking perhaps to 30-40 per cent. The French have argued for more than 50 per cent to be allocated equiproportionally. The Japanese have argued for only about 20 per cent. We should press on the French the need for a significant selective element and on the Japanese the need to move closer to a range of figures which may be negotiable with developing countries.

26. On problem countries, there is no need for urgent G5 discussions at present. A brief is at Flag M.

27. On the Versailles follow-up and the general state of the world economy, we are anxious that the ground should be properly prepared for Williamsburg. We are still committed to an overall prudent approach to the management of the economic recovery. We are aware, however, of a need for continued efforts to improve policy co-ordination between major countries. This stems from the need still to reduce the volatility of exchange rates as well as the need to ensure that each country plays its part in sustaining the recovery. These are often related.

28. In the case of the first, greater certainty about the course of US monetary and fiscal policies would be particularly helpful In that of the second, it will be important that unduly restrictive policies in countries with good inflation, budgetary and external performance (eg Japan) do not hinder recovery. Expectations of better co-ordination are being increased, eg by Mr Sprinkel's inadimadvertent musings aloud in Paris, by M Delors' own call for concerted action, by the Scandinavians' initiative in the OECD and by such outside commentators as the Institute for International Economics in Washington.

26. We do not share the view of those arguing for concerted reflation, but we do believe the OECD Ministers' meeting and the Williamsburg Summit will have to address these issues. The OECD Secretariat is already doing a lot of technical work in this area. In the G5 context, there would seem value in having before Williamsburg a further Ministers' meeting for which the IMF Managing Director should be asked to produce a paper setting out clearly his views on the overall thrust of policies and the scope for a better balance between countries. Detailed briefs on the
...2 world and US economies are at Flags N and O.

G10 Ministers/Deputies' meeting

27. These meetings were arranged essentially to give an opportunity to review any further developments in the GAB discussions with Saudi Arabia and to prepare the industrial countries' position more generally for the Interim Committee. Mr Littler's note of the meeting in London on January with the Saudis is attached at
... Flag Q. In the event, the Executive Board has now discussed a final version of the GAB decision containing an enabling clause which leaves open the form of association with the Saudis.

28. There are still issues of substance to be resolved on whether the Saudis participate at both first and second windows, how their role in any decision-making is to be organised, what access they will have themselves to GAB resources and how close their association generally with G10 discussions is to be. It seems unlikely that the G10 meetings in Washington will be able to address these adequately, but matters may become clearer if the Saudis indicate their own thinking. An indication in the communique of Saudi intent to provide resources alongside the GAB - with details to be settled later - might be the best way forward.

29. On the quota increase, the Chancellor will be looking first to G10 colleagues to persuade the Americans to raise their sights on the overall rise to at least 50 per cent. On distribution, the group as a whole will want to argue for an adequate degree of selective increase in order to improve their own position - although not to the extent of jeopardising LDC support for the
... package as a whole. See quotas brief at Flag D.

President Raegan

34. We have still not heard whether President Reagan will be able to see you. If he is able to, this will now need to be prepared on the spot. The US Press unfortunately - with White House prompting - might well present the whole IMF exercise as an all-American initiative to rescue the world economy. Nevertheless, this may be a price to pay for identifying the Administration wholeheartedly with the package.

A. Bottrill

A BOTTRILL

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

ICMS/Doc/83/1

January 14, 1983

INTERNATIONAL MONETARY FUND

INTERIM COMMITTEE OF THE BOARD OF GOVERNORS ON THE INTERNATIONAL MONETARY SYSTEM

There follows the agenda for the twentieth meeting of the Interim Committee, which is to be convened at 10:00 a.m., on Thursday, February 10, 1983, in the Eugene Black Auditorium at the World Bank Building in Washington, D.C.

AGENDA

1. Adoption of Agenda

2. Approval of Minutes of Nineteenth Meeting (September 4, 1982)

* 3. World Economic Outlook

* 4. Fund Resources:

   a. Increase in Quotas under the Eighth General Review

   b. Enlargement and Revision of the General Arrangements to Borrow

5. Other Business

6. Press Communiqué

* The intention is to take up items 3 and 4 together. Members are invited, therefore, to present their remarks on Items 3 and 4 in a single intervention.

cc PS/Chancellor ✓
Mr Burns
Mr Lavelle
Mr Hall
Mr Atkinson

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RESTRICTED

FM UKDEL IMF/IBRD WASHINGTON 042214Z FEB 83

TO PRIORITY FCO

TELEGRAM NUMBER 75 OF 4 FEBRUARY

IMF: INTERIM COMMITTEE

1. FOLLOWING IS THE LATEST VERSION OF THE PROGRAMME FOR THE CHANCELLOR'S VISIT FOR THE INTERIM COMMITTEE, FEBRUARY 6-11.

TUESDAY, FEBRUARY 8

16.15 MR LITTLER, MR LAVELLE, MR HALL AND MR GILCHRIST ARRIVE DULLES AIRPORT ON BA 277

20.00 CHANCELLOR, MR BURNS AND MR KERR ARRIVE NATIONAL AIRPORT ON PAN AM 887

WEDNESDAY, FEBRUARY 9

[? 07.15] CHANCELLOR'S APPEARANCE ON ABC TV QUOTE GOOD MORNING AMERICA UNQOUTE, 1717 DE SALLES STREET NW

08.45 REGISTRATION FOR PARTICIPANTS, IMF ENTRANCE HALL

09.00 MR LEO VAN HOUTVEN (IMF SECRETARY) TO CALL ON CHANCELLOR IN HIS IMF OFFICE (ROOM 12-300H, TEL.NO. 477 8184)

09.15 MANAGING DIRECTOR TO CALL ON CHANCELLOR (ROOM 12-300H)

? 11.00 CHANCELLOR TO BRIEF UK PRESS

11.50 GOVERNOR AND MR LOEHNIS ARRIVE NATIONAL AIRPORT (SHUTTLE FROM NEW YORK)

12.00 MR SHANG MING, CHINESE MEMBER OF INTERIM COMMITTEE, ACCOMPANIED BY MR ZHANG (IMF EXECUTIVE DIRECTOR), MME. HE (DEPUTY DIRECTOR, DEPARTMENT OF INTERNATIONAL ORGANISATIONS AND CONFERENCES) AND MR ZHANG (INTERPRETER)

12.30 SECRETARY REGAN TO CALL ON THE CHANCELLOR IN ROOM 12-300H

13.00 CHANCELLOR TO LUNCH WITH SECRETARY REGAN TO MEET SENATORS AND CONGRESSMEN (IMF 2ND FLOOR, MD'S DINING ROOM). MANAGING DIRECTOR AND MEXICAN AND BRAZILIAN FINANCE MINISTERS WILL BE PRESENT.

NOW 11.00 ~~? 15.30~~ MR B T CHIDZERO, ZIMBABWEAN MEMBER OF THE INTERIM COMMITTEE (MINISTER OF FINANCE) TO CALL ON CHANCELLOR (ROOM 12-300H)

? 16.00 DR MANMOHAN SINGH, INDIAN MEMBER OF INTERIM COMMITTEE (CENTRAL BANK GOVERNOR) TO CALL ON CHANCELLOR (ROOM 12-300H)

17.00 G5 MEETING AT BLAIR HOUSE

18.30 G5 TO MEET WITH MANAGING DIRECTOR AT BLAIR HOUSE FOR DRINKS

19.00 G5 WORKING DINNER AT BLAIR HOUSE

[? 21.30] G10 DEPUTIES MEETING (IF NECESSARY) IN IMF BOARD ROOM, 12TH FLOOR

THURSDAY, FEBRUARY 10

08.30 G10 MINISTERS MEETING, IMF BOARD ROOM, 12TH FLOOR

RESTRICTED /10.00

(P.T.O).

10.00 INTERIM COMMITTEE MEETING, EUGENE BLACK AUDITORIUM, WORLD BANK 'C' BUILDING, 11TH FLOOR (ENTRANCE THROUGH E BUILDING--ACROSS FROM IMF)

13.00 CHANCELLOR'S LUNCH FOR INTERIM COMMITTEE MEMBERS (MANAGING DIRECTOR'S DINING ROOM, 2ND FLOOR)

15.00 INTERIM COMMITTEE RESUMES

20.00 CHANCELLOR'S WORKING DINNER FOR INTERIM COMMITTEE MEMBERS AT THE F STREET CLUB, 1925 F STREET NW (TEL: 331 0020)

FRIDAY, FEBRUARY 11

10.00 INTERIM COMMITTEE

AFTER CONCLUSION OF MEETING: CHAIRMAN'S PRESS CONFERENCE WITH MANAGING DIRECTOR

13.00 G7 DEPUTIES MEETING

20.45 CHANCELLOR, AND MESSRS. BURNS, LITTLER, KERR, LAVELLE, HALL, AND MR LOEHNIS, DEPART DULLES ON BA 276.

2. FCO PLEASE ADVANCE TO P/S CHANCELLOR, LITTLER, LAVELLE (TREASURY), P/S GOVERNOR, LOEHNIS AND GILCHRIST (BANK OF ENGLAND), T BURNS (TREASURY)

ANSON

MONETARY D

ERD

(ADVANCED AS REQUESTED)

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233-3415
Telex 262405

4 February 1983

IMF INTERIM COMMITTEE

Attached is a statement made by the Chancellor of the Exchequer, Sir Geoffrey Howe QC MP, at a briefing for journalists today on the meeting of the Interim Committee of the International Monetary Fund to take place in Washington on 10-11 February.

PRESS OFFICE
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33/83

NOTE FOR EDITORS

This will be the first meeting of the Interim Committee since the Chancellor was elected Chairman of the Committee in December.

THE IMF INTERIM COMMITTEE MEETING IN WASHINGTON, 10-11 FEBRUARY

/Statement by the Chancellor of the Exchequer: 4 February/

The meeting of the Interim Committee next week will focus on a practical issue: an increase in resources directly available to the Fund from quotas and their distribution. At the same time it provides an opportunity for member countries to take stock of the outlook for the world economy.

2. The two issues are linked. We must manage world economic recovery so that it is sustained without rekindling inflation. We must ensure that countries with severe debt problems are restored to economic health.

3. The past two years of transition from high inflation have seen a major increase in demands on Fund resources - both its so-called 'ordinary resources', based on the quotas subscribed by members, and its borrowed resources. Fund lending rose to record levels in 1981 with net commitments of over SDR 12 billion. At present there are over 20 operative stand-by arrangements and seven agreements for extended financing, together totalling nearly SDR 18 billion. In recent months there have been a number of new approaches to the Fund, in particular by major Latin American countries.

4. It is clear that the Fund will continue to perform a central role in the global adjustment process as the world moves out of recession. So it is essential that it should have the resources it needs.

5. The decision to advance the timing of the Interim Committee is one indication of the importance attached by the international community to this issue. A major first step towards the replenishment of Fund resources was taken by the G.10 countries in Paris last month. GAB arrangements were increased by over

SDR 10 billion: and it was agreed to make credits available to the Fund for lending to non-participants if major payments imbalances threaten the stability of the international monetary system. I am hopeful that other countries, such as Saudi Arabia, may also feel it right to associate themselves with these arrangements in due course.

6. I spoke in Toronto last September about the role of the Fund in providing an orderly framework within which private capital flows can take place. It does not displace them but can act as a catalyst for their continuation. I do not see its role simply as lender of last resort: members should approach it where possible at an early stage. The Fund's facilities have also evolved to reflect the fact that structural maladjustments take time to correct. We have to strike a balance between this and the revolving character of the Fund's resources.

7. How much increase in resources does the Fund need? In my capacity as UK Governor I have spoken of at least 50 per cent. Some have argued for less and some for a good deal more. The firm decision reached on the extension of the GAB should have narrowed this range. If adjustment is successful, the scale of payments imbalances we have seen in recent years should fall. If events do not follow that course it would, in my view, be right to augment resources by borrowing - just as the Fund will need to continue to do until the new arrangements are in place. But we do need a substantial increase in quotas before long, and my own view of the required scale is unchanged.

8. As regards the distribution of quota increases, we need to reach an agreement which is uniform, fair and systematic. The outcome must maintain progress towards a reflection of members' positions in the world economy, but also seek to do so in an orderly and balanced way.

9. Earlier this week I set out the role of the Fund within a four-point strategy for global recovery. The issues for decision next week are not straightforward. There are still significant

differences among member countries on how they should be resolved, and there is a lot of hard bargaining still to be done. But I believe there is a widespread recognition of the need to reach agreement. I take encouragement from that.

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India	G
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Brief for bilaterals

Background briefs

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IMF liquidity	-
US Congressmen	- (sep folder)

Larosière's reappointment

Effects of lower oil prices (relevant to G5)

Eighth Quota Review

Chairman's points to make

1. In proposing that Interim Committee meeting be accelerated, I took into account:

a. the importance for international confidence of a substantial increase in Fund resources;

b. the widespread political will to reach agreement;

2. Managing Director to be congratulated on progress made in Executive Board since Toronto:

a. further narrowing of views on the size of quota increase (para 6 of Director's Report);

b. agreement that increases will be distributed uniformly and without abrupt changes to quota shares and that calculated quotas should be the key for the selective element of the increase (paras 8 and 10);

c. provisional agreement that 25 per cent of the quota subscription should be paid in reserve assets (para 18).

The G10 has made very rapid progress in agreeing proposals to enlarge and extend the function of the GAB in response to the remit from Toronto (final para).

3. Objectives for the Interim Committee meeting are:

a. to agree a single figure for the quota increase;

b. to reach final agreement on how it will be distributed, how it will be subscribed for, and understandings on the timetable for ratification;

/c. to give guidance to the Executive Board on the other areas for further study in the period up to the Annual Meetings7.

4. On size and distribution of quota increase, recognise that flexibility will be needed on all sides. Have suggested that discussion on <u>size</u> is likely to be focused on the range SDR 85-100 billion, and that on <u>distribution</u> while there is a wide spectrum of views, there is a substantial body of opinion in the middle supporting an equiproportional element of 25-40 per cent. In no way wish to constrain discussion, but believe that eventual outcomes are likely to be in the middle ground, and therefore particularly interested in hearing Committee's view on the middle ground.

<u>UK line</u>

5. UK advocated increase of at least 50 per cent in quotas at Toronto, based on a careful assessment of Fund needs during 1980s. Since then -

a. several large countries have sought major Fund programmes, straining the Fund's present liquidity.

b. need for Fund-supported adjustment may spread to oil exporters;

c. there are question marks over future levels of commercial recycling;

On the other hand -

d. GAB increase and extension will be helpful in ensuring adequate contingent resources in times of crisis;

e. Good progress is being made in reducing current account imbalances. (Most LDCs are now pursuing vigorous adjustment);

g. acceleration of this review automatically accelerates Ninth Review so 1989 lending can be financed from next quota increase, not this one. Though distant, this is not insignificant.

6. On balance, we stick by our Toronto assessment that an increase of at least 50 per cent is appropriate.

7. On distribution, our preference is for all the increase to be distributed in line with calculated quotas, but recognise that this goes too far too fast for some. We could accept an equiproportional element in the 25-40 per cent range. Not unreasonable that actual quota shares should move 20 per cent along the road to calculated quota shares, with the possibility of further movement at next review.

8. Attach high importance to uniformity of treatment. Recognise that very small countries often face peculiarly intractable problems, but not convinced that special quota increase is the right answer. Nevertheless, willing to look sympathetically at methods of helping them providing they can be uniformly applied to all members. /One method might be to round up final quotas to the nearest SDR 0.5 billion rather than to SDR 0.1 billion as at present7.

BACKGROUND

1. The views of individual constituencies on Size and Distribution are set out in a separate brief. Changes in quotas require an 85 per cent majority. The position of the US, who hold 20 per cent of the voting power, is therefore crucial.

Size of Quota increase

2. The US public position is to limit the quota increase to SDR 85bn, on the grounds that the LDC imbalances will fall to sustainable levels more rapidly than most imagine. But they indicated privately to us that they would be prepared to move to SDR 90bn and possibly a little bit more (by which we understand them probably to mean a 50 per cent increase to SDR 91.6bn). It will be crucial to discover before the meeting whether this is their absolute sticking-point. There are press reports, for example, of Secretary Regan's appearance before the House Banking Committee just before Christmas in which Regan was reported as having talked about an extra $40bn (implying at December exchange rates about SDR 97½bn). This led several LDCs at the time, the Indians in particular, to hope that the US might rise to SDR 100bn. It will be important that false LDC hopes are dispelled early in Washington before entrenched positions are taken in the Interim Committee itself.

3. In recent weeks the financial press and others have tended to focus more and more on the probability of a 50 per cent increase. Expectations would certainly be jolted if the US refused to go even this far. In such circumstances the political damage to the Fund of US intransigence would be at least as severe as the financial shortfall. If the US went to SDR 90bn, one could no doubt blur the distinction between SDR 90bn and a 50 per cent increase. If, for Congressional reasons or otherwise, the US administration hesitates to agree even SDR 90bn, then the prospects of Interim Committee agreement are greatly jeopardised. In such circumstances, a consensus <u>might</u> still be achieved if the US Administration were to concede instead a small SDR allocation (which Congress may be less able to block) or alternatively agree to accelerate quite significantly the timing of the Ninth Review, but these fallbacks should be explored only as a last resort.

4. As regards other Interim Committee members, the Germans and ourselves are clearly and of long-standing in the SDR 92-100bn range. We have said "at least 50 per cent". The Germans have said that 50 per cent is the upper end that could reasonably be justified but they are prepared to add on a safety margin up to SDR 100bn: in private they have indicated in G5 that they regard anything below SDR 90bn as unrealistic.

5. Until recently most Executive Directors (apart from US, Germany and UK) had been publicaly advocating an increase in Fund size to SDR 100-125bn, although privately most G10 were signalling acceptance of SDR 90-100bn. But this view did not take into account the prospect of a GAB enlargement nor, the possible 18-month acceleration of both this and the Ninth Review. If the increase in the GAB (from SDR 6½bn to SDR 17bn) is taken into account, the divergence of view on the total resources available to the Fund is considerably narrowed. This is particularly so in respect of the useable addition to Fund resources: only about half a quota increase would be in useable currencies, but most of a GAB increase is likely to be useable. Moreover, while acceleration of the present quota Review does not itself affect the appropriate size of the quota increase, it does mean that the next quota increase is accelerated. The Americans have spoken about the Ninth Quota Review being implemented by the end of 1988, a year earlier than might have been expected, and this would mean that 1989 drawings (of say about SDR 5bn) could be financed out of the Ninth Review, rather than out of the present one.

6. These considerations seem to have been instrumental in persuading many Directors to lower their sights to SDR 90-100bn. Larosiere's view is that it would be easier to get a more enthusiastic response if we could get a result somewhat higher than SDR 90bn. This figure was a bit tight (we agree) but he thought that even SDR 90bn would do in the last resort.

Nevertheless, and in spite of the Chancellor's request to colleagues to be flexible, the possibility remains that one or more Governors may conceivably take a strong stand against accepting an increase to less than SDR 100bn. If the gap between them and the US is otherwise unbridgeable, it could be worth exploring a two-stage quota increase - say, to SDR 85bn in 1984 and a further SDR 15bn in 1986; but this should be a last resort).

7. Assuming a willingness on all sides to look for a compromise outcome, there are not many obvious figures within the SDR 90-100bn range around which views might coalesce. The most likely are:

SDR billion	
91.6	50 per cent increase in quotas
95.0	mid-point between SDR 89bn and SDR 100bn
97.5 (approx)	a $40bn increase.

8. We continue to believe there is a sound intellectual basis for figures in this range. Studies earlier this year suggested that LDC requirements would be covered by a quota increase to SDR 90-100bn. Since then our estimate of LDC demands upon Fund resources in the mid- to late-1980s has somewhat altered qualitatively, though we emerge with the same range as before. The probable pattern is for LDC deficits to be rather lower than we expected (reflecting more rapid adjustment by Latin American economies) but for the Fund to finance a rather larger share of them (reflecting lower growth of commercial bank lending).

Distribution of Quota increase

9. The Executive Board has reached a consensus that the method of selecting adjusting quota shares will be to distribute some (or conceivably all) of the quota increase pro-rata with calculated shares. This is "Method 3", or "the Australian" approach, which we have been consistently advocating.

10. The effect of different mixes of equiproportional/selective increases for various sizes of Fund in the range of SDR 90-100bn is set out in the attached tables. There are a number of points worth noting:

a. Up to SDR 92bn, the ranking of the top five countries is unchanged even if all the quota increase is distributed selectively, and it remains unchanged up to SDR 100bn with even a very small equiproportional element. The ranking of the top five is thus unlikely to be disturbed.

b. Of the G10 members, all stand to gain quota share with the exception of Canada, US and UK, who, in increasing order, stand to lose it.

c. For any given mix of equiproportional/selective increase, the shift in quota shares will tend to be greater, the larger is the overall increase in quotas. On a 50/50 split for example, the NOLDCs lose more quota share with a quota increase to SDR 100bn than if the increase is limited to SDR 90bn.

The term "adjustment coefficient" measures the percentage shift of actual quota shares towards the goal of calculated quota shares. (Adjustment coefficients are a useful concept for those who wish to settle the distribution issue independently of a decision on the size of the Fund. In practice, however, although size and distribution are being considered in conjunction, a decision on size is likely to emerge first, whereupon the distribution issue becomes a straightforward question of how much of the specified quota increase is to be distributed equiproportionately and how much selectively).

11. Opinions in the Executive Board on the size of the equiproportional element range from 0-75 per cent in predictable fashion. Those with most to lose (Indians, Chinese, Africans) want 75 per cent. Other non-oil LDCs (eg Brazil are looking for

over 50 per cent). (Japan, Germany and Arab oil exporters other than Saudi Arabia) want no equiproportional element at all. In between are the majority of industrial countries and Saudi Arabia who are looking for a 25-50 per cent equiproportional element, with the weight of opinion (including US and ourselves) in the range 25-40 per cent. (For a Fund of SDR 90bn, equiproportional elements of 25 per cent and 40 per cent produce an adjustment coefficient of about 25 and 20 respectively). No-one is suggesting an equiproportional element of between 0 per cent to 20 per cent and it is reasonable to assume that if there is to be an equi-proportional element at all, it will be at least 20 per cent of the total. This seems likely. The Executive Board agreed that each member should receive a "meaningful increase". If there was no equiproportional element the most overshadowed country (Laos) would receive a scarcely " meaningful increase" of between 4 per cent and 6 per cent.

12. The UK has not expressed strong views on the size of the equiproportional element. Our interest in retaining second place suggests that some equiproportional element would be desirable. On the other hand, we want to see an improvement in the quota share of the industrial countries as a group, which suggests that the equiproportional element should not be too large. This gives us a wide measure of flexibility. The US should be similarly placed.

13. However, the range of views is wide, and some of the extreme views are strongly held. In particular, Japan who has been motivated throughout the review by a desire to increase her quota share, may push hard for a low equiproportional increase, particularly if total quotas are to be held to below SDR 100bn. At the other extreme, the two African constituencies are worried that if their already low quota share is significantly reduced they will not be able to muster enough votes to elect their own Director. China is anxious not to be overtaken by Netherlands (this can possibly be accommodated - see separate brief for bilateral meeting). Special (ie non-uniform) treatment is being sought by Iran, and also by Very Small Members. Iran is asking to be allotted to quota increase which she failed to take up after re-

repeated prodding, at the last quota review. If this is pressed at the Interim Committee, it will need to be deflected firmly to the Executive Board for study, outside the context of the General Quota Review and without commitment. The arguments for and against special treatment for Very Small Members are set out fairly fully in the Executive Directors' Report: the suggested handling is discussed at para 20 below.

14. To clinch agreement on distribution, some sweeteners may have to be offered to those with extreme or strongly-held positions. A number of ideas have been canvassed, some promising, others unhelpful. These are discussed below:

15. Agreeing that the Ninth Quota Review should also have a selective element. The Germans have already indicated they will push for this if they judge the equiproportional element in the present quota review is "excessive". Some LDCs (eg Brazil) have also favoured the idea. It seems a sensible way of bringing actual quota shares more into line with calculated quota shares without involving abrupt and hence unpalatable shifts. There is a good precedent for setting the main lines of the next Review so far in advance. The decision that the present review should be the occasion for bringing quotas more into line with relative economic positions was taken in the framework of the last quota review.

16. Smaller size of Fund itself reduces LDC loss of quota share. As noted at para 10(c) above, other things being equal, the larger the size of the Fund the larger the shift in quota shares. Conversely, the smaller the size of the Fund, the more the shift in quota shares is damped down. Thus the Indians, for example, who were pressing for a doubling of quotas to SDR 125bn with 75 per cent of the increase distributed equiproportionally, would have lost the same amount of quota share as under a 50 per cent increase in quotas of which only 37½ per cent is distributed equiproportionally. This could be a telling point if the Indians and other LDCs hesitate to come into the middle ground, but it may provoke the response that what LDCs might have conceded on quota share to secure a large increase in quotas is not on offer if quotas are to rise only to SDR 90bn.

17. Basic votes. Voting power is determined by quotas, but each member also has a Basic Vote equivalent to a quota of SDR 25 million. Basic votes account in aggregate for about 7 per cent voting power, and they disproportionately boost the voting power of smaller members (mainly LDCs). Because the size of the Basic Vote is enshrined in the Articles an 85 per cent majority is required to increase it. LDCs have suggested that Basic Votes might be increased as a means of offsetting the effect of a reduced quota share on LDC voting power. But it is unrealistic to expect the necessary majority could be obtained for changing the Articles. An alternative might be to distribute equally to each member a tranche of quota increase as a surrogate for an increase in Basic Vote. But this would be a transparent attempt to evade the Articles, and cuts across the convention that quotas depict relative economic positions. It is a dangerous road to travel, and should not be encouraged.

18. Representation at Executive Board. Loss of voting power could conceivably jeopardise the maintenance of the existing number of LDC constituencies. More probably it could involve some re-arrangement of the existing constituencies without affecting their number. The constituencies most at risk would be the two African ones, the Argentinian seat, China (a sole-member constituency), and India. The two African constituencies are already unwieldly, each with over 20 members, many of whom are heavily involved with the Fund. Their amalgamation would cause serious practical problems in the Executive Board. Some re-assurance might be offered, therefore, that the Fund is anxious to see two African constituencies continue, irrespective of the reduced voting power they will command. The other constituences in jeopardy should be able to attract additional members.

19. Access to Fund resources. Access is not formally on the agenda of the Interim Committee. It has not been discussed in detail in the Executive Board and Larosiere is anxious to avoid Board discussion until after the main features of the quota review have been determined. How far access is likely to be in the forefront of LDC concerns is difficult to judge at this stage. It

has not been raised spontaneously by any of the LDCs we have consulted. Many of the LDCs who stand to lose quota share have already drawn heavily on Fund resources (eg India, Pakistan, Zambia, Jamaica), and the question of future annual access limits may be rather academic. In these circumstances, there seems little advantage to be gained in pushing access as a bargaining counter, particularly in the light of the subjects complexity. It nevertheless came up in a general way, along the lines of para 5 of the Executive Directors' Report. The Communique might well ask Executive Directors in the period up to the Annual Meeting to study what would be appropriate levels of access. If it would be helpful in achieving consensus on the size of the Fund, the Communique might go further and envisage that, given the rather slower economic recovery than earlier anticipated and the acceleration of the Eighth Quota Review, there will be a continuing need for some Enlarged Access for at least an initial period following implementation of the quota increase. There would probably also be consensus for the view that existing cash access should at least be maintained for the average member. If it would be helpful in achieving consensus on distribution of the quota increase, we could go along with suggestions

that existing cash access to the Fund's conditional facilities should be maintained for those members who stand to lose quota share, even if this means a slightly increased cash access for the average member. The following table shows the increase in cash access for the average member which would be required to ensure that the members named below retained their present access: an increase in Fund size to SDR 90bn has been assumed and three mixes of equiproportional/selective increase are illustrated.

Equiproportional % / Selective %	0 / 100	30 / 70	50 / 50
China	22	15	11
India	29	20	14
Bangladesh	35	23	16
Zimbabwe	32	21	15
Sudan	30	20	14
Tanzania	27	18	13
Laos	43	28	20

This suggests that cash access for the average member would have to be increased by perhaps 20-28 per cent to ensure that the member who stands to lose most quota share (Laos) retains its existing cash access. It would be a very generous concession and might not attract US, German, or Japanese sympathy.

20. Very Small Countries. The suggestion that the 17 countries with quotas of less than SDR 10 million should receive special treatment features prominently in the Executive Directors' Report (para 13). The 17 countries are Belize, St Lucia, Grenada, Antigua Dominica, St Vincent (represented by Canada), Vanuatu, Western Samoa, Solomon Islands, Seychelles (represented by Australia), Guinea-Bissau, Djibouti, Comoros, Cape Verde, Sao Tome (Francophone Africa), and Maldives and Bhutan (represented by Libya/Iraq and India respectively). There is little technical merit in their case. Most are already overendowed with quota relative to their calculated quota share. Their voting power benefits strongly from the existence of Basic Votes. Many of them belong to small constituencies and are therefore adequately represented at the Executive Board. Special treatment for these members, although it would not absorb much of the quota increase and have only a negligible effect on the quota shares of other members, nevertheless cuts across the principle of uniformity. There is however widespread LDC support, and also advocacy from Canada, Australia and France. It is not clear how serious a problem this is likely to be in Washington. A sensible course might be to insist on uniformity and to rule out the concept of a minimum quota, but to seek consensus on the rounding-up of all new quotas once they have been determined. Small members would tend to benefit disproportionately if quotas are rounded up to, say the nearest SDR0.5m rather than to the nearest SDR0.1m as at present LDCs as a group would benefit, but the benefit would be marginal would absorb probably no more than SDR 40 million above the present method of rounding. Another option, rather less neat, would be to agree a safeguard under which the quota of no member would rise by less than SDR 2 million: this would in practice boost the quotas of only the smallest members. Whichever method may be

chosen the key point is to ensure that the decision is taken by the Interim Committee and not remitted to the Executive Board, which would not only delay the preparation of the Resolution to Governors but also leave a loose end that could conceivably be used to unravel the package.

21. Timetable for ratification. The possible timetable for implementation has not been discussed in the Executive Board. It is, however, an important element in the package; and it would be helpful to international confidence, and useful as a lever over slothful members, to get a commitment into the Communique that, say, members will use best efforts to obtain necessary parliamentary ratification by end-1983, and will in any event let the Managing Director know if they foresee any difficulty in obtaining ratification by mid-1984. The Managing Director might be asked to submit regular reports to the Interim Committee and Executive Board on ratification obtained. In the past the quota increase has normally come into effect only when 75 per of the voting power has notified the Board of parliamentary ratification. This so-called "participation" figure is not, however, enshrined in the Articles and could be lowered so as to allow the quota increase to come into effect earlier, if the Fund so decides. This is a point which might be taken up privately with the Managing Director in the first instance.

22. There is merit, in any event, in registering in the Communique the expectation (to which the US has subscribed) that the Ninth Quota Review will be implemented by January 1989. This would ensure that even if the Eight Quota Review slipped in time, work would start in sufficient time to implement the Ninth Quota Review by the date specified. The Communique might also include wording to reflect the discussion at paragraph 7 of the Executive Directors' Report, perhaps along the lines that if the long-term demand upon the Fund's resources appears to be straining the Fund's liquidity, acceleration of the next Review would be one of the options to be considered.

23. Little thought has been given to the timetable for implementing the GAB extension and enlargement. For some, including the UK, primary legislation will be required and it would probably be convenient for most to obtain parliamentary approval for both the quota increase and the revised GAB simultaneously. Nevertheless, the strains on the Fund's liquidity over the next 12 months or so suggest that an earlier implementation of the GAB increase and extension would be very helpful. Barring a General Election we would hope to obtain the necessary UK legislative approval for both quota increase and GAB revision by the end of this year.

FUND SIZE SDR 90bn

Split of equiproportional/selective

	Present	30/70	40/60	50/50
US	20.66	19.79	19.91	20.03
UK	7.19	6.83	6.88	6.93
Ger	5.23	6.12	6.00	5.89
Fr	4.72	5.03	4.98	4.94
Jap	4.08	4.79	4.69	4.59
Ind	61.29	62.49	62.32	62.15
Oil Exp	10.92	11.65	11.55	11.44
No LDC	27.80	25.86	26.13	26.41
Adjust coeff	-	22.5	19.3	16.1

FUND SIZE SDR 92bn

Split of equiproportional/selective

	Present	30/70	40/60	50/50
US	20.66	19.75	19.88	20.01
UK	7.19	6.82	6.87	6.92
Ger	5.23	6.16	6.03	5.91
Fr	4.72	5.04	4.99	4.95
Jap	4.08	4.82	4.71	4.61
Ind	61.29	62.54	62.36	62.19
Oil Exp	10.92	11.68	11.58	11.47
No LDC	27.80	25.78	26.56	26.35
Adjust coeff	-	23.6	20.2	16.8

FUND SIZE SDR 95bn

Split of equiproportional/selective

	Present	30/70	40/60	50/50
US	20.66	19.70	19.83	19.97
UK	7.19	6.80	6.86	6.91
Ger	5.23	6.21	6.08	5.95
Fr	4.72	5.06	5.01	4.96
Jap	4.08	4.87	4.75	4.64
Ind	61.29	62.62	62.43	62.24
Oil Exp	10.92	11.73	11.61	11.50
No LDC	27.80	25.65	25.95	26.26
Adjust coeff	-	25.0	21.5	17.9

FUND SIZE SDR 100bn

Split of equiproportional/selective

	Present	30/70	40/60	50/50
US	20.66	19.60	19.75	19.90
UK	7.19	6.76	6.82	6.88
Ger	5.23	6.29	6.15	6.01
Fr	4.72	5.09	5.04	4.98
Jap	4.08	4.94	4.82	4.70
Ind	61.29	62.74	62.54	62.33
Oil Exp	10.92	11.80	11.68	11.55
No LDC	27.80	25.45	25.78	26.11
Adjust coeff	-	27.3	23.4	19.5

SDRs

Points to make

Chairman's points

(i) Welcome agreement on the method of payment for quota increase (in SDRs or reserve currencies).

(ii) Agree that Executive Board should review changes in global liquidity position and outlook, and continue over the next few months to examine the case for an SDR allocation.

UK line

(iii) We have an open mind about an SDR allocation - but the priority is to secure an increase in the Fund's conditional liquidity, to support adjustment.

Background

1. The Executive Board's discussion of how the 25 per cent hard currency element of the quota increase is to be subscribed is set out at paragraphs 14-18 of this report. There was a consensus that 25 per cent of the quota increase should be subscribed in either SDRs or reserve assets. The granting of this option will need to be included in the Resolution submitted to Governors for a postal vote.

2. In the discussion, 14 Directors took the opportunity to press for new SDR allocations. (France, Canada, Austria, Saudi Arabia, Libya, Iran, India, China, Brazil, Venezuela, Argentina, Indonesia, Nigeria and Guinea). This was the first substantial discussion on allocation since Toronto. G5 (other than France) argued that SDR allocations must be considered against the criteria of global long-term need for liquidity, as prescribed in the Articles, but expressed no views on the merits of an allocation. France and several LDCs have argued that that size of SDR increase should be sufficient to accommodate the reserve asset subscription (ie SDR 7½bn, if quotas are increased to SDR 92bn).

3. When the Chancellor met M Delors on 18 January, the Chancellor made the point that the Saudis, French and British felt there was now beginning to be a stronger case to be made for an allocation, but the US and Germany had yet to be persuaded. In Toronto, the language on an allocation had been strengthened compared to previous references by the Interim Committee: it should be further strengthened now. There should be a commitment to study the question of an allocation. M Delors agreed and said that UNCTAD would certainly call for an allocation. He suggested it should be of the same order as the quota increase. (Note: A 50 per cent increase in SDRs would imply an allocation of about SDR 10 billion). The Chancellor said it would be going too far at the Interim Committee to guarantee an allocation of this size.

4. The Interim Committee will probably not have time for a substantive discussion of the case for an SDR allocation, and the best course is almost certainly to remit it to the Executive Board with a view to returning to the subject at the Annual Meeting in September.

5. The arguments for an SDR allocation include the fact that liquidity shortages have become serious for many countries in recent months. Banks have been increasingly reluctant to lend to major debtors. Foreign exchange reserves for the world as a whole have remained broadly flat over the past two years (end-1980 SDR 325 billion; end-1981 SDR 342 billion; end-1982 SDR 334 billion). This financial stringency has been accompanied by a steep slowdown in world activity and trade, although inflation has fallen faster than expected. If individual countries are reluctant to expand their monetary aggregate for fear of the effect on their exchange rates and banks are not willing to lend, then there may be a case for international action to expand liquidity.

6. On the other side, it may be argued that the main need is for conditional liquidity provided through IMF programmes rather than unconditional liquidity through SDRs. It is also the case that although liquidity has been strained over the past year, interest rates have now fallen and real monetary growth has resumed in the major countries. This, together with recovery in the world economy, should ease developing countries' problems. An allocation of SDRs in early 1984, as the recovery gathers pace, could give a unnecessary impetus to inflationary expectations.

7. The arguments, therefore, are finely balanced - which suggests the need for careful consideration in the Executive Board both as to the need and size of any SDR allocation.

INTERIM COMMITTEE MEMBERS: ANALYSIS OF POSITIONS

This note briefly analyses the positions taken by the various constituencies on the key issues of the Size and Distribution of the Quota increase. Some have no clear position: others have given conflicting indications of where they stand. The flexibility of their positions is assessed (obviously rather subjectively) as follows:

* Flexibility indicated
** Preference indicated - but some flexibility likely
*** Rigidity indicated

US

*** Size: Increase in quotas to be limited to the low end of the SDR 85-100bn range (- not above SDR 92bn?)

* Distribution: Voting power only slightly affected by precise mix. (At SDR 90bn, Nil equiproportional 18.7 per cent; 75 per cent equiproportional - 19.6 per cent). Would support adjustment co-efficient of 20 or slightly above (At SDR 90bn, this implies, say, 30-37 per cent equiproportional).

UK

** Size: At least 50 per cent increase, could accept up to SDR 100bn.

* Distribution: Equiproportional element unlikely to be less than 25 per cent, and probably in 25-40 per cent range.

Germany

** Size: Only 50 per cent increase justifiable, but could include a safety margin up to SDR 100 bn. Have privately indicated reluctance to see less than SDR 90bn.

** Distribution: Prefers 0-25 per cent equipro-portional element, 50 per cent and over would be unacceptable. May press for Ninth Review to contain further quota share adjustments.

France ** Size: Not below SDR 90bn.

** Distribution: Prefers at least 50 per cent equiproportional (the only industrial country this high), but lower equiproportional elements benefits their national position.

Japan ** Size: Prefers above SDR 100bn; but anyway at top end of SDR 85-100bn range.

*** Distribution: Prefers nil equiproportional, has asked Fund for figures based on 20 per cent equiproportional, has privately indicated difficulty with adjustment factor below 20 per cent (ie more than 25 per cent equiproportional with Fund size of SDR 100bn, 37 per cent with Fund size of SDR 90bn).

Canada * Size: Prefers top end of SDR 90-100bn range.

** Distribution: Close to UK position. May lobby for special treatment for very small countries (this constituency contains Caribbean islands).

Australia * Size: As for UK, but rather more flexible. Constituency will not make difficulties.

** Distribution: Flexible about equiproportional/selective split, but likely to press hard for special treatment for very small countries (because of Pacific islands in his constituency).

Italy * Size: Initially sought a doubling of quotas, now probably in upper part of SDR 90-100bn range.

** Distribution: Probably in 25-40 per cent equiproportional range. 50 per cent and above would be unacceptable.

Netherlands	*	Size: In SDR 90-100bn range.
	*	Distribution: Inclines towards nil or low equi-proportional element.
Belgium	**	Size: In upper part of SDR 90-100bn range. SDR 90bn "insufficient".
	*	Distribution: Reasonable equiproportional element acceptable, but should not go too far. 25-50 per cent equiproportional indicated.
Nordics	*	Size: Prefers SDR 100bn, but quite flexible.
	*	Distribution: Leans towards low equiproportional element to help Japanese. Otherwise they are not greatly affected directly and could accept any reasonable proposal.
Saudi Arabia	*	Size: Prefer SDR 100bn, but would settle even for lower end of SDR 90-100bn.
	*	Distribution: Very flexible. First choice 50 per cent equiproportional, 40 per cent would still provide meaningful increases for everyone.
Iraq (incl Libya)	**	Size: Prefers doubling, but expects an increase to within SDR 90-100bn.
	**	Distribution: Have argued for nil equiproportional element, but the constituency has diverse interests, and we do not expect them to take a harder line than the Japanese.
Algeria (incl Iran)	**	Size: Could accept SDR 100bn, but note that Iran is pressing for special treatment to restore to her the quota increase under the Seventh Review which she failed to take up. The overall effect would be to lift Iran's quota by SDR 0.4bn.

Algeria (incl Iran) Cont/d	*	Distribution: Confused. First choice is for low equiproportional element (from which Iran alone benefits). Second preference is very high (75 per cent) equiproportional. They have largely neutralised themselves.
China	**	Size: As for India, but more likely to compromise.
	**	Distribution: Prefer 75 per cent equiproportional, but will lobby Chancellor about fear of being overtaken by Netherlands (this happens with Fund size at SDR 95bn, at 30 per cent equiproportional; and with Fund size at SDR 90bn, at less than 25 per cent equiproportional). This might undermine their claim to be a sole member constituency. This fear suggests they recognise major concessions will need to be made to reach compromise.
India	**	Size: Prefer at least a doubling, but like others, would grab SDR 100bn.
	***	Distribution: Prefer 75 per cent equiproportional and have indicated they set considerable store by a high equiproportional element, and have shown l ttle disposition to compromise as yet.
Brazil	*	Size: Initiallypreferred a doubling, can accept SDR 100bn.
	*	Distribution: Prefers 75 per cent equiproportional out of sympathy for other LDCs. Willing to see further adjustments at Ninth Quota Review.
Mexico	*	Size: Initially preferred a doubling, can accept SDR 100bn.
	*	Distribution: Could accept equiproportional of at least 50 per cent.

Argentina

* Size: Initially preferred a doubling, can accept SDR 100bn.

** Distribution: Could accept equiproportional of at least 50 per cent. Although they have been quiet about it, the constituency may not be viable with much greater selective element. At Fund size SDR 90bn, voting power falls from 2.71 per cent to 2.53 per cent with 50/50 mix, and 2.37 per cent with 0/100 mix - ie less even than China's.

Anglophone Africa

*** Size: Like India. They recognise scope for trade-off between size and distribution, but may still find difficulty in going below SDR 100bn.

** Distribution: Prefers 75 per cent equiproportional but recognises need for compromise. Their chief concern is to maintain viability of their constituency. At Fund size SDR 90bn, and equiproportional element 25 per cent, their voting power slips from 3.16 per cent to 2.82 per cent: this would still be a viable constituency. Largest member (Nigeria) benefits from low equiproportional element.

Francophone Africa

** Size: Wanted a very large increase, could accept SDR 100bn.

*** Distribution: Preferred 75 per cent equiproportional, and unlikely to be happy conceding much less without some understanding that a Francophone African constituency will persist. Their voting power in the lowest already (2.31 per cent); would drop to 1.96 per cent at Fund size SDR 90bn and 50/50 mix, and to 1.84 per cent at 0/100 mix.

Thailand

** Size: Could accept SDR 100bn.

* Di-tribution: Prefers 75 per cent equiproportional, but some flexibility indicated.

INTERIM COMMITTEE

Bilateral with Australians

Points

1. Welcome constructive role Australians have played in Quota Review.

2. Understand concern for small countries. Good progress made on size and distribution and Interim Committee seems in mood to finalise review at this meeting rather than remitting mechanics of special treatment back to Board. Therefore overriding premium on not introducing contentious items at this stage which might unravel Review. A remit to Executive Board would act to delay voting on quota resolution by a couple of months.

3. Important to maintain unformity of treatment - this has been prime objective of Review. The reason why Australia distribution method attracted such support. No case has been established that economic problems of small countries are unique. Proportionately larger percentage of small countries have adopted Article VIII status - a rough and ready measure of openness and flexibility - than larger ldcs. This does not suggest that they find external problems significantly greater.

4. However, if it helped to expedite Review, might be a case for helping small countries by rounding up quotas by, say, SDR 0.5mn. This would be uniform but assist the small countries disproportionately. It would also be relatively cheap.

Background

5. There is a widely-held (though a minority) view in the Executive Board that very small countries (defined as the 17 countries with quotas below SDR 10mn) should receive special treatment in the Quota Review. This view has been identified with Australia (which has small islands in its constituency) but has been supported by France and Canada. Both the staff and the majority (certainly in terms of voting power) of Directors are against the idea, on the grounds that the smallest numbers are already relatively overendowed with quota and even more so with voting power (by virtue of the equal distribution of basic votes),

and that the paramount need is for uniformity. Special concessions might also act to stimulate others (eg Iran) and so unravel the Review.

6. None of the suggestions proposed so for has met with our approval largely since we do not regard the small countries' problems as unique. Rounding up their quotas by SDR 2.5mn while others were rounded up by only SDR 0.1mn would not be uniform; a straight percentage increase would almost certain be regarded as needing further calculation and so Executive Board decision. Ministers would not be able to take it on the spot.

7. Two options worth considering might be

a. A single minimum increase (perhaps about SDR 2mn) applicable to all members, but biting in practice only on very small countries. This method would increase quotas by about SDR 10mn.

b. Rounding up of all quotas to the nearest, say, SDR 0.5mn. This obviously benefits the smallest members proportionately more than others. The principle of rounding up (at present to the next highest SDR 0.1 mn) is well-Established, and the method should be easier to sell to those countries who are against special treatment for the smallest countries. The benefit, more widely spread among LDCs, would increase quotas by about SDR 40 million.

CONFIDENTIAL

FROM: A R H BOTTRILL

DATE: 7 February 1983

CHANCELLOR

Pwp

cc Sir Douglas Wass
Mr Littler
Mr Burns
Mr Unwin
Mr Lavelle
Mr Odling-Smee
Mr Hall
Mr Atkinson
Mr Graham

PS/Governor (B/E)
Mr Anson (UKDEL/IMF)

IMF INTERIM COMMITTEE: MEETING WITH US CONGRESSMEN

I attach a short note on US and UK budgetary policies for your use when seeing US Congressmen. You may also wish to draw on this material when seeing President Reagan.

2. We have provided two graphs on the US budget deficit and personal savings, but we have been hampered by not having received yet the US budget documents. Nevertheless, I have spoken to the Embassy in Washington and I understand that David Stockman has produced an elaborate set of about 20 graphs on all aspects of US fiscal policy. Sets of these will be waiting for you when you arrive. They should be a more effective way to make points to either Congress or the President than anything we can produce.

3. In the meantime, the CSO at our behest is producing charts on developing countries' debt problems and the use of IMF resources. We shall submit these separately.

A Bottrill

A R H BOTTRILL

FISCAL POLICY IN THE US AND UK

Points to make

(i) The US Federal budget deficit has increased sharply in recent years - partly as a result of the recession. In absolute terms, it has risen from $28 billion in 1979 to an estimated $207 billion in the current year (FY 1983) - equivalent to 6½ per cent of GDP.

Federal budget deficit

	$ billion	Per cent of GNP
FY 1979	28	1¼
FY 1980	60	2¼
FY 1981	58	2
FY 1982	111	3½
FY 1983	207	6½
FY 1984	189	5½
FY 1985	194	5
FY 1986	148	3½
FY 1987	142	3¼
FY 1988	117	2½

(ii) The recently published budget proposals project 4 per cent a year growth in the US economy from next year onwards and, alongside this, a welcome reduction in the budget deficit. But even in five years time, the deficit would still be $117 billion - equivalent to about 2½ per cent of GNP. This would still be twice as large as the average size of deficits in the decade before the 1973-74 oil price rise (despite the fact that deficits in this period were increased by the Vietnam war, the Great Society programme and the Apollo moon project).

(iii) In the current year, the Federal deficit seems likely to be larger than the total personal savings of US citizens.

	Federal deficit % of GNP	Personal savings % of GNP	Rates of deficit to saving %
1979	1¼	4	28
1980	2¼	4	59
1981	2	4	50
1982	3½	5	75
1983	6½	5¼	124

(iv) There are striking parallels in the measures that the UK has had to take and in those the US is now contemplating to reduce this deficit. In the UK, two elements have been important - first, the medium-term thrust of our strategy in the past four years and second our readiness to take firm action despite the problems of recession.

(v) The UK had a reputation of fiscal irresponsibility under the previous Administration when public sector borrowing (PSBR) rose to almost 10 per cent of GDP in 1975. Under IMF guidance the deficit was reduced but still averaged 6 per cent of GDP in late-1970s. Since the introduction of our first Medium-Term Financial Strategy we have almost halved this to 3-3½ per cent for the current fiscal year. Our strategy is to secure further reductions.

72/5.
~~75-6~~

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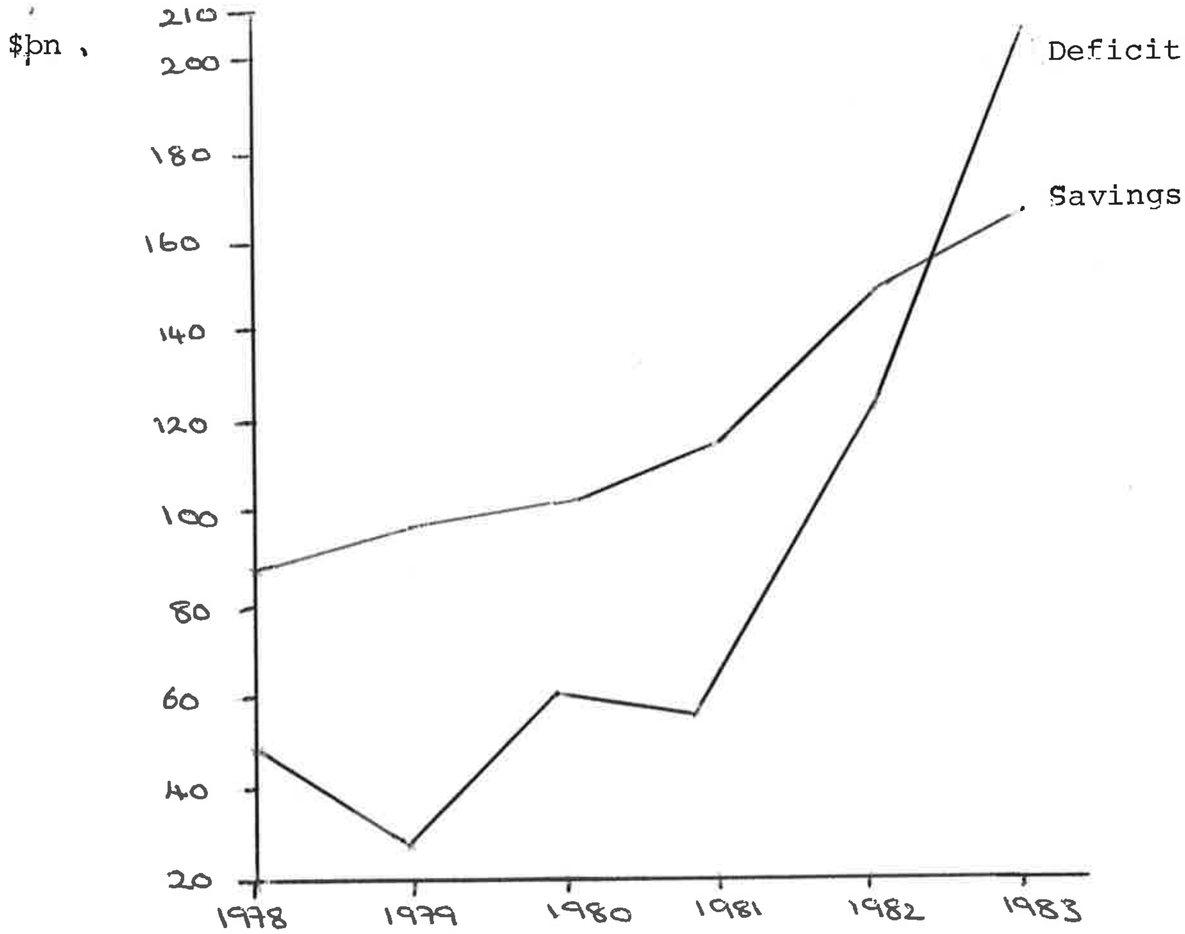
	1980-81	1981-82	1982-83	1983-84	1984-85
1982 FSBR	5¾	4½	3½	2¾	2
Autumn Statement	5¾	3½	3¼	2¾ **	2 **
Out-turn	5¾	3½	3* estimate	Projections at time of 1982 Budget	

(vi) Although we have allowed the deficit to reflect at least in part the effects of recession, we have not shirked from firm action. In particular, we have used firm cash limits to curb the rise in public payrolls; we have cut central government manpower by 10 per cent; and we have kept a firm control on non-priority programmes (eg. housing). But we all know how difficult it is to cut social programmes. We have not hesitated therefore also to act on the revenue side. In particular, in 1981 we raised taxes by some £3 billion (1½ per cent of GDP). We have raised social security contributions. We have also raised certain public sector charges eg. medical prescriptions and public housing rents.

(vii) Interested, therefore, to see similar shape to proposed US measures. These include the six-month delay in social security cost of living adjustment (as proposed by bipartisan Greenspan Commission), its extension to other benefits, a one-year freeze on other non-defense domestic expenditure (including Federal payrolls and pensions), measures to control the growth of automatic entitlement programmes, and health care reform.

(viii) These decisions not always politically easy. But UK has found that only by taking hard decisions has it been possible both to check the Budget deficit and within a firm overall ceiling on expenditure to give priority to such items as defense. UK is meeting its NATO commitment for 3 per cent a year real growth.

U[illegible] FEDERAL DEFICIT AND PERSONAL SAVINGS 1978-83 ($bn)



US FEDERAL DEFICIT AS A PROPORTION OF GDP 1978-86

pup

FROM: A R H BOTTRILL
DATE: 8 FEBRUARY 1983

CHANCELLOR

Never raised, since setting was entirely different

cc Mr Littler
Mr Unwin
Mr Lavelle
Mr Carey

Mr Anson (UKDEL/IMF)

IMF INTERIM COMMITTEE: LUNCH WITH CONGRESS

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A. Bottrill

A BOTTRILL

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2. At the time of the settlement of the pipeline dispute last November, the US side accepted in the margins of discussions on East/West economic relations (on which work is proceeding separately) that the other Western nations would wish to hold urgent talks on the problem of extraterritoriality. So far, the UK has been alone in pressing for matters to be taken forward. The UK aim is to secure amendments to the US Export Administration Act, the legal instrument for extraterritorial controls in the trade field, to limit its effects. The Act is due for renewal this September. The matter is therefore of some urgency. The UK is encouraging Alliance and Community partners as

CHANCELLOR'S VISIT TO WASHINGTON 9/10 FEBRUARY:
EXTRATERRITORIALITY

Points to Make

1. British Government is most concerned at the way successive US Administrations have extended export controls to companies in the UK. The pipeline affair last year was the most dramatic case; but it was not the first.

2. The Western Alliance can operate effectively only on the basis of consent among its members. Agree that strategic goods must not fall into the wrong hands: UK is playing a full part in the joint search for improvements in the agreed system of strategic controls.

3. But controls operating in the UK must be imposed only by the British Government. This is a fundamental issue of sovereignty.

4. We are clear that the extraterritorial application of US export controls is contrary to international law.

5. It also damages jobs and profits in the UK; will lead to hostility to US investment here; and will harm both our economies.

6. The renewal this year of the Export Administration Act gives US Administration and the Congress an oportunity to eliminate this problem, which is increasingly damaging to the Alliance. We trust that this opportunity will be taken.

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4. So far, the US Administration has tended not to take this question very seriously. But it is an important issue. It would be useful if the Chancellor could register with Congressmen and contacts in the US Administration the fact that we view this matter with considerable concern. If not dealt with to the mutual satisfaction of all concerned, it could have serious political and economic consequences for relations between the United States and her European partners. In particular, the UK might have to consider taking further steps to protect its legitimate trading interests.

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DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

CONFIDENTIAL

The Rt Hon Francis Pym MC MP
Secretary of State for
Foreign and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
London
SW1A 2AL

4 February 1983

UNITED STATES TRADE CONTROLS: EXTRATERRITORIALITY

I am writing about our strategy to counter the United States claims to apply their controls on international trade and financial transactions extraterritorially.

In his despatch on "The Siberian Pipeline: Lessons for the Future", Sir Oliver Wright said:

> ".... when we see trouble brewing we .... must explain our concerns quickly and clearly to a wide audience .... We must not soft pedal as we .... have tended to do in the past .... we must be prepared to lobby loudly and informally and early in the process ....".

The need now arsies to put these principles into practice. The United States Export Administration Act, one of the principal United States domestic enabling powers, expires on 30 September and the renewal processes are starting in the United States Congress. Officials from our Departments, headed by one of my Deputy Secretaries and your Legal Adviser, have recently renewed discussions in Washington with senior officials in the Administration; and I have reviewed our strategy following their report.

Our first objective should be to have the revised United States Export Administration Act amended so as to remove the claim to extraterritorial jurisdiction. We must take all opportunities to put the arguments robustly to members of the United States Administration and of the Congress. I hope that colleagues will use any opportunity which presents itself for this: we will be glad to arrange for briefing.

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My officials are working with yours on a restatement of our position aimed to influence the renewal process in the Congress. We are urging other countries, both those affected last year by the Pipeline and others, such as Canada and Australia, who like us have a history of opposition to United States extra-territoriality, similarly to express their concerns. And we are encouraging representation from the European Community. Industry in the United States has strong concerns about the Act, particularly about the "trigger-happy" way in which this United States Administration and the previous one have resorted increasingly to using economic controls for foreign policy purposes; their concerns, while not identical to ours, overlap because subsidiaries of United States companies in our countries find it very troublesome to be caught between conflicting policies and laws.

A second objective is that the Administration should, as we have pressed them to do, remove the controls which now harm British companies which are United States subsidiaries: preventing or restricting trade with a number of countries (Cuba, Vietnam, Kampuchea, North Korea); and inhibiting their trade with the wealthy Arab countries, because of the United States regulations to counter the Arab Boycott. The complete failure by the United States side to respond in the recent talks to this practical request which we tabled fifteen months ago is a measure of their failure to tackle this matter with sufficient recognition of our objection to these intrusions on our sovereignty. I am pleased that you will be raising this with Vice President Bush. You will see that I have minuted the Prime Minister asking that she should herself underline our concern to him.

It is nonetheless apparent that there will be many voices in Washington, both in the Administration and in the Congress, against limiting the extraterritorial reach of the Export Administration Act. Moreover, this reach is also embodied in other United States statutes. During the coming weeks we need to establish that it is our purpose to resist any future extra-territorial exercise of these powers. Just as the United States may continue to make this claim of policy and law, so our policy and law rejects it. Unless and until we reach a better understanding on the matter, the use of the Protection of Trading Interests Act powers to resist United States encroachments needs to become the expected this.

We need to make it absolutely clear that we are no longer prepared to wait until the American Administration has inflicted damage on our companies, but that we will take measures in advance designed to head off such damage. We now need therefore to develop a more explicit statement of the counter-action we propose to take; and to put this to the United States at the time and in he way most likely to influence favourably the terms in which the United State Act is renewed. And if we fail to achieve

our objectives, and have to make use of the powers to protect our companies, the Administration and the Congress will have been fully forewarned.

I propose that we should decide now that, if the Export Administration Act (EEA) is not amended so that the powers cannot be applied extraterritorially, we should promptly make an Order under Section 1(1) of the PTI Act. This would specify that the extraterritorial application fo the EEA and other comparable United States laws and/or regulations made, or to be made, thereunder are damaging or would threaten to damage our trading interests. This could be accompanied by an Order under Section 1(2) of the Act, requiring persons carrying on business in the United Kingdom who are affected by such applications of the United States laws to notify me of this. At a later stage, we could proceed to a general Direction under Section 1(3), requiring such persons not to comply with the United States measures.

Such a Direction could be used in relation to existing United States measures of the kind I have referred to earlier which affect our trade, unless the Administration expresses itself willing to remove the extraterritorial aspects of these measures, as far as their discretion under statute permits.

I have also asked my officials to examine with yours whether it would be possible to make a general Direction under Section 1(3) in relation to future use of the United States enabling powers (both the EA Act and other similar powers) to apply controls to such companies. The great advantage of this would be that it would hold the line, legally and politically, in advance. Thus in a politically sensitive case, where we shared United States broad objectives but doubted or opposed their intention to employ economic sanctions, we would not face the choice between divisive objection and inaction in defence of our own interests.

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From the Secretary of State

CONFIDENTIAL

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EXPORT ADMINISTRATION ACT

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From the Secretary of State

CONFIDENTIAL

The Rt Hon Francis Pym MC MP
Secretary of State for
Foreign and Commonwealth Affairs
Foreign and Commonwealth Office
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SW1A 2AL

4 February 1983

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It is nonetheless apparent that there will be many voices in Washington, both in the Administration and in the Congress, against limiting the extraterritorial reach of the Export Administration Act. Moreover, this reach is also embodied in other United States statutes. During the coming weeks we need to establish that it is our purpose to resist any future extra-territorial exercise of these powers. Just as the United States may continue to make this claim of policy and law, so our policy and law rejects it. Unless and until we reach a better understanding on the matter, the use of the Protection of Trading Interests Act powers to resist United States encroachments needs to become the expected this.

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US officials are dealing with these as a continuation of the attempts to influence the internal process in the Congress. We are seeing other practices. Last week officials from the Republican and others, such as Garcia and [illegible], who like us, using a strategy of appealing to United States public-opinion, particularly to express their concerns. And we see considerable representation from the European Community. Certainly the United States has strong concerns about our ..., particularly about the "bridge-money" way in which this United States Administration and the previous one have managed deliberately to using economic sanctions for foreign policy purposes, their countries, while not attached to companies, foreign subsidiaries of United States companies in the countries (like the [illegible] requirements) to be caught between conflicting policies and laws.

A second concern is that the Administration should, as we have pressed hard to do, resolve the situation which has left British companies under new United States requirements: prohibiting or restricting trade with a number of countries (Libya, Nicaragua, North Korea, and including their trade with the Western Arab countries) because of the United States legislation to counter the Arab Boycott. The companies affected by the United States with regard to the present rules of their contracts without being able to continue their business as a measure of their failure to settle this matter with sufficient recognition of our jurisdiction in these circumstances. I am pleased to report that we are relating this with the Commerce Department, and we have offered the Prime Minister's agreement that she should herself mention our concern to them.

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We need to make it absolutely clear that we are no longer prepared to wait until the American legislators see the difficulties caused to our companies but that we will take measures to minimise damage to them from such damage. We now want therefore to consider a more explicit statement of the counter-action we propose to adopt and to put this to the United States at the time and in the way most likely to influence Congressional action to ensure the United States Act is amended. Both of these are necessary.

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Yours sincerely,

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IMF INTERIM COMMITTEE 10-11 FEBRUARY
WORLD ECONOMIC PROSPECTS

Points to make

/As the UK's views on economic developments are similar to the Chairman's, separate points for each have not been provided./

i. World activity has yet to recover. Depressed output levels of recent years have been part of cost of bringing down entrenched inflation. Now, however, inflation has fallen and there should be room for more real output growth within existing framework of prudent financial policies.

ii. Latest IMF forecasts have been revised down but still expect modest recovery in 1983 with GDP growth of 1½ per cent in the US, 3 per cent in Japan but little, if any, increase in Europe.

iii. Deferred and modest recovery prospects imply the need for continued careful monitoring of policies. Essential major countries maintain prudent counter-inflationary policies and resist calls for excessive reflation - but at the same time important that policies are not more restrictive than intended.

iv. Monetary policy should be firm but flexible. It should not allow any renewed surge in inflation, but important to take into account the full range of factors when assessing the degree of monetary tightness.

v. Fiscal policy should aim to put structural deficits on a convincing declining path in the medium-term. (US has a special responsibility). But recession inevitably increases the cyclical part of the deficit and it is right to take this at least partly into account in setting budgetary targets.

vi. Convergence of policies among major countries (SDR block) on a counter-inflationary path is essential if a stable international monetary framework is to be achieved and exchange rate volatility reduced.

vii. Problems of developing countries still a cause for concern - but important steps have been made to reduce the difficulties to manageable proportions. Welcome implementation of firm adjustment programmes by many countries - often with Fund help. Important that commercial banks, too, should continue to help finance the adjustment process.

viii. Need to avoid protectionism. Not the way to solve payments problems or exchange rate fluctuations. Trade restrictions could impoverish us all.

<u>Background</u>

1. Real GNP in the industrial countries is estimated to have fallen slightly last year reflecting weak domestic and external demand. Growth prospects have been revised down but the latest IMF forecast sees output picking up during this year and growing by 1-2 per cent. The US is expected to grow by $1\frac{1}{2}$ per cent, Japan by 3 per cent but little revival is envisaged in Europe. World trade fell last year for the first time since 1975 but a mild recovery is expected this year.

2. Tentative signs of the recovery are beginning to appear now that inflation and interest rates have come down. The leading indicators have continued rising in the US as housing starts and retail sales picked up at the end of 1982. The fall in business confidence in Europe may have bottomed out as expected production levels rose while in Germany, construction has been rising and orders have improved recently though this may be partly due to temporary investment incentives expiring.

3. Higher consumers' expenditure, some stockbuilding and construction investment may be the principal sources of growth this year with little contribution from external demand. However domestic demand and hence the recovery is expected to remain weak in Germany, France, Italy and Canada. Although difficult to pin-point, recovery could start early this year in Japan and North Amercia with some slower decline in Europe. By mid-year activity in all major economies should have begun to pick up.

4. Deferred recovery inevitably led to a continuing rise in unemployment in most industrial countries last year. Although the increase may start to level off the unemployment rate in the major economies may reach 9 per cent later this year.

5. Inflation has been brought down much faster than anticipated. For the major countries it has fallen from 12 per cent on average in 1982 to 5½ per cent over the past year to December 1982. A wide dispersion persists which underlines the need for convergent policies. Some further decline is expected early in 1983 but there are reasons for expecting some up-turn thereafter. Earnings may recover as activity picks up, profit margins will be restored and non-oil commodity prices may increase.

6. Lower inflation together with weak private credit demand allowed some reduction in interest rates in the second half of last year. Since November rates have tended to stabilise. More recently US short-term rates fell further to 8 per cent in mid January but have risen again to 8½ per cent as market attention focussed on budget prospects. Interest rates in Germany and the Netherlands are below US rates but elsewhere in Europe nominal rates remain high. Real interest rates have eased but are high compared to past experience.

7. The aggregate current account deficit for the major countries increased a little in 1982 and the forecast for a further increase this year is dominated by the prospective US deficit. IMF is forecasting a US deficit (including official transfers) of around $30bn in 1983 compared to a $12bn Japanese surplus and a smaller $6bn German surplus.

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8. Non-oil developing countries' adjustment has concentrated on reducing imports and as a result their current accounts fell in 1982. IMF forecasts point to a further fall this year.

NODCS	1981	1982	1983 (IMF forecasts)
Current Accounts ($bn)[1]	-100	-90	-70
Commercial bank lending ($bn)	53	25	20-25
Import Volume (per cent)	2	- 4	2½
Export Volume (per cent)	7	3½	6½

1 Excluding official transfers

9. This represents considerable progress given their adverse terms of trade and depressed export markets. Financial constraints may have been tighter than expected. IMF estimates that private bank lending contracted sharply in 1982 and may not build up again this year. In this light their forecast of 2½ per cent import volume growth for this year may be a little optimistic.

10. Exchange rates remain volatile. The dollar's depreciation since November in response to falling US interest rates and a large prospective external deficit has been uneven. Its effective rate had depreciated 8 per cent by early January but then recovered, as interest rates firmed, which cut the depreciation to around 3 per cent.

11. The DM gains have virtually all been eroded as the dollar recovered and as election fears gathered. Most of the particularly strong appreciation of the yen (18 per cent in effective terms) has been maintained. It has eased slightly reducing the appreciation to around 15 per cent since its low in November. Although it has recovered its losses during 1982 it remains undervalued.

Policies

12. The task for policy is to create the conditions for a durable recovery to become established without provoking renewed inflation. Some allowance should be made for the recession while maintaining a sound medium term strategy against inflation. Lower inflation should allow more room for growth given unchanged monetary targets while on the fiscal side it should reduce drag and permit a greater volume of expenditure from budgets fixed in cash terms. Policies of major countries should be co-ordinated so that economic performance converges towards low inflation and sustainable growth.

13. Experience with monetary policy in 1982 is difficult to assess, particularly in the US at a time of institutional change and changing liquidity demands. Last year the Fed suspended its M1 target and adopted a more flexible approach but some have argued its stance is now too lax. M2 growth in the last four months of 1982 was broadly in line with the revised higher target of 9½ per cent. The Fed is considering maintaining the 1982 targets for this year and a final decision is expected shortly.

14. German experience has been the most successful and growth in 1982 at 6 per cent remained well within the 4-7 per cent target which is to be continued this year. A further indication of some easing of policy is the Bundesbank's decision to relax bank regulations (it recently raised banks' rediscount quotas). In France monetary growth for 1982 may have been close to the 12½-13½ per cent target. For this year France has adopted a tighter single figure target of 10 per cent. Canada abandoned its M1 target in November and policy is guided by the exchange rate and other factors.

15. As regards fiscal policy, although most governments since 1979 have been aiming for firm control over public expenditure, the effects of the recession have pushed up deficits. OECD estimates the general government deficits of the major industrial economies have risen mostly due to the recession from 2 per cent of GDP in 1979 to over 4 per cent in 1982. Only Japan and the UK have secured a reduction in their deficits although Germany has managed to offset much of the effects of lower activity by firm discretionary policies. Midly expansionary policies in France and the US have contributed along with the recession to the overall increase in their fiscal deficits.

16. OECD estimates deficits for the major economies in 1983 may remain around 4 per cent of GDP despite the expected recovery in output. Although the Japanese government announced a reflationary package last October the budget for fiscal 1983, which starts in April, still projects a tighter fiscal position than the likely outcome for fiscal 1982.

17. The recent US budget forecasts a fall in the deficit as a percentage of GDP from 6½ per cent in the current fiscal year, FY83, to 5½ per cent in FY84 and to 3½ per cent by FY 86. These deficits are high compared with previous experience and are in spite of favourable growth assumptions. The budget measures still have to be passed by Congress. In view of these factors the budget has not entirely satisfied concern over the Administration's future fiscal stance (see separate US brief).

AMJ

IMF INTERIM COMMITTEE 10-11 FEBRUARY 1983

UNITED STATES ECONOMY

Points to make

i. Resumption of sustainable non-inflationary growth in US is vital for the recovery in the developed and developing economies. Marked reduction in inflation over past year together with lower interest rates should help foster up-turn in US and elsewhere.

ii. Welcome forecast of resumed growth for 1983. Overall rise modest but better prospects for later in the year.

iii, After protracted recession and dashed recovery in 1981 important that policies should be firm but flexible enough to permit higher activity without increasing inflationary pressures.

iv. Welcome Fed's flexible approach to monetary targets but need to take account of other factors. As economy recovers monetary growth should be kept within prudent limits.

v. Welcome Administration's commitment to reducing deficit over medium term. This is essential to reduce the risk that interest rates and inflation may rise as economy recovers. Projected deficits for mid-1980s however, will still be high relative to past experience.

vi. Sound and convincing US monetary and fiscal policies important not only for progress on inflation and recovery of output but also for stability of international financial and trading system. US needs to recognise international repercussions of its policies.

vii. Modest depreciation of US dollar following decline in US interest rates has helped unwind some of the large appreciation of past two years. Should help to curb protectionist pressures in US. Important that any further realignment of dollar should be gradual and orderly. Administration should have a care for

the exchange rate in setting economic policies.

BACKGROUND

1. After showing a further slight increase in the third quarter US GDP fell by 1/2 per cent in the fourth quarter. Output for 1982 as a whole was about 1 3/4 per cent lower than in 1981. Industrial production fell steeply during 1982 but may have levelled off in December. It is 12 per cent below its July 1981 peak.

2. Unemployment rose to 10.8 per cent in December compared to around 8 1/2 per cent at the end of 1981. Consumer price inflation has fallen sharply and in December prices were only 3.9 per cent higher than a year earlier.

PROSPECTS

3. Tentative signs of the recovery are slowly appearing. Leading indicators have continued to rise. Housing starts and retail sales picked up at the end of 1982. Manufacturing investment intention surveys, however, are still bleak. Most forecasters expect a recovery throughout 1983 with higher consumers' expenditure, a rebuilding of stocks and higher construction investment being the likely sources of growth. The US Administration's budget forecast for growth of 1 1/2 per cent is broadly in line with the IMF's and our own.

4. The Administration has also assumed 4 per cent growth a year between 1983-88. Although growth of this magnitude in the upswing of the cycle is perhaps plausible this performance over 5 years would be better than at any time since the early 1960s. The out-turn could be lower. Unemployment is expected to rise from 9 1/2 per cent in 1982 to 10.7 per cent in 1983 but decline slowly to about 6 1/2 per cent by 1988.

5. Inflation has fallen from a peak of over 14 1/2 per cent in 1980 to 6 per cent on average in 1982. Most forecasters expect some further fall in 1983 to around 4 1/2-5 per cent and some

pick-up thereafter. The Administration projects inflation running at 4 1/2 per cent over the period to 1988, in spite of the strong growth forecast. This could be optimistic - especially if the dollar weakens and commodity prices rise.

6. The dollar's fall in recent months has been uneven. In effective terms it fell by 8 per cent between the start of November and mid-January but has recovered at least part of the lost ground as expectations of further cuts in the discount rate have faded.

7. The current account moved into deficit of over $4 bn in 1982. Most forecasters now expect a much higher deficit of around $30-40bn this year as a result of previous losses of competitiveness and the effects of domestic recovery. Latest official estimates put the 1983 trade deficit alone at around $60-$70 bn. Large prospective deficits together with other factors such as the ending of the flight to quality may lead to some further depreciation of the dollar.

POLICIES

8. There has been growing concern over a shift in the policy stance in the US in the light of seemingly contradictory official statements. The stance of monetary policy should become clearer when the 1983 targets are announced shortly, but the Fed may be unwilling to see interest rates rise until a recovery has been firmly established. On fiscal policy the recent budget has demonstrated the Administration's concern but has not fully convinced the markets of its ability to reduce deficits adequately. It is difficult to escape the conclusion that defacto the emphasis of policy may be shifting but there has been no major relaxation so far.

MONETARY POLICY

9. Since October last year monetary policy has moved to a slightly less restrictive stance. As M1, the most closely watched aggregate and, to a lesser extent , M2 were said to be affected by

institutional and other changes the Federal Reserve suspended the M1 target add set new, higher M2 targets for the last part of the year.

10. In the event M1 grew by 8 1/2 per cent during 1982 well above the 2 1/2-5 1/2 per cent target range. M2 rose by about 10 per cent during 1982 compared with the initial 6-9 per cent target (latterly revised up to a 9 1/2 per cent target). All the aggregates were outside their target ranges before the relaxation and distortions took effect, and some have argued that policy is now too lax.

11. Recent developments have created uncertainty over the future course of US monetary policy in view of some official statements stressing the need for an early recovery. Mr Volcker's re-affirmation before the Congressional Joint Economic Committee that inflation remains the major threat to economic recovery may help allay fears. The 1982 monetary targets are likely to be maintained this year. The budget forecasts assume that interest rates will decline gently in 1983 and beyond, but the size of the deficit casts doubt on this.

FISCAL POLICY

12. In past 30 years, the Federal government budget has oscilliated between surplus and deficit though the average deficit has tended to increase over time. During the 1970s much of the post-Vietnam fall in defence spending was matched by a growth in transfer payments over and above the growth of social security contributions. Recipients of social security payments (two-thirds of transfer payments) rose by 40 per cent while the number of recipients of Medicare (half of remainder) doubled in the 1970s. In the last few years, however, there has been both a substantial rise in defence spending and a continued rise in transfer payments while personal taxation has been held down by the recession and tax cuts. This has contributed to the rise in the deficit.

13. The FY84 budget, published on 31 January, should have announced major steps towards overcoming these adverse trends in

the Federal government's finances. Although social security, issues were tackled, little was achieved in the areas of defence or personal taxation. The budget plans to reduce the deficit from 6 1/2 per cent of GDP in FY83 to around 2 1/2 per cent by FY88.

	£billion	Per cent of GDP
FY 1983	207	6.5
1984	189	5.4
1985	194	5.1
1986	148	3.6
1988	117	2-3 (estimate)

14. The proposals to reduce expenditure include a 6 month delay on cost of living adjustments for socaal security and other indexed benefits, a 12 month freeze on other non-defence items including military and civil service pay and retirement benefits add measures to control the growth of automatic entitlement programmes and reform of health care. For FY84 the volume of non-defence spending is to fall by 3 per cent while defence expenditure rises by 10 per cent.

15. Revenues are to be raised by including Federal employees in the social security system and higher contributions. The new contingency tax plan, if adopted would take the form of a 1 per cent surcharge on taxable income of individuals and companies and a £5 a barrel excise tax on oil.

16. A major concern is the 'structural' component of the deficit. The Administration's estimates imply this would still be about 2-3 per cent of GDP in 1988 after the economy had returned broadly to full employment. More importantly perhaps this assumes all the proposals will be implemented and that growth of around 4 per cent a year materialises. Congress, however, may be unwilling

to implement the contingency tax plan and may have doubts over some recommendations from the Greenspan Commission.

17. If some of the measures are not implemented or if growth proves slower, then even greater expenditure savings will be required if taxes are not to be raised further. The Administration has perhaps not yet demonstrated clearly its ability to reduce deficits convincingly over the medium term. The potential inflationary effects of this remain a source for concern.

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OCDE A PARIS

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FROM
OECD A PARIS TELEX 620160 PARIS

TO
THE RT. HON. SIR G. HOWE, Q.C., M.P.
CHANCELLOR OF THE EXCHEQUER
H.M. TRESURY
LONDON

''

GROUPE DES DIX

LE PRESIDENT DES MINISTRES
ET DES GOUVERNEURS

CONFIDENTIEL

1ER FEVRIER 1983

NOTE DU PRESIDENT
AUX MINISTRES ET AUX GOUVERNEURS DU GROUPE DES DIX

COMME CONVENU, LES MINISTRE ET LES GOUVERNEURS DU GROUPE DES DIX SE REUNIRONT LE 10 FEVRIER 1983, AU SIEGE DU FONDS MONETAIRE INTERNATIONAL A WASHINGTON DANS LA SALLE DU CONSEIL D'ADMINISTRATION AU DOUZIEME ETAGE. LA REUNION COMMENCERA A 8 HEURES 30.

LA REUNION SERA CONSACREE A UN NOUVEL ECHANGE DE VUES SUR LES QUESTIONS FIGURANT A L'ORDRE DU JOUR DE LA REUNION DU COMITE INTERIMAIRE.

HAUTE CONSIDERATION.

JACQUES DELORS

GROUP OF TEN

THE SECRETARIES

CONFIDENTIAL

FEBRUARY 1, 1983

NOTE FROM THE SECRETARIES

WITH A VIEW TO FACILITATING PRACTICAL ARRANGEMENTS, WOULD YOU KINDLY COMMUNICATE TO THE SECRETARIES, C/O IMF, OFFICE IN EUROPE, TELEX 610712, PARIS, THE NAMES OF THE MEMBERS OF YOUR DELEGATION THAT WILL BE ATTENDING THE MEETING OF THE DEPUTIES ON FEBRUARY 9 AND THE MEETING OF THE MINISTERS AND GOVERNORS ON FEBRUARY 10.

BEST REGARDS.

THE SECRETARIES

CH/EXCHEQUER
REC. - 1 FEB 1983
ACTION Mr Littler
COPIES TO Mr Lavelle
Mr Bottrill
Mr Atkinson

MR. P. ATKINSON
DEVELOPECONOMIE

262405 TRSY G
OCDE AM

pwp

INTERIM COMMITTEE MEETING
February 10, 1983

Summary of Positions on Size and Distribution

Position		Voting Power (per cent)	Number of Constituencies
Size (SDRbn)			
	85	19.52	(1)
At least	91.65 (i.e. 50 per cent increase)	16.35	(3)
	90-100 range	3.69	(1)
	100 Acceptable or minimum	30.54	(8)
	125 or Double	28.23	(9)
Distribution (Per cent share equiproportional increase)			
I.	Prefer 0%	3.62	(1)
	Not more than 20%	3.88	(1)
	Sub-total	7.50	(2)
II.	Between 20% and 75% acceptable	52.69	(10)
	No view expressed	15.76	(3)
	Sub-total	68.45	(13)
III.	75% or more	22.48	(7)

INTERIM COMMITTEE MEETING
February 10, 1983

Tally of Positions

Morning

Constituency	Voting Power (per cent of total)	Size	Distribution
1. United States	19.52	85bn adequate	30% equiproportional reasonable.
2. Germany	5.04	At least 50% increase appropriate: i.e. 91.65bn	No figure mentioned.
3. Mexico	4.84	Doubling needed. If not doubled, advance next ninth review of quotas	Equiproportional at lea 75%.
4. Italy	3.90	100bn necessary	Large share for selecti No figure.
5. Japan	3.88	100bn necessary	Not more than 20% for equiproportional.
6. Libya (Kuwait - Pakistan & others)	3.62	100bn acceptable as compromise	Prefers selective 100%.
7. India	3.44	Urged 125bn	Equiproportional at lea 75%.
8. Saudi Arabia	3.28	Doubling appropriate. Minimum 100bn desired by many. Urged compromise	Not far from 50% for ei equiproportional or selective.
9. Thailand (South East Asia)	3.11	Urged 125bn	Equiproportional at lea 75%.

INTERIM COMMITTEE MEETING
February 10, 1983

Tally of Positions

Afternoon

Constituency	Voting Power (per cent of total)	Size	Distribution
1. United Kingdom	6.82	At least 50% i.e. 91.65bn	No comment.
2. France	4.49	At least 50% essential	Equiproportional 33.3%.
3. Canada	4.26	At least 100bn	Selective 40-50%.
4. Netherlands	4.15	At least 100bn (some in constituency favor doubling)	Netherlands: 75% selective.
5. Belgium	4.14	Doubling essential. 100bn as compromise, if next review is advanced	Equiproportional less than 50%.
6. Philippines (Australia, New Zealand-Korea and others)	3.69	90-100bn is a feasible range	Varying views for equiproportional to be more less than 50%.
7. Scandinavia	3.31	Accept 100bn but prefer more	Equiproportional less th 50%.
8. Anglophone Africa	3.15	Double	Equiproportional at leas 75%.
9. Brazil	3.09	Double	Equiproportional 50%.
10. China	2.82	Double	Equiproportional not les than 75%.
11. Algeria (Iran-Morocco and others)	2.76	Double	Equiproportional not les than 75%.
12. Argentina (Chile and others)	2.71	Double	Mostly equiproportional.
13. Francophone Africa	2.31	Double	Equiproportional close to 100%.

U.S. QUOTA

Assumptions: 1. Exchange rate SDR1 = US$1.10
2. Total amount available for U.S. contribution to GAB and quota increase: US$8 billion

Needed for GAB: $2.68 billion (SDR 2.44 billion)
Leaves for quota increase: $5.32 billion
SDR equivalent: SDR $4.84 billion (Allowing for an increase of present U.S. quota of SDR 12.607 billion by 38.38 per cent.)

* * * * * * * * *

Assumed Fund of SDR 92.5 Billion (51.56 per cent Increase)

	Amount required for full U.S. Subscription		Reduction in Size of Fund if Total that U.S. has available is limited to $8 Billion	
Eq./Sel.	SDR Billion	US$ Billion	SDR Billion	US$ Billion
50/50	5.89	6.48	1.05	1.16
40/60	5.77	6.35	0.93	1.02
30/70	5.65	6.22	.81	0.89

Assumed Fund of SDR 92.5 bill (51.56 % increase)

US quota increased by 4.84 SDR bill to 17.45 bill.

all other quotas kept at the level calculated from 92.5 bi[illegible]

total Fund

equi / selo	total size Fund	% increase	US share quota	US share votes
50/50	91.45	49.8 %	19.08 %	18.~~[illegible]~~3[illegible]
40/60	91.57	50.0 %	19.06 %	18.3[illegible]
30/70	91.69	50.3 %	19.03 %	18.3[illegible]

be excessive. A 50% increase could however be regarded as the minimum required. Some of the arguments for a much larger increase seem to be based on the assumption that severe global imbalances may recur throughout the 1980s. If adjustment is successful, the scale of imbalances should, however, fall. If unexpectedly severe balances do recur, it would be more appropriate to augment the Fund's resources by borrowing.

As for the distribution of the quota increase, it should be achieved in a way that is uniform, fair, and systematic. It should allow quota shares to change in an orderly way over time to reflect more clearly members' positions in the world economy. The allocation of any increase in quotas according to calculated quota shares seems to meet these criteria in a straightforward and transparent fashion.

Conclusions

My conclusions can be summarised under five headings.

First, we must maintain and sustain the central institutions, the Fund and the Bank. That means support for their key roles, in surveillance and advice on adjustment policies, and in providing development finance. And it means support through the assurance of adequate additional resources, for example, by reaching early agreement on a substantial increase in Fund quotas, and through the timely release of agreed contributions to IDA-VI.

Secondly, we must continue to pursue responsible financial policies. This means a firm but flexible approach to monetary policy, taking into account all monetary indicators and avoiding excessive tightness or easing of financial conditions. And it means that we must continue to reduce budget deficits, putting further downward pressure on interest rates. In this respect we look particularly to the United States. For companies — or countries — facing difficulties at present, lower interest rates are an urgent requirement.

Thirdly, we must work for greater exchange rate stability. This certainly means building on the joint responsibilities recognized at the Versailles summit, which could involve a fuller and more secure expression of the original purpose of the Bretton Woods agreement than we have seen for many years.

Fourthly, governments of almost all industrial countries, including my own, need to persuade their peoples of the need for pay restraint, permitting labour costs to adjust and profitability to increase. We must also remove unnecessary controls, encourage flexibility in goods and labour markets, and avoid resort to protectionism.

Finally, countries with excessive debts must like the rest of us follow appropriate adjustment policies, and private sector banks will need to show a matching responsibility. The former should accept that rescheduling can only be effective if accompanied by the right policy changes; the latter that adequate supervision and prudent individual risk assessments are essential components of a stable system.

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The International Monetary Fund: its role in the world's economies

H M Treasury

The Chancellor of the Exchequer, the Rt Hon Sir Geoffrey Howe, QC, MP, has recently been elected Chairman of the International Monetary Fund's Interim Committee which advises the Board of Governors on the management of the international monetary system. The Interim Committee meets on 10 and 11 February 1983 in Washington to discuss the size and distribution of increases in quotas needed to provide additional resources for the Fund.

During the IMF's annual meeting in Toronto last September, the Chancellor, who is also Governor of the Fund for the United Kingdom, addressed fellow Governors on the world economy and the international financial situation. Extracts from that speech, which is still relevant today, are reproduced below.

There are two preconditions for economic success, nationally and internationally, which are valid without regard to the state of the cycle or even the most fashionable set of equations. They are stability and flexibility.

By *stability* I mean a firm economic framework, founded on fair political systems securely rooted in the rule of law, and a currency which maintains its value. I mean, too, an international exchange-rate structure which offers a reasonable measure of stability, while allowing freedom for rates to reflect differential economic performance.

By *flexibility,* I have in mind a willingness to promote and adjust to economic change, and a willingness and capacity to challenge market rigidities: a willingness, too, to check and reverse any tendency towards protectionism.

The causes of decline

Both of these conditions for economic success have been inadequately met in recent years. The stability of the Bretton Woods system was eroded as inflation built up in many countries. Around the world flexibility has been more and more stifled by the entrenchment of inflationary expectations, the fossilization of many market structures — particularly rigidity in labour markets — and the spread of protectionism.

The oil price shocks owed something to the growing strength of inflationary pressures. But they were reinforced by the scale of OPEC's action. The disposition of many countries was to seek to print and float their way out of trouble. It is easy to see why. But the outcome, as we all know too well, has been high inflation.

With what consequences? In the industrial countries, high unemployment. And in the developing countries, the inevitable setback to forecasts of growth that relied upon a continuation of high commodity prices and low interest rates.

The common objectives

Faced by these mounting problems, the international community has, during the three years that have passed since the second oil shock, moved towards a large measure of agreement on the strategic objectives we should follow to obtain a sustainable recovery. This is no mean achievement.

This agreement rests upon an increasingly clear understanding of the need for a sustained and successful fight against inflation, and for the policies that this

implies. It rests on the firm control of monetary growth, and of public deficits and public spending — themes that the Managing Director has stressed frequently. It rests on the better working of markets, the reduction of costs, and the improvement of profits. It points the way perhaps to a new Fund role surveying countries' policies, which would not be unlike its old position in relation to exchange rates.

The tensions of transition from an era of high inflation can perhaps be seen as global withdrawal symptoms. For across the world the inflationary fever has been checked.

Inflationary expectations in most of the major industrial countries are changing significantly. Given the predominant weight of the United States in the world economy, and the importance of its currency in international financial markets, the progress registered there is particularly important.

And in the United Kingdom we have brought inflation down to around one third of the peak rate suffered two years ago. And the prospect, with Government borrowing following the downward path we set then, is for further falls. Elsewhere, too, there has been progress.

But of course there is justified world-wide anxiety about the pain of the process. We need not only strong nerves but also the determination to persuade our people that the course on which most of us here agree really is the best, and that a turn-around in policy now would only plunge us back again into rising inflation and, still worse, unemployment. Defeating inflation may be profoundly uncomfortable, but to be defeated by inflation would have been disastrous.

The way ahead

But agreement on the diagnosis, and on the proper course of treatment, does not absolve us from the need to be sensitive in our precise prescription. How can we best help each other and our common interest?

First, we must foster both the stability of our system and its ability to adapt to change. We need more than ever the international financial institutions which we have inherited from the Bretton Woods era, and we need to defend and develop their tried and familiar roles in contributing both to stability and to change: in the one case to adjustment, in the other to development.

From time to time there are calls for new institutions. What their roles would be, and how they would be defined, is not clear. What is clear, in my view, is that this is not the time for a fundamental reappraisal of a tested institutional structure which has served us well, and never more so than at the present juncture.

As I said last year, new institutions are not the key to a better future. But we must certainly encourage the evolution of the Fund and the Bank in response to changing needs. And it is to this that I now turn.

The development of the multi-currency system

Last year I spoke about the network of our joint responsibilities towards each other and towards the world monetary system. I suggested that the special drawing right (SDR) could not be a worthwhile asset unless its component currencies retained their value. I spoke also of the reciprocal obligations which would arise if the countries whose currencies are represented in the SDR in fact discharged that responsibility.

This theme was taken up in the statement issued at the Seven Power Economic Summit at Versailles, acknowledging a joint responsibility towards the world monetary system. That statement recorded the agreement of the Seven that greater stability in the system depended on convergence of policies, which would maintain the internal and external value of t currencies of the signatory countries. And it laid special emphasis on the role of the Fund. There was special reference, too, to the currencies constituting the SDR, and to developing multilateral cooperation in relation to them which would reinforce the Fund's role.

We need to carry forward our thinking about how a multi-currency world monetary system can best be made to work to the advantage of us all. Floating rates absolve none of us from our responsibilities towards others. It is unlikely that we shall return to a system wholly dominated by one currency. But the Versailles undertakings could prove a major step towards a more stable multi-currency system, with countries sharing the responsibility for providing the asset base of the system, and working together to ensure that currencies maintain their value.

The Versailles undertakings rightly put the emphasis on major countries following non-inflationary policies, and on international cooperation. Monetary stability in a multi-currency system depends first on principal currencies — let us say for this purpose the five SDR currencies — gaining and retaining a reputation as low-inflation currencies. The more important a currency is in the world, the more important this becomes in the interests of the system. There is a special reciprocal obligation among the Five. They have as well an obligation, recognized at Versailles, to other nations. Within the Five there is a particular need for cooperation on policy, a recognition by each of an international obligation and a right to urge the needs of the system on its partners.

An orderly multi-currency system has implications for the world-wide management of reserves, a matter of legitimate interest to the Fund. Reserves are there to be used in need and to ease the process of adjustment. But sharp swings in the currency composition of reserves, whether as a result of diversification or intervention, could in some circumstances add undesirably to instability.

The SDR would be more likely to be held in reserves on its own merits as a strong unit if the value of its component currencies were better maintained. SDR assets would also be increasingly attractive to the private sector. Both developments should be mutually reinforcing and would help international stability.

The US economy: key to the timing of recovery

The US Administration's firm and public commitment to prudent monetary and fiscal policies should be a reassurance that inflationary pressures will not once again be allowed to undermine the recovery. As many of us know from our own national experience, however, the implementation of these policies is far from easy.

Our own experiences have taught us how complex is the operation of monetary policy. Monetary conditions need to be assessed in the light of a range of indicators: the growth of the various monetary aggregates, progress on inflation, the exchange rate, and liquidity pressures on companies.

Experience in the United States is pointing to similar conclusions. I welcome, therefore, the flexible but firm approach of the American authorities. And, of course, we all welcome the reduction in US interest rates in recent weeks. We can all welcome, too, the passage by Congress of the US President's tax package. My own country had to take hard decisions last year in the course of carrying through our own medium-term financial strategy. Firm monetary policies do have to be pported by stringent fiscal control if a reduction in interest rates is to be sustained. This will be particularly important as the US economy picks up and private demand for credit revives.

If a sympathetic outsider may offer a view, it seems clear that an important battle has been won. But a long campaign may still lie ahead. The deficit needs to be clearly set on a declining trend for the medium term. Convincing success in that direction would bring immeasurable benefit not only to the US economy but also to the rest of the world. It would give economic agents and governments everywhere the confidence that recovery, at least in the world's largest economy, was likely to be sustained and non-inflationary. The medium term starts now.

The international banking system

There is concern at present about the effects of such over-borrowing on the international banking system. I need hardly stress the importance of sustaining its stability. In the past decade international banking has grown apace. A bigger share of savings has been made available through the major financial centres for international lending, both to companies abroad, and to sovereign borrowers. This process, made more necessary by the two oil shocks, has helped to carry the world economy through them. Technological development, especially in communications, inevitably also played a part in increasing international lending. We are moving towards a single global market.

There is little prospect that this process will be reversed or that the intermediation discharged by the banking system will be substantially transferred to international financial institutions. Their share in the total transfer of resources is likely to remain a relatively modest proportion of the total. So we all have a powerful interest in the health of the international banking system.

This is one of the contexts in which a return to more normal levels of interest rates will be valuable. Very high interest rates have helped to produce accumulations of debt of shorter and shorter maturity.

Equally valuable in this context will be our full support for the international financial institutions. An effective Fund is part of the framework within which the banking system operates: we need to demonstrate that the international community remains determined to restore the creditworthiness of its members by a judicious combination of help and programmes of adjustment. And, of course, adjustment by borrowers who have problems, whether they be companies or countries, is as essential to the banks as it is to the Fund. Creditworthiness maintains the flow of resources to borrowers. It also maintains the flow of interest and repayments to banks.

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There is no alternative to tackling each problem case, whether it is a country, a corporation or a bank that is in trouble, on its merits. There can be no general and automatic system of debt relief which will spare banks the costs of imprudent lending or debtors the pain of adjustment. Rescheduling of debt can be neither automatic nor painless. Capital markets have long memories and may for a long time be reluctant to provide funds for development if borrowers take hasty decisions for the sake of temporary relief. Banks should not withdraw credit indiscriminately from a whole region because one or two countries in that region are suffering payments difficulties. But equally borrowers should not regard rescheduling as an easy way out: that could only be counter-productive.

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H M Treasury

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During the IMF's annual meeting in Toronto last September, the Chancellor, who is also Governor of the Fund for the United Kingdom, addressed fellow Governors on the world economy and the international financial situation. Extracts from that speech, which is still relevant today, are reproduced below.

There are two preconditions for economic success, nationally and internationally, which are valid without regard to the state of the cycle or even the most fashionable set of equations. They are stability and flexibility.

By *stability* I mean a firm economic framework, founded on fair political systems securely rooted in the rule of law, and a currency which maintains its value. I mean, too, an international exchange-rate structure which offers a reasonable measure of stability, while allowing freedom for rates to reflect differential economic performance.

By *flexibility,* I have in mind a willingness to promote and adjust to economic change, and a willingness and capacity to challenge market rigidities: a willingness, too, to check and reverse any tendency towards protectionism.

The causes of decline

Both of these conditions for economic success have been inadequately met in recent years. The stability of the Bretton Woods system was eroded as inflation built up in many countries. Around the world flexibility has been more and more stifled by the entrenchment of inflationary expectations, the fossilization of many market structures — particularly rigidity in labour markets — and the spread of protectionism.

The oil price shocks owed something to the growing strength of inflationary pressures. But they were reinforced by the scale of OPEC's action. The disposition of many countries was to seek to print and float their way out of trouble. It is easy to see why. But the outcome, as we all know too well, has been high inflation.

With what consequences? In the industrial countries, high unemployment. And in the developing countries, the inevitable setback to forecasts of growth that relied upon a continuation of high commodity prices and low interest rates.

The common objectives

Faced by these mounting problems, the international community has, during the three years that have passed since the second oil shock, moved towards a large measure of agreement on the strategic objectives we should follow to obtain a sustainable recovery. This is no mean achievement.

This agreement rests upon an increasingly clear understanding of the need for a sustained and successful fight against inflation, and for the policies that this

be excessive. A 50% increase could however be regarded as the minimum required. Some of the arguments for a much larger increase seem to be based on the assumption that severe global imbalances may recur throughout the 1980s. If adjustment is successful, the scale of imbalances should, however, fall. If unexpectedly severe balances do recur, it would be more appropriate to augment the Fund's resources by borrowing.

As for the distribution of the quota increase, it should be achieved in a way that is uniform, fair, and systematic. It should allow quota shares to change in an orderly way over time to reflect more clearly members' positions in the world economy. The allocation of any increase in quotas according to calculated quota shares seems to meet these criteria in a straightforward and transparent fashion.

Conclusions

My conclusions can be summarised under five headings.

First, we must maintain and sustain the central institutions, the Fund and the Bank. That means support for their key roles, in surveillance and advice on adjustment policies, and in providing development finance. And it means support through the assurance of adequate additional resources, for example, by reaching early agreement on a substantial increase in Fund quotas, and through the timely release of agreed contributions to IDA-VI.

Secondly, we must continue to pursue responsible financial policies. This means a firm but flexible approach to monetary policy, taking into account all monetary indicators and avoiding excessive tightness or easing of financial conditions. And it means that we must continue to reduce budget deficits, putting further downward pressure on interest rates. In this respect we look particularly to the United States. For companies — or countries — facing difficulties at present, lower interest rates are an urgent requirement.

Thirdly, we must work for greater exchange rate stability. This certainly means building on the joint responsibilities recognized at the Versailles summit, which could involve a fuller and more secure expression of the original purpose of the Bretton Woods agreement than we have seen for many years.

Fourthly, governments of almost all industrial countries, including my own, need to persuade their peoples of the need for pay restraint, permitting labour costs to adjust and profitability to increase. We must also remove unnecessary controls, encourage flexibility in goods and labour markets, and avoid resort to protectionism.

Finally, countries with excessive debts must like the rest of us follow appropriate adjustment policies, and private sector banks will need to show a matching responsibility. The former should accept that rescheduling can only be effective if accompanied by the right policy changes; the latter that adequate supervision and prudent individual risk assessments are essential components of a stable system.

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implies. It rests on the firm control of monetary growth, and of public deficits and public spending — themes that the Managing Director has stressed frequently. It rests on the better working of markets, the reduction of costs, and the improvement of profits. It points the way perhaps to a new Fund role surveying countries' policies, which would not be unlike its old position in relation to exchange rates.

The tensions of transition from an era of high inflation can perhaps be seen as global withdrawal symptoms. For across the world the inflationary fever has been checked.

Inflationary expectations in most of the major industrial countries are changing significantly. Given the predominant weight of the United States in the world economy, and the importance of its currency in international financial markets, the progress registered there is particularly important.

And in the United Kingdom we have brought inflation down to around one third of the peak rate suffered two years ago. And the prospect, with Government borrowing following the downward path we set then, is for further falls. Elsewhere, too, there has been progress.

But of course there is justified world-wide anxiety about the pain of the process. We need not only strong nerves but also the determination to persuade our people that the course on which most of us here agree really is the best, and that a turn-around in policy now would only plunge us back again into rising inflation and, still worse, unemployment. Defeating inflation may be profoundly uncomfortable, but to be defeated by inflation would have been disastrous.

The way ahead

But agreement on the diagnosis, and on the proper course of treatment, does not absolve us from the need to be sensitive in our precise prescription. How can we best help each other and our common interest?

First, we must foster both the stability of our system and its ability to adapt to change. We need more than ever the international financial institutions which we have inherited from the Bretton Woods era, and we need to defend and develop their tried and familiar roles in contributing both to stability and to change: in the one case to adjustment, in the other to development.

From time to time there are calls for new institutions. What their roles would be, and how they would be defined, is not clear. What is clear, in my view, is that this is not the time for a fundamental reappraisal of a tested institutional structure which has served us well, and never more so than at the present juncture.

As I said last year, new institutions are not the key to a better future. But we must certainly encourage the evolution of the Fund and the Bank in response to changing needs. And it is to this that I now turn.

The development of the multi-currency system

Last year I spoke about the network of our joint responsibilities towards each other and towards the world monetary system. I suggested that the special drawing right (SDR) could not be a worthwhile asset unless its component currencies retained their value. I spoke also of the reciprocal obligations which would arise if the countries whose currencies are represented in the SDR in fact discharged that responsibility.

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But agreement on the diagnosis, and on the proper course of treatment, does not absolve us from the need to be sensitive in our precise prescription. How can we best help each other and our common interest?

First, we must foster both the stability of our system and its ability to adapt to change. We need more than ever the international financial institutions which we have inherited from the Bretton Woods era, and we need to defend and develop their tried and familiar roles in contributing both to stability and to change: in the one case to adjustment, in the other to development.

From time to time there are calls for new institutions. What their roles would be, and how they would be defined, is not clear. What is clear, in my view, is that this is not the time for a fundamental reappraisal of a tested institutional structure which has served us well, and never more so than at the present juncture.

As I said last year, new institutions are not the key to a better future. But we must certainly encourage the evolution of the Fund and the Bank in response to changing needs. And it is to this that I now turn.

The development of the multi-currency system

Last year I spoke about the network of our joint responsibilities towards each other and towards the world monetary system. I suggested that the special drawing right (SDR) could not be a worthwhile asset unless its component currencies retained their value. I spoke also of the reciprocal obligations which would arise if the countries whose currencies are represented in the SDR in fact discharged that responsibility.

This theme was taken up in the statement issued at the Seven Power Economic Summit at Versailles, acknowledging a joint responsibility towards the world monetary system. That statement recorded the agreement of the Seven that greater stability in the system depended on convergence of policies, whi[ch] would maintain the internal and external value of t[he] currencies of the signatory countries. And it laid special emphasis on the role of the Fund. There was special reference, too, to the currencies constituting the SDR, and to developing multilateral cooperation in relation to them which would reinforce the Fund's role.

We need to carry forward our thinking about how a multi-currency world monetary system can best be made to work to the advantage of us all. Floating rates absolve none of us from our responsibilities towards others. It is unlikely that we shall return to a system wholly dominated by one currency. But the Versailles undertakings could prove a major step towards a more stable multi-currency system, with countries sharing the responsibility for providing the asset base of the system, and working together to ensure that currencies maintain their value.

The Versailles undertakings rightly put the emphasis on major countries following non-inflationary policies, and on international cooperation. Monetary stability in a multi-currency system depends first on principal currencies — let us say for this purpose the five SDR currencies — gaining and retaining a reputation as low-inflation currencies. The more important a currency is in the world, the more important this becomes in the interests of the system. There is a special reciprocal obligation among the Five. They have as well an obligation, recognized at Versailles, to other nations. Within the Five there is a particular need for cooperation on policy, a recognition by each of an international obligation and a right to urge the needs of the system on its partners.

An orderly multi-currency system has implications for the world-wide management of reserves, a matter of legitimate interest to the Fund. Reserves are there to be used in need and to ease the process of adjustment. But sharp swings in the currency composition of reserves, whether as a result of diversification or intervention, could in some circumstances add undesirably to instability.

The SDR would be more likely to be held in reserves on its own merits as a strong unit if the value of its component currencies were better maintained. SDR assets would also be increasingly attractive to the private sector. Both developments should be mutually reinforcing and would help international stability.

The US economy: key to the timing of recovery

The US Administration's firm and public commitment to prudent monetary and fiscal policies should be a reassurance that inflationary pressures will not once again be allowed to undermine the recovery. As many of us know from our own national experience, however, the implementation of these policies is far from easy.

Our own experiences have taught us how complex is the operation of monetary policy. Monetary conditions need to be assessed in the light of a range of indicators: the growth of the various monetary aggregates, progress on inflation, the exchange rate, and liquidity pressures on companies.

Experience in the United States is pointing to similar conclusions. I welcome, therefore, the flexible but firm approach of the American authorities. And, of course, we all welcome the reduction in US interest rates in recent weeks. We can all welcome, too, the passage by Congress of the US President's tax package. My own country had to take hard decisions last year in the course of carrying through our own medium-term [fi]nancial strategy. Firm monetary policies do have to be [su]pported by stringent fiscal control if a reduction in interest rates is to be sustained. This will be particularly important as the US economy picks up and private demand for credit revives.

If a sympathetic outsider may offer a view, it seems clear that an important battle has been won. But a long campaign may still lie ahead. The deficit needs to be clearly set on a declining trend for the medium term. Convincing success in that direction would bring immeasurable benefit not only to the US economy but also to the rest of the world. It would give economic agents and governments everywhere the confidence that recovery, at least in the world's largest economy, was likely to be sustained and non-inflationary. The medium term starts now.

The international banking system

There is concern at present about the effects of such over-borrowing on the international banking system. I need hardly stress the importance of sustaining its stability. In the past decade international banking has grown apace. A bigger share of savings has been made available through the major financial centres for international lending, both to companies abroad, and to sovereign borrowers. This process, made more necessary by the two oil shocks, has helped to carry the world economy through them. Technological development, especially in communications, inevitably also played a part in increasing international lending. We are moving towards a single global market.

There is little prospect that this process will be reversed or that the intermediation discharged by the banking system will be substantially transferred to international financial institutions. Their share in the total transfer of resources is likely to remain a relatively modest proportion of the total. So we all have a powerful interest in the health of the international banking system.

This is one of the contexts in which a return to more normal levels of interest rates will be valuable. Very high interest rates have helped to produce accumulations of debt of shorter and shorter maturity.

Equally valuable in this context will be our full support for the international financial institutions. An effective Fund is part of the framework within which the banking system operates: we need to demonstrate that the international community remains determined to restore the creditworthiness of its members by a judicious combination of help and programmes of adjustment. And, of course, adjustment by borrowers who have problems, whether they be companies or countries, is as essential to the banks as it is to the Fund. Creditworthiness maintains the flow of resources to borrowers. It also maintains the flow of interest and repayments to banks.

In these ways we can help to underpin confidence. But there is certainly work to be done at the level of the banking system itself. The first oil shock produced tremors which gave a salutary impetus to international cooperation in banking supervision. There has been steady improvement in such cooperation and in national standards of banking supervision, covering risk assessment, prudential standards, monitoring and control. But I am sure central banking colleagues would agree that there is further progress to be made. Some recent developments testify to that. In particular it is important that there should be a watertight allocation of supervisory responsibilities, and that when agreement has been reached on a principle such as the consolidation of the accounts of banking groups, priority is given to the legal or administrative steps needed to give effect to it.

Recent events will have brought home to banks that they alone are responsible for the assessment of credit risk, and that credit risk applies to sovereign borrowers as well as to others. Proper risk analysis is a responsibility which no banking management can abdicate. What cannot be accepted is the charge that the authorities should not have allowed commercial banks to lend as much as they have. This assumes that the authorities can be better judges of credit risk than banks themselves. I can think of many actions by public administrations around the world which put a very large question mark over that proposition.

There is no alternative to tackling each problem case, whether it is a country, a corporation or a bank that is in trouble, on its merits. There can be no general and automatic system of debt relief which will spare banks the costs of imprudent lending or debtors the pain of adjustment. Rescheduling of debt can be neither automatic nor painless. Capital markets have long memories and may for a long time be reluctant to provide funds for development if borrowers take hasty decisions for the sake of temporary relief. Banks should not withdraw credit indiscriminately from a whole region because one or two countries in that region are suffering payments difficulties. But equally borrowers should not regard rescheduling as an easy way out: that could only be counter-productive.

Financing of the Fund

This brings me to the financing role of the Fund itself, in providing an orderly framework within which private capital flows can take place. I do not subscribe to the view that the Fund should be confined to a role of lender of last resort. During the last decade many countries, both developed and developing, have tended to treat it as such. When they have already exhausted the credit available from other sources, they have had eventually to seek Fund support for an adjustment programme which has necessarily been much more painful than if the difficulties had been acted upon earlier. This should not be seen as an argument for increasing the access to the Fund's resources, but rather, as the Managing Director has indeed urged, for encouraging members to approach the Fund at an early stage.

On the other hand, as he has also pointed out, members may be disinclined to make a timely approach to the Fund unless it clearly is in a position to offer resources in sufficient volume. Moreover, the structural nature of much of the maladjustment — in both developed and developing countries — tends to take longer to correct than problems of excess aggregate demand. The Fund's facilities have rightly evolved to reflect this, but the objective of adjustment supported by the Fund should still be the restoration of a member's economy over a reasonable period to a position which can be sustained from other sources of finance. We must not lose sight of the revolving character of the Fund's resources.

These considerations suggest to me that quotas will need to be increased substantially, particularly if the Fund's borrowed resources are to be gradually displaced as they mature. In my view a doubling of quotas would

BRIEFING FOR PROBLEM COUNTRIES

Argentina

Total indebtedness at end-1982 was an estimated $39 bn. Financial sanctions between the UK and Argentina were lifted jointly in September. Following subsequent negotiations, Argentina reached agreement in early November with the four main UK clearing banks on the settlement of debt arrears built up while the sanctions were in force. Other UK banks also subsequently began to receive payments from the Argentines. We understand that these arrears have been more or less settled. This paved the way for the signing of a $1.1 bn banks' bridge loan on 31 December and enabled discussions to continue on a further $1.5 bn medium-term loan (which bankers expect to be finalised by end-February) and on the rescheduling of $5.5 bn of public sector debt maturities overdue on 1.12.82 and falling due from that date to 31.12.83. Official support has come from the IMF in the form of a 15-month Standby Arrangement worth SDR 1.5 bn and a CFF for SDR 520 mn. These were approved at an Executive Board meeting on 24 January. As well as fulfilling normal performance criteria, drawings under the programme after end-July are subject to the removal of existing discriminatory restrictions (which in effect means the remaining restrictions against UK interests). A $500 mn BIS facility has been arranged but does not involve UK participation. Despite the rapid international response to Argentina's financial difficulties, there are widespread fears that the unstable domestic political situation will conspire to make the IMF programme unworkable and thus jeopardise further bank loan disbursements which are conditional on continued access to Fund resources.

Brazil

Total indebtedness at end-1982 was an estimated $81 bn. Following difficulties, particularly in October, in obtaining medium-term finance in the wake of the Mexican crisis, the authorities turned to official bodies, international organisations and banks for emergency loans to see them through the remainder of 1982.

Official support has included credits of $1.5 bn from the US Treasury; $1.2 bn (UK participation of $110 mn) from the BIS, supplemented by a parallel facility of $250 mn from the Saudi Arabian Monetary Agency (SAMA); and an SDR 500 mn CFF from the IMF. A request for an SDR 4.2 bn 3-year EFF should be approved by the IMF Executive Board by end-February. International banks, which had provided bridging finance totalling $2 bn, were approached on 20 December for a four-project package consisting of: (i) $4.4 bn in new money (for the whole of 1983); (ii) the rescheduling of $4.0 bn (the authorities have since quoted a figure of $4.7 bn) of 1983 maturities on public and private sector debt; and the restoration of (iii) trade-related credit lines and (iv) interbank facilities to the higher of their exposure to Brazil at 30. 6.82 or 31.12.82. Whilst projects 1 and 2 have received a good response from banks (commitments respectively of $4.1 bn and $4.3 bn), the restoration of credit lines has been more difficult. There are also fears that the Brazilian forecast of a trade surplus of $6 bn is over-optimistic and as a result banks could well be approached for further financing later in the year.

Mexico

Total indebtedness at end-1982 was an estimated $83 bn. Concerted international co-operation in helping to resolve the country's external financial difficulties and early indications of the willingness of the new administration, which took office on 1 December 1982, to adopt sound economic adjustment measures facilitated IMF approval of a 3-year EFF and a first credit tranche drawing, totalling SDR 3.6 bn, on 23 December. With the aim of closing Mexico's financing gap in 1983, the IMF's Managing Director had earlier asked commercial banks to lend $5 bn in new money (over $4.7 bn had been committed by end-January) and had also requested a total of $2 bn (over $1.8 bn committed) in official export credits from various governments (including the UK). Under the $925 mn BIS bridging facility (UK participation of $140 mn), which had been linked, inter alia, to progress on an IMF arrangement, all but $70 mn of the third (and final) tranche had been drawn by 20 January. Following an agreed extension for four months to 23 March 1982 of an original 90-day moratorium on public sector capital repayments due to banks, the authorities submitted formal rescheduling proposals to the Advisory Group of banks in early December. Under the proposals, principal payments on public sector debt outstanding at 23 August 1982 and falling due between then and end-1984 would be rescheduled over up to 8 years. Plans to reschedule private sector debt are expected to be announced shortly. Looking to the future, major uncertainties over the Mexican's ability to adhere to the IMF's tough programme targets are reinforced by the likelihood of a further reduction in the price of oil, which accounts for some 75% of the country's exports. Any serious under-performance in relation to the IMF programme would risk unwinding the current international financial rescue operation.

NIGERIA

1 Nigeria's debt problem is an accumulation of arrears on trade, estimated at $3 bn. Nigeria has failed to match expenditure to falling oil revenues. When reserves were nearly exhausted in April 1982 a monthly ceiling of $1.2 bn was placed on foreign exchange disbursements. Imports however continued at a high level with the consequent build-up of arrears. The Nigerian government has now taken further measures to limit imports to $900 mn per month and if these are effective the current account could be in surplus in 1983.

2 Nigeria's immediate problem is to deal with the $3 bn arrears. To do this she will need to borrow. Although her long-term debt is no more than $12 bn (est.) and her debt service ratio is a comparatively comfortable 15% her reputation in the markets is poor. The Nigerians have invited an IMF team to Lagos in the hope that they will bless Nigeria's economic measures and that this will help re-establish confidence in the markets. Nigeria will not go directly to the Fund for assistance (at least not before the August elections) since this would almost certainly be conditional on a devaluation of the Naira. Warburgs are advising on external financing.

3 Nigeria is the weakest link in OPEC. Her incompetent marketing leads to fluctuations in oil production levels and she is more exposed than other OPEC members to competition from the North Sea and US producers. Provided Nigeria is able to maintain 1982 average production levels, a small fall in the price of crude (eg $4) would be manageable since oil revenues have been estimated conservatively in the 1983 budget.

4 Nigeria's long-term problems include poor management, lack of administrative control, and corruption. An overvalued Naira and excessive reliance on oil have contributed to the disappearance of a once successful agricultural sector. With the end of the oil boom bankruptcies and unemployment have risen, leading, inter alia, to the government's precipitate expulsion of 2 mn illegal immigrants.

THE PHILIPPINES

The balance of payments has continued to deteriorate, largely reflecting further weakening of exports: the trade deficit in 1982 totalled $2.8 bn and the current deficit $3.4 bn (8 1/2% of GDP) compared with $2.2 bn and $2.3 bn (6% of GDP) respectively in 1981. The overall balance of payments deficit was $1.1 bn for the year as a whole - twice the original projection, which was itself criticised by the IMF as excessive.

The Philippine authorities have announced a number of corrective measures - including a 3% import surcharge, closer control of short-term borrowing (which has risen rapidly in recent years) and a reduced ceiling on approvals for medium and long-term borrowing. They have also postponed some of their major industrial development projects (which are heavily dependent on external finance) as part of a more general effort to restore budgetary stability. Agreement with the IMF on a standby facility (for $350 mn) and a CFF drawing, is likely to be reached this month (the Board discussion is on 25 February) and a second Structural Adjustment Loan from the IBRD should also be available this year.

The performance criteria sought by the Fund are not yet known for certain, although it is reported that the budget deficit will be required to be limited to 2.4% of GDP this year (after 3.9% last year) and 2% in 1984. The Philippine government are reportedly seeking to reduce the overall balance of payments deficit to some $0.5-0.6 bn this year. Although gross reserves ($2.42 bn at end-December, equivalent to 3.7 months imports) are still reasonably high, the degree of adjustment implied by this target looks unimpressive. There have been a number of forecasts in recent months that the Philippines will be forced to reschedule some of its debt this year, and reports of greater caution towards lending to the Philippines on the part of the banks. The burden of short-term debt makes the Philippines vulnerable to the erosion of confidence.

Total debt at end-1982 stood at $17 bn, of which $13 bn was in the form of medium or long term loans, $4 bn short-term revolving credits.

The Philippines has a very high proportion of debt maturing within 1 year. At end-June 1982, the proportion had reached 61% of total debt compared with 57% at end-1981 and 41% at end-1978.

3.2.1983

SOUTH KOREA

Since 1979 South Korea has adjusted relatively successfully to the sharp deterioration in the external position. Following the second oil shock, adjustment policy measures included a large depreciation of the won against the US$ and tight monetary control. The current account deficit has been narrowed, in successive years to an estimated US$2.55 bn in 1982 from US$4.15 bn in 1979.

Despite adjustment, however, sharp increases in external debts have occurred. Between 1978-81 total disbursed debt more than doubled to just over US$33 bn. Over the same period the medium and long-term debt service ratio increased from 13.2% to 19.9%, and this at a time of substantial increases in the value of exports. Furthermore, although the won has depreciated against the US dollar, it has strengthened against other major currencies, with a consequent loss of competitiveness. The large cost of debt servicing is now a constraint upon the government's willingness to depreciate further against the US dollar.

Total disbursed debt was estimated by the IMF to be $35.8 bn at end 1982, of which $12.8 bn (36%) was short term. On projections for 1983, total debt will increase by 10.6% to US$39.6 bn while merchandise exports are expected to increase by 12% to US$23.5 bn. However, this latter figure may be optimistic as it is predicated on 3% economic growth in the US.

S Korea achieved very fine terms for most of its borrowings in 1982 but the less generous terms offered to the Korean Exchange Bank on a prospective US$500 mn loan may reflect a hardening of the market's attitude.

3 February 1983

Venezuela

Total indebtedness at end-1982 was an estimated $28 bn. With oil accounting for 95% of exports and 60% of fiscal income the weakness in the oil market led to severe strains in Treasury finances last year. Together with the country's difficulties in the euromarkets this has led to sustained speculative pressure on the Bolivar and a sharp fall in reserves. Confidence in the country has also been badly shaken by the collapse of the Banco de los Trabajadores (the Trade Unions' bank) which was brought under the control of the government in late November. Venezuela is currently attempting to refinance $2.4 bn of short-term debt maturing by end-March and intends to refinance a further $3.5 bn by the end of this year (out of a total of $8.7 bn). The programme started quite successfully in October but has run into difficulties following a series of late payments by some state agencies, in particular the development agency CVF (which has been declared in default). In view of the danger that the refinancing programme could collapse as a result the authorities have said they will ensure that the $84 mn of CVF arrears will be settled. In addition, a small advisory committee of foreign banks is to be formed in order to improve communications between the government and the banking community. Venezuela's Finance Minister, Dr Arturo Sosa, is currently planning a foreign tour to clarify the details of both this and the country's overall refinancing plan for 1983. International reserves totalled around $11 bn at end-1982, but foreign exchange reserves in the hands of the Central Bank were only some $2.5 bn - leaving Venezuela insufficiently liquid to sustain heavy repayments as a result of refinancing shortfalls or to cope with further capital outflows without, for example, gold sales. The possibility of IMF assistance has also been raised by Sosa for the first time, although he may only be referring to the possible future conversion of SDR holdings and/or drawings on the country's reserve tranche.

YUGOSLAVIA

Total indebtedness is about $20 bn. Notwithstanding an IMF upper-tranche programme, Yugoslavia failed to come to grips with increasingly severe payments imbalances in the late 1970s. These resulted from high growth and from investment financed by heavy foreign borrowing for projects which often would not yield convertible currency earnings to service the debt. With reserves now largely exhausted, an international package involving both governments and banks is being devised under IMF auspices to provide Yugoslavia with new credit whilst restructuring existing debts. (To cope with the Yugoslavs' insistence that they will not reschedule, other euphemisms are being employed.) Agreement with the IMF on a tight programme for the third year of the current standby agreement is the key to the proposed financial package. The programme aims, inter alia, to cut real incomes by 7% and includes further devaluations of the dinar and increases in subsidised prices and in interest rates. Imports have been cut drastically and, even if exports do not achieve the 20% increase to which the Yugoslavs aspire, it may be possible to reduce the deficit on convertible-currency current account from $1 bn in 1982 to something close to balance in 1983.

The financial package is intended to help Yugoslavia meet maturing debt of $4.5 bn maturing in 1983 and finance a current account deficit of $1 bn during the first six months. The surplus in the seasonally strong second half would boost reserves to help Yugoslavia through the difficult first half of 1984. The indications are that a package is feasible, although its adequacy will depend on the success of the IMF programme, the quality of the finance provided by governments and a reasonably comprehensive response from the banks.

Funds totalling $0.6 bn net should be available from the IMF and IBRD if Yugoslavia meets the terms of the standby agreement. Governments have offered $1.3 bn in medium-term credits. Most of this is in the form of export credits (whose relevance to Yugoslavia's immediate financing needs must be somewhat questionable). Only about $330 mn is financial credit; and, of this, only about $190 mn is not tied to refinancing maturities. Some financial offers are conditional on improvements in the quality of offers by other

governments (notably by the FRG and France). It is proposed that HMG's contribution to the government credits will be £78 mn (equivalent to about $120 mn at current exchange rates) and of high quality, taking the form of untied financial credits and of loans to refinance payments due to ECGD. Any disbursement under credits agreed before early December last year would be additional to the $1.3 bn; ECGD have about £75 mn in the pipeline. In addition ECGD will remain on cover for short-term business. Alongside the $1.3 bn government package assistance of $100 mn to $200 mn may also be forthcoming from Kuwait.

The commercial banks are being requested to roll over some $3 bn of maturing debt this year and to provide a further $1 bn in new money. They have formed an international Advisory Committee (with Barclays Bank International representing the British banks) to take matters forward and Yugoslavia has, at their suggestion, sought a 90-day deferral of maturities falling due before 31 March to give more time for discussions. The Advisory Committee plans to meet again on 7 and 8 February.

Because Yugoslavia's payments position is seasonally weak in the first half of the year and much of the financing package will not be available until later, the BIS is considering a request for a short-term loan of $0.5 bn backed partly by Yugoslav collateral and partly by central banks. The Bank of England's share might be of the order of $30 mn. It is intended that part of the financial loan to be made available by HMG should serve if necessary to take out the Bank and a Treasury indemnity will not be required.

FROM: M A HALL
3 February 1983

c c Chief Secretary
Economic Secretary
Mr Littler
Mr Lavelle
Mr Bottrill
Mr Monaghan
Mr Page
Mr Towers

CHANCELLOR

PRE WASHINGTON BRIEFING : PRESS AND MEDIA CONTACTS

You have a number of engagements tomorrow related more or less directly to the forthcoming Washington meetings. This minute provides briefing for all of them.

2. By way of general briefing, you will wish to leaf through the briefs prepared for your appearance before the TCSC, and such of the briefs for Washington as are ready in time. You will also wish to draw generally on the speaking note prepared for the press conference. OF are submitting directly both the Washington briefs and the draft opening remarks.

(i) Sarah Hogg

Miss Edwards' attached minute describes the arrangements and content of the interview.

(ii) Andreas Whittam Smith

Andreas Whittam Smith is coming in at our suggestion for a chat about US attitudes and public positions, on the lines you discussed so usefully with Peter Riddell.

(iii) Press Briefing

This will be at 11 am in your office at the Treasury. Briefing and questions will be on-the-record. If you wish to go off-the-record, we shall need to say so explicitly. We shall distribute at the meeting a text of your opening remarks. We may well put this out as a press release later in the day. A list of journalists attending is attached. Attendance is by invitation, but

we have cast the net fairly widely, to cover both foreign and British press.

Mr Littler will support.

(iv) Geoffrey Owen

Geoffrey Owen, Editor of the Financial Times, is coming at his own request for a general briefing on the international situation, and priorities for the paper over the coming weeks and months. He will already have seen your Toronto speech.

I imagine you will want to go over the ground in your statement to the TCSC. It is also worth highlighting the Brussels issue, and looking forward to the Williamsburgh Summit.

(v) Peter Norman

Peter Norman - who used to work for the Times - is coming to see you at No 11. This arises from a suggestion of mine that he might like to do an interview with you ahead of the Interim Committee, fairly soon after the Wall Street Journal European edition began publication. The most recent copy of the newspaper is attached. The interview will not be written up in question and answer form, but as a continuous narrative with extensive quotation. I hope to persuade Peter Norman to hold over his piece until 10 February, to coincide with the opening of the Interim Committee meeting. He is, however, slightly alarmed at the fact that we are doing a large general briefing, and may feel he has to go to press on Monday. His decision will obviously depend on how "exclusive" he feels his interview is.

I have suggested to him that a particular theme he might follow through is the role of the Americans in all this, both in discussion of the GAB and the quotas, and through the immense importance of their budget deficit and economic policies to the health of the world economy. This will obviously need delicate handling, in that nothing could be worse than a piece describing you as about to go round

Washington advising the Americans on how to run their economy. Another good theme is the British role in international monetary affairs, demonstrated by our disproportionate involvement in the Fund, and major role in shaping the emerging strategy for recovery.

M A HALL

6/1 3/2 am.

FROM: MISS E M EDWARDS
28 January 1983

MAM 31/1

1. MR PAGE
2. MR HALL
3. CHANCELLOR

cc: Mr Monaghan

INTERIM COMMITTEE: SARAH HOGG

Sarah Hogg has asked whether she may interview you in advance of the forthcoming Interim Committee meetings, and you have said you are prepared to agree to a recorded interview at No 11, for the Channel 4 evening news programme.

The subject would be the Interim Committee, how you feel about your chairmanship, and in particular how you see its deliberations helping to resolve the 'world financial crisis'.

The time needed for recording the interview would not exceed 20 to 30 minutes, for which you have space in your diary at present at 10 am on Friday, 4 February. Actual transmitting time is likely to amount to 5 or 6 minutes in all, part on that evening, and the rest on Wednesday, 9 February.

E. M. Edwards

MISS E M EDWARDS

Mr Hall.

PRESS BRIEFING CHANCELLOR'S OFFICE 11.00 AM

4 FEBRUARY re IMF INTERIM COMMITTEE

Those journalists who will be attending the briefing are listed below:

Financial Times	M Wilkinson and A Harris
Times	F Williams
Guardian	Rodgers
D. Telegraph	R Lord
D. Mail	C Fildes
D. Express	K Fleet
D. Mirror	G Goodman
E. Standard	J Levi
S. Observer	W.Keegan
S. Telegraph	A.Murray
Mail on Sunday	M Barnfather
Economist	Marjorie Dean
Investors Chronicle	Shakhar Das
Financial Weekly	D Smith
Reuters	S Fidler
P.A.	Mr Cheston
Birmingham Post	I Richardson
New York Times	B Feeder
Washington Post	Mr Bahree
AP Dow Jones	Marshal Gitler
BBC-TV	JAMES LONG
BBC-Radio	D Harrod
BBC World Service	J Morgan
ITN	G Smith
IRN	D Moffit or T Maddox
Channel 4	S Hogg
TV-AM	Peter Day
Business Week	J Trotter
Newsweek	R Henkoff
NCB	Newsdesk representative
JiJi Press	"
Frankfurter Allegeman Zeitung	Mr Rudolf
Asahi Shimbun	Mr Kidi-Mura
Die Welt	Mr Furler
AFP	Jean Declamy

Peter Norman, W St. Jnl
A Whittam-Smith

FROM: A R H BOTTRILL
DATE: 8 FEBRUARY 1983

CHANCELLOR

cc Sir D Wass
Mr Littler
Mr Burns
Mr Unwin
Mr Lavelle
Mr Odling-Smee
Mr Hall
Mr Atkinson
Mr Graham

PS/Governor (B/E)

Mr Anson (UKDEL/IMF)

IMF INTERIM COMMITTEE: MEETING WITH US CONGRESSMEN

I attach a short list of points to make, together with a set of charts on developing countries' debt problems and the use of Fund resources. This might form the core of your remarks to US Congressmen as well as being useful when you see President Reagan.

4,6,7 are good.

2. Much of the material for the charts is culled from IMF sources, but you might like to seek the Managing Director's advice as to whether it would be useful to have sets of the graphs available for the Congressmen and subsequently for the President. We are indebted to the CSO for drawing the graphs.

A. Bottrill

A BOTTRILL

ENC

Meeting with US Congressmen

Points to make

(i) The current deficits of non-oil developing countries have risen steeply since the 1979-80 oil price rise. In 1980, they totalled more than $100 billion and only fell slightly last year. (Chart 1).

(ii) The deficits reflect not only the rise in oil prices but also the slowdown in world trade which has reduced the growth of markets for developing countries' exports. World trade fell last year for the first time since 1975. (Chart 2).

(iii) Developing countries' current deficits have also been increased by the worsening of their terms of trade for both oil and non-oil commodities. These have fallen continuously for the past five years. (Chart 3).

(iv) The cumulative effect of the current deficits run by non-oil developing countries has been a massive increase in their external debts. These have tripled from about $160 billion in 1974 to about $600 billion now. (Chart 4).

(v) High world interest rates have added to the cost of servicing this debt, so that interest payments and amortisation together accounted for about $100 billion last year. Chart 5. Debt service accounted for almost a quarter of export revenues in non-oil developing countries as a whole - but for some individual countries the figures were much higher, eg Mexico (63 per cent), Brazil (67 per cent), Argentina (98 per cent) and Chile (65 per cent).

(vi) Restoration of major debtor countries to credit-worthiness and economic health requires firm adjustment policies over a number of years. These are being put in place - often with IMF help. Net new lending commitments by the Fund, which averaged only SDR 1-2 billion a year in 1978-79 and 1979-80, have increased to about SDR10 billion a year in each of the past three years. (Chart 6).

Meeting with Congress

30. The Chancellor will want to take Mr Regan's views into account on how to handle this. The UK delegation in Washington will also provide some material. The broad point of course is to seek Congressional support for a quota increase of at least 50 per cent. Some Congressmen have apparently been concerned to limit the total US contribution under both the GAB and the quota increase to SDR 8bn. The US has 25 per cent of the GAB, equivalent to SDR 4¼ billion. It currently has 21 per cent of total quotas, equivalent to SDR 12½ billion. An increase in quotas to SDR 92bn could raise the US quota to about SDR 18 billion. = +5½ BN SDR = 6 BN $

31. In terms of the size of the total US budget currently running at about $800 billion a year or even this year's deficit of about $200bn, these sums are small. You will want to show appreciation of Congressmen's domestic difficulties over the deficit, but stress that IMF resources are used for conditional finance. You will also want to stress the tough adjustment policies that major debtor countries are being asked rightly to undertake with IMF help. The success of these efforts is in the interests of the world financial system as a whole - not least US banks.

32. You might point out that Europe is playing its part with a contribution of more than half of the GAB and a readiness to agree to a quota increase of at least 50 per cent. The IMF is of course a mutually co-operative club. The GAB was last activiated in 1978 to finance US drawings of SDR 800 million of its reserve tranche.

...2 33. A list of the Congressmen you will be seeing is attached as background, together with a recent Wall Street Journal report of the House Banking Committee's views.

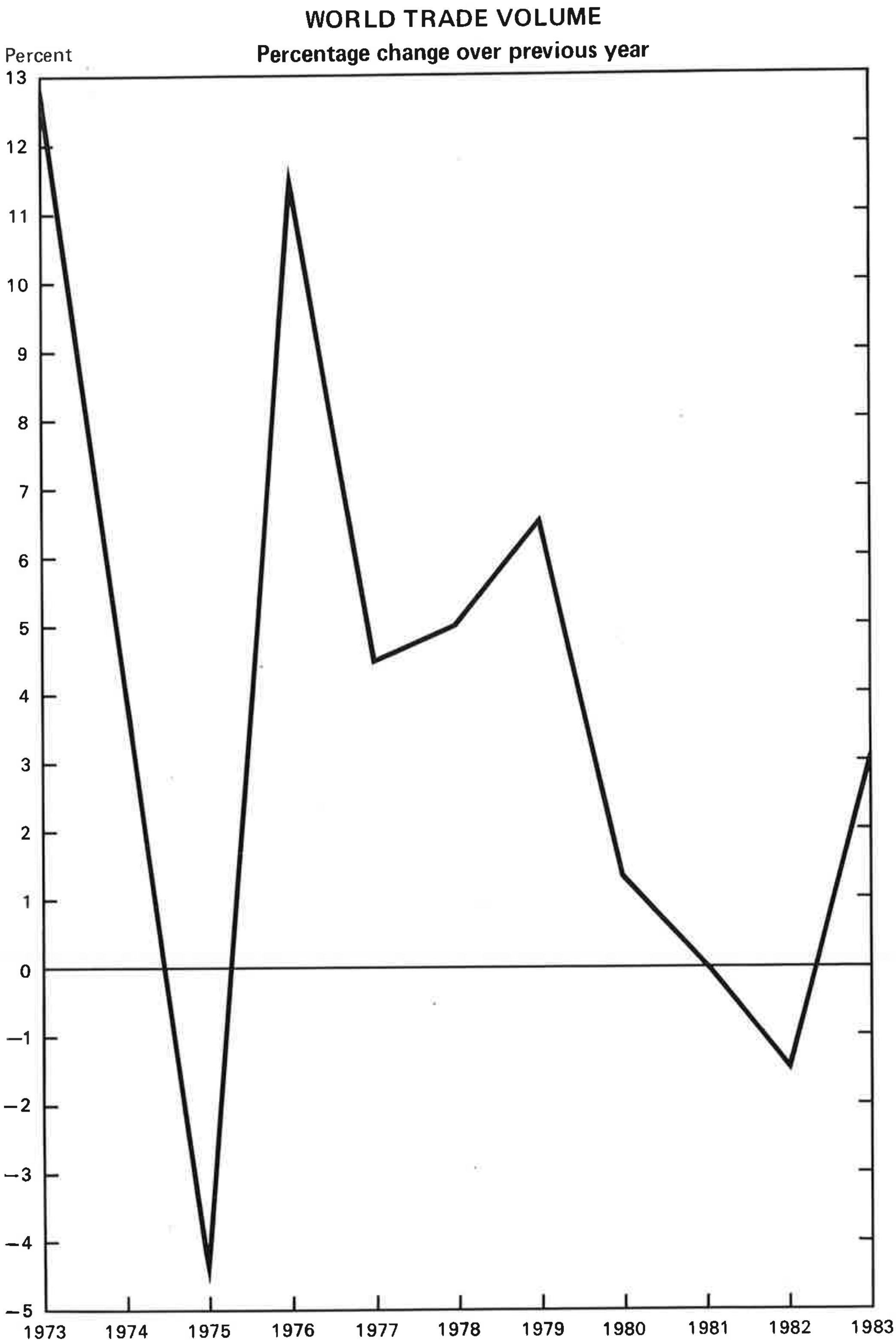
(vii) It is important to distinguish between the role of Fund lending and overseas aid transfers. Fund loans are to provide temporary balance of payments finance while domestic policies are changed and structural adjustments are made to the economy. They should have a catalytic effect in encouraging private finance. A significant amount of adjustment is already taking place. The Fund staff expect the non-oil developing countries to reduce their current deficits still further this year - to perhaps $70 billion. But the process is slow.

(viii) This means that the Fund's resources needs to be replenished to allow it to continue its support for adjustment policies. This includes the need for both borrowed resources and quota resources which are being run down by the substantial calls on the Fund. (Chart 7).

(ix) The enlargement and extension of the General Arrangements to Borrow from SDR 6½ billion to SDR 17 billion agreed by industrial countries in Paris last month should provide the Fund with a valuable credit line in case of a threat to the international monetary system. We need now to secure a substantial and prompt increase in Fund members' quotas to provide the Fund with resources to play an effective role over the next five years.

(x) The United States - as the Fund's largest member and the world's foremast financial power - has a key role in this exercise as well as a vital interest in its success.

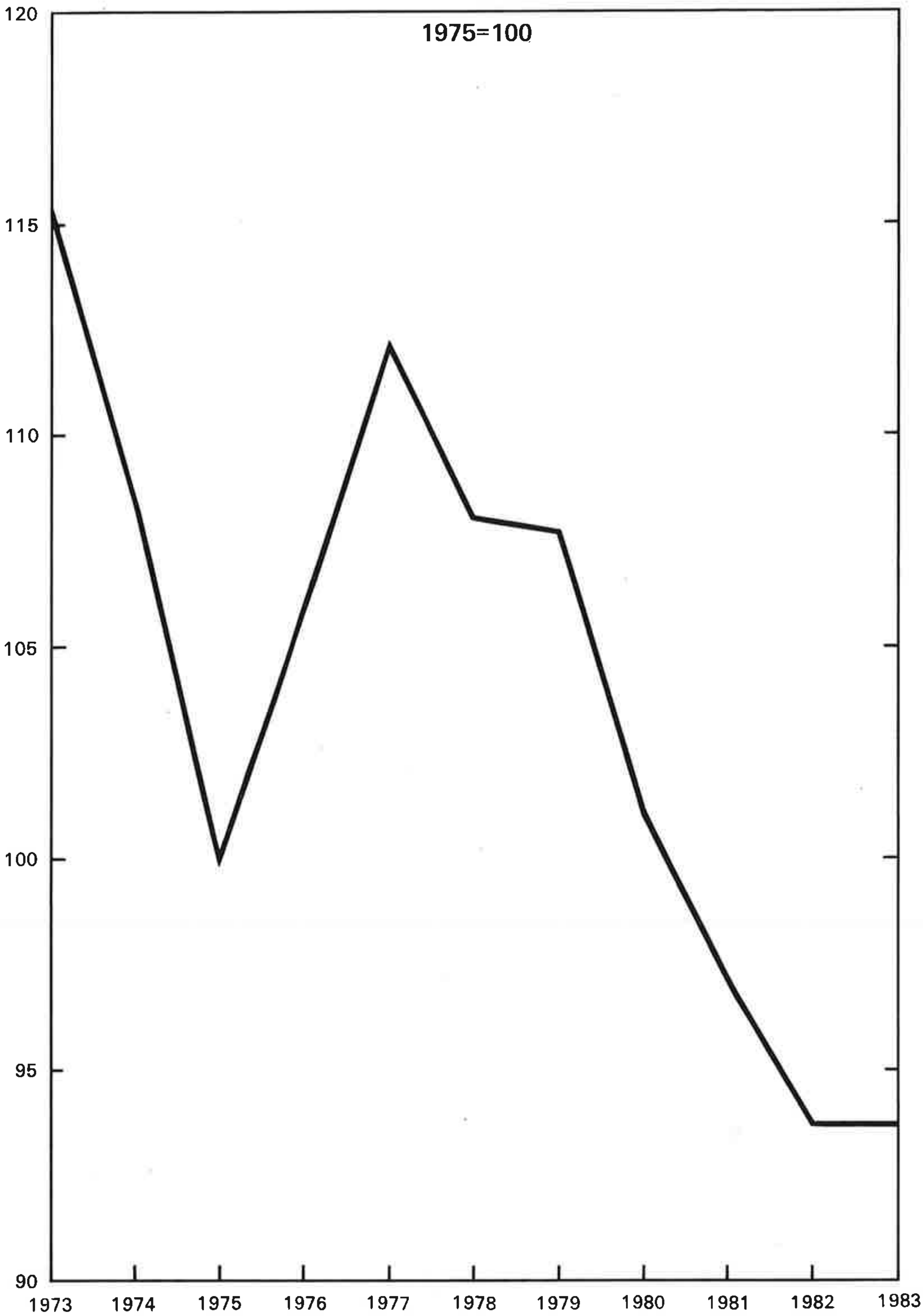
CHART 2



Source : IMF World Economic Outlook

CHART 3

NON–OIL DEVELOPING COUNTRIES' TERMS OF TRADE

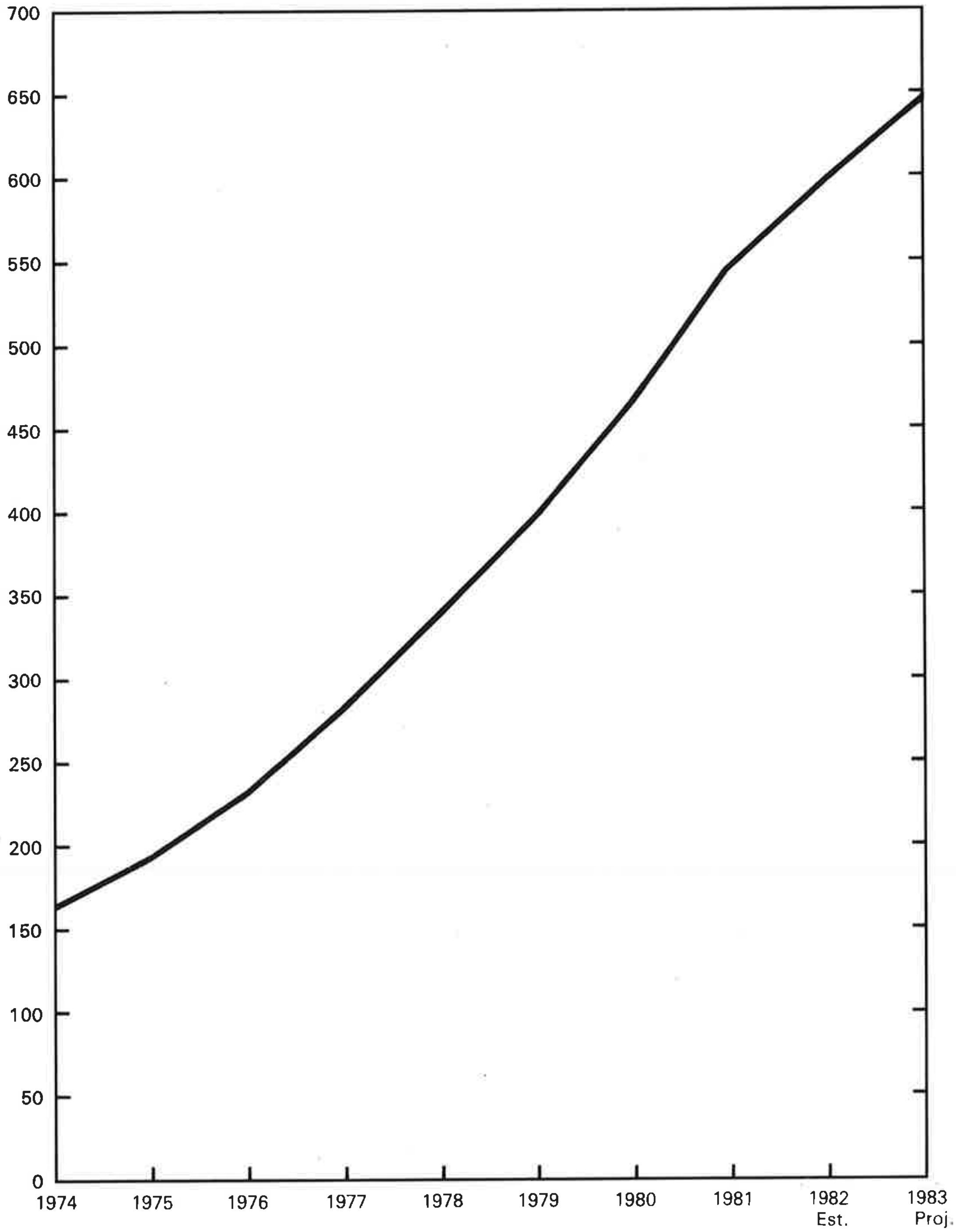


Source : IMF World Economic Outlook

CHART 4

NON-OIL DEVELOPING COUNTRIES:
EXTERNAL DEBT, 1974-83

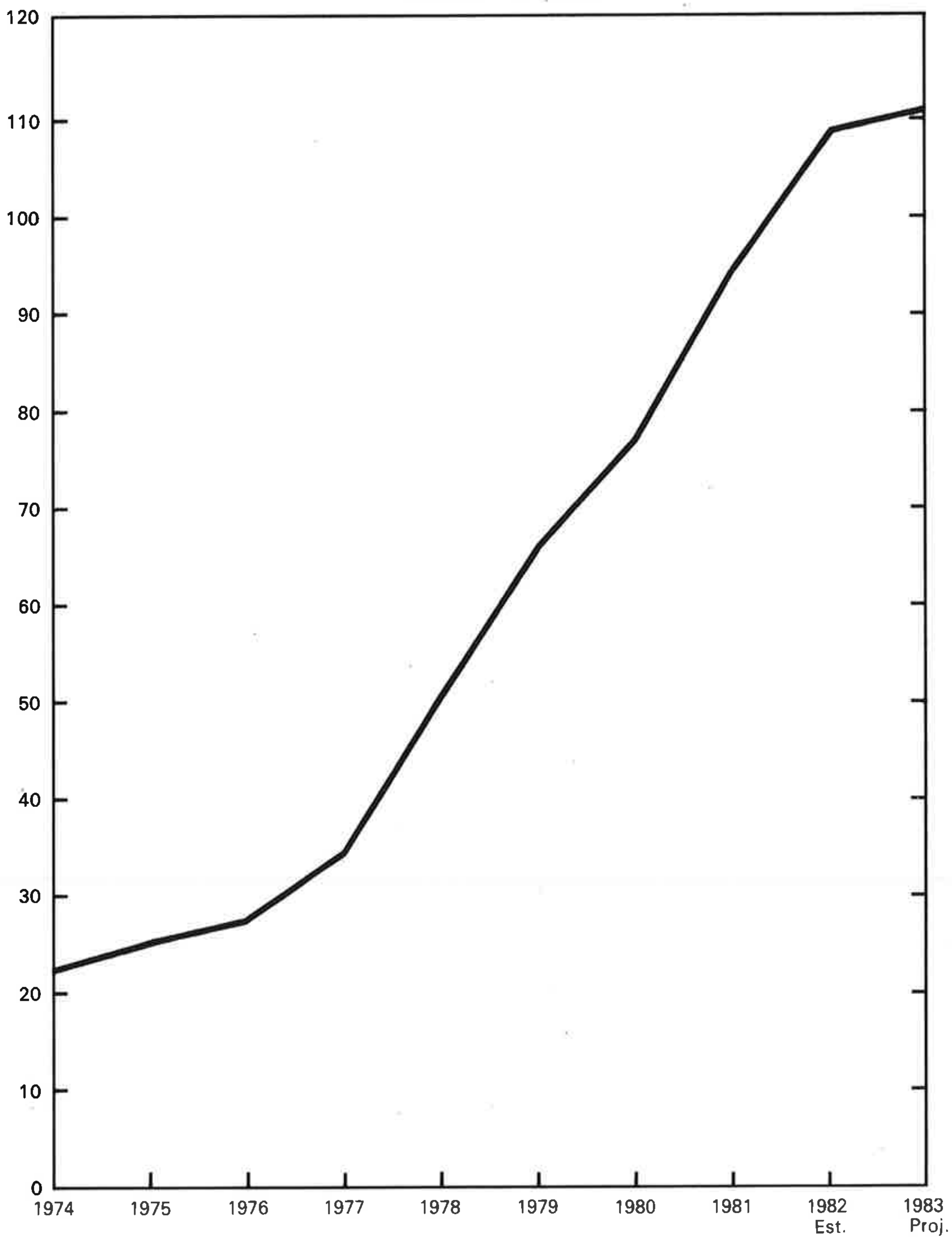
(Total disbursed; in billions of U.S. dollars; at end year)



Sources : World Bank Debtor Reporting System; and Fund staff estimates and projections.

CHART 5

NON-OIL DEVELOPING COUNTRIES:
DEBT SERVICE[1], 1974-83
(In billions of U.S. dollars)



Sources : World Bank Debtor Reporter System; and Fund staff estimates and projections.

[1]Interest payments on short-and long-term debt, and amortization payments on long-term debt.

FROM: J O KERR

DATE: 15 February 1983

(pwp)

cc Mr Burns
Mr Littler
Mr Lavelle
Mr Cassell
Mr Hall
Mr Walsh - Washington

MR BOTTRILL

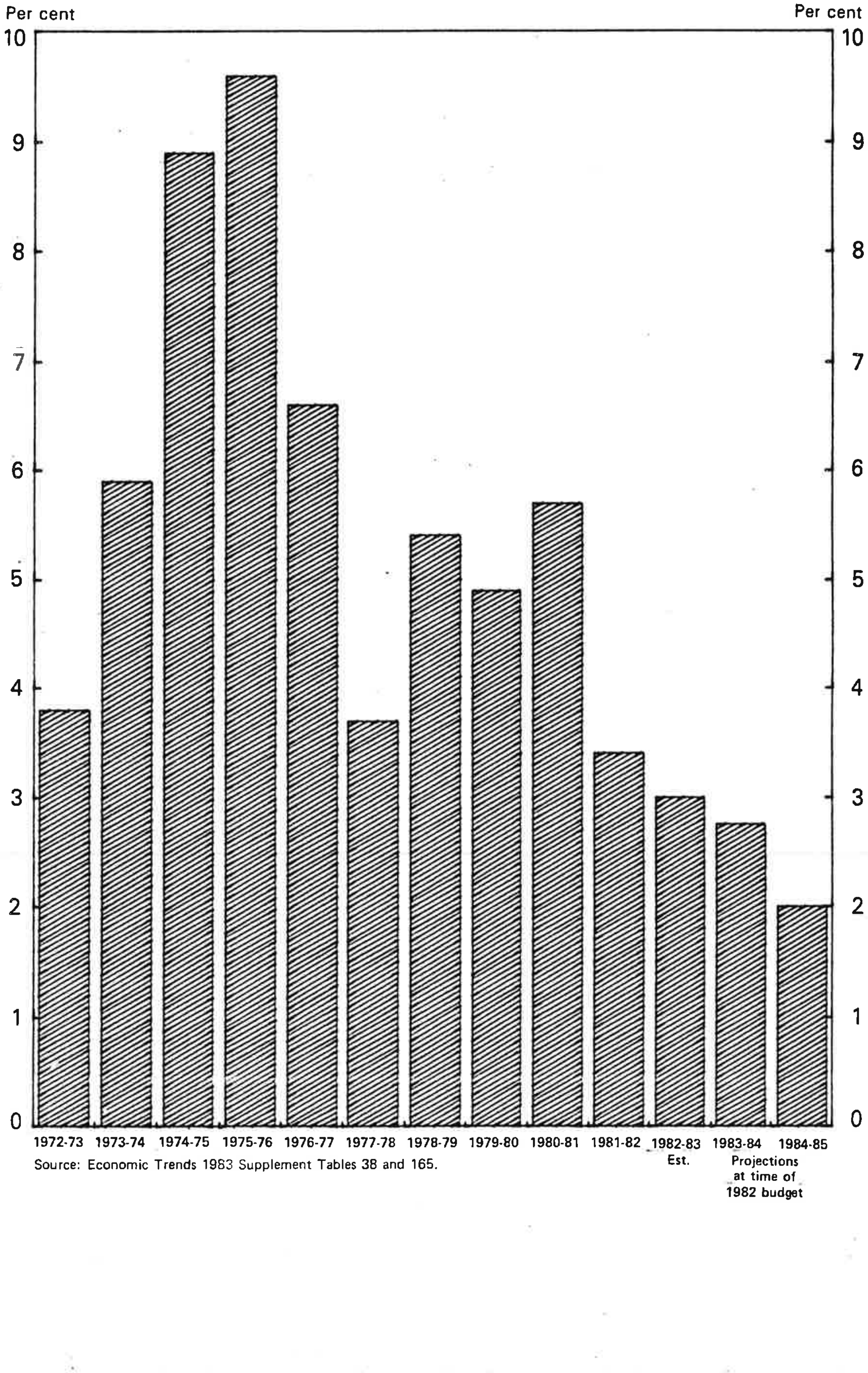
IMF INTERIM COMMITTEE: MEETING WITH US CONGRESSMEN

The Chancellor was most grateful to you - and the COI - for the set of charts attached to your minute of 8 February. He made use of them at Secretary Regan's lunch with US Congressmen on 9 February; and would have used chart 6 and 7 at his meeting with the President, had the blizzard not wiped it out.

2. He also planned to use, in the White House, the attached further chart - constructed by Mr Walsh in Washington - showing the PSBR as a proportion of GNP. He thought it an admirable chart - and admirably constructed at very short notice; and I am sending copies of it to Mr Cassell and Mr Hall, who may be able to think of future uses for it.

J O KERR

U.K. PUBLIC SECTOR BORROWING REQUIREMENT AS A PERCENTAGE OF GROSS NATIONAL PRODUCT



Source: Economic Trends 1983 Supplement Tables 38 and 165.

From: the Rt. Hon. Edward du Cann, M.P.

HOUSE OF COMMONS
LONDON SW1A 0AA

Pl. copy to Mr Wittles
Mr Lavelle
Mr Kemp.
Then pwp.

pwp

17 February 1983

Dear Geoffrey,

It is most courteous of you to have sent me a copy of the communique of the meeting of the IMF Interim Committee.

I am sure the Treasury Committee will be very glad to see this in the context of the report that we are writing.

The Rt Hon Sir Geoffrey Howe, Q.C., M.P.

CONFIDENTIAL

PMJ

FROM: T BURNS
DATE: 17 FEBRUARY 1983

CHANCELLOR

cc. Sir D Wass
Mr Littler
Mr Byatt
Mr Middleton
Mr Unwin
Mr Cassell
Mr Odling-Smee
Mr Sedgwick
Mr Evans
Mr Kerr
Mr Lavelle
Mr Bottrill
Mr Allen

DISCUSSIONS IN WASHINGTON: FEBRUARY 1983

1. During discussions in Washington last week I attempted to gain some insight into the following issues:-

i. the alternative interpretations of monetary policy and the likely effects of the recent bulge of the monetary aggregates

ii. the prospect for recovery of output and whether the good inflation performance is sustainable

iii. the prospects for action on the Budget deficit and the implications of the prospective large deficits

iv. US views on the "margin for manoeuvre" arguments directed towards those countries with lower inflation.

A list of the visits made is attached as an annex.

Monetary Policy

2. There are two distinct views about the recent behaviour of the monetary aggregates. The "monetarists" (for example Brunner, Meltzer, Sprinkel and some at the AEI) argue that a large part of the monetary

growth in the latter part of 1982 was a genuine monetary impulse. They think that it will have the usual effect of boosting nominal GDP. They argue that the recent sharp velocity decline is a reflection of recession and the scale of the monetary injection; that it will be reversed, as it always has been in the past leading to higher inflation. On this interpretation the recent rise in the long term interest rates is a reflection of apprehension about inflation prospects.

3. The "Fed" view which seems to be largely supported by Feldstein is that the monetary aggregates recently have been dominated by special factors reflecting institutional change and intermediation. The change in velocity is large and might be sustained. Disinflationary pressures are strong and it was right to take a risk with the monetary aggregates. It is argued that it was important that after the Fed allowed short term rates to fall long rates also fell so confirming the legitimacy of the move. This is what happened initially. Recently there has been some upward drift of long rates suggesting that possibly interest rate reductions have gone far enough for the moment.

4. There is little doubt that US monetary policy is in considerable disarray. The Fed have been moving to wider aggregates without success. I am inclined to accept a good part of the Fed argument which implies that velocity change last year resulted in US monetary policy being considerably tougher than intended. We have experienced similar problems with £M3 over the past 3 years.

5. The problem for the US authorities now is to find something to put in its place. In the UK we were able to take refuge in the "range of monetary indicators" presentation but in our case the narrow aggregates were growing slowly at that point and have remained either within or below the target ranges. The US are heading for trouble with all the aggregates. The UK monetary problems were also eased because of the clear progress that was being made on the budget deficit. In the US the position is still the reverse with the budget deficit worsening. Mr Middleton has pointed out the great risks involved in concentrating on wider aggregates at a time when fiscal policy is getting further out of hand.

6. Yesterday Volcker rebased and increased the targets but there can be no confidence that he will stick to them. They now have a difficult task of re-establishing some credibility in monetary policy. Their policy is now pinned on continuing success against inflation. If that remains under control they may be able to ride out the current confusion. But if it picks up, for example because of a sharp dollar depreciation it will be difficult to avert a further tightening of policy.

7. For the moment there seems to be some determination on the part of the Fed to avoid any significant increase in short term interest rates. They point to very high real interest rates at present, particularly on an after tax basis. At the same time they acknowledge that possibly they have been leading the market too rapidly towards lower short term rates.

8. For the moment the "monetarists" seemed to be gagged in public as the President has indicated that he is entirely content with Fed behaviour. But they may not remain silent and leaks indicating dissent are already emerging. It must be very difficult for those like Sprinkel who have these doubts about the conduct of monetary policy.

Output and inflation

9. These differences on monetary policy are reflected in views about recovery and inflation prospects.

10. It seems to be agreed that recovery is on the way. The differences of view relate largely to its timing and strength.

11. The optimistic group are talking of 5 or 6% growth through the year. This is based on an acceleration of monetary aggregates, a rising level of final demand and recent heavy destocking which is expected to be reversed or at least come to an end.

12. Those being more cautious point out that so far, apart from yesterday's industrial production figures, there is no hard evidence of recovery and optimistic expectations have had to be revised several times over the past six months. They acknowledge that the employment statistics point in the right direction but there are some ambiguities there also.

13. The group that is most worried about monetary growth are most optimistic on output but are also most concerned about inflation and inflationary expectations.

14. But there are some very optimistic inflation figures around. For example the Fed are looking for inflation in the 3-4% range. It is argued that although there has been some benefit this year from commodity prices, food prices and lower interest rates which will not be repeated there could be strong downward pressure continuing from lower energy prices and lower labour costs as earnings growth slows and productivity improves. Recently the US has been experiencing better than expected productivity figures in a way reminiscent of our own experience.

15. I was impressed by the strength of opinion about the imminent upturn and clearly there are some good arguments - particularly from lower interest rates and the recent scale of destocking. But we have seen in our own case the difficulty involved in sustaining pick up against the background of high real interest rates, poor profitability and cost competitiveness and weak overseas markets. Of course in the UK we have had the problem of world recession to cope with while domestic demand has been recoverying. The US should not have as big a problem but the difficulties of the LDC debtor countries could provide an echo of that effect. On the same comparison the US could continue to make impressive progress against inflation.

16. From our point of view we must hope that Volcker is correct. A US recovery at about 4% a year combined with further downward pressure on inflation is a very convenient message. I would go part of the way with them but there is a significant risk of further interest rate and exchange rate instability in the US if the economy turns around too fast.

Budget Deficit

17. The Budget deficit remains a big talking point. Everyone I spoke to was clearly alarmed. The prospect is for a deficit of 6% of GDP; over time a larger proportion of this deficit is "structural" rather than "cyclical".

18. The worries are

i. high <u>prospective</u> Budget deficits could damage <u>current</u> activity by increasing real interest rates <u>now</u>

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iii. it is likely to increase the real exchange rate putting pressure on mature industries and thus creating demands for increased protection.

19. I sensed a strong determination to try to do something about the Budget deficit but no real consensus about the particular measures that should be taken. The Congressional Budget Office is looking for an end to the indexation of tax thresholds, some reduction of spending programmes (including defence) and higher indirect tax. (The introduction of a VAT, mentioned in some quarters, was considered unlikely as the collection system does not exist at the moment.)

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Margin for Manoeuvre

21. I spent some time with Feldstein discussing the pressure from some countries and international organisations for the US and UK, along with others, to take advantage of lower inflation to stimulate their domestic demand.

22. I argued that in terms of our own MTFS lower inflation was likely to leave room within the framework for higher output. But that was expected to emerge automatically by sticking to the existing guidelines and did not imply "reflationary" action by government. Having successfully reduced inflation this was not the time to reverse policies and attempt to achieve convergence by regressing towards the mean of inflation in the industrial countries.

23. Feldstein wholly agreed although he recognised the pressure at the Summit to be seen to be taking action. I argued that it was important to convince other countries of the way in which recovery was expected to emerge within the framework of these policies. A discussion of this kind could be helpful in improving understanding of the policies being pursued in both our countries.

TB

T BURNS

ANNEX

VISIT TO WASHINGTON - FEBRUARY 1983

Sprinkel	(US Treasury)
Klein	(Wharton Econometrics)
Fellner, Stein and Penner	(American Enterprise Institute)
Pechman and Perry	(Brookings Institute)
Rivlin	(Congressional Budget Office)
Axilrod and Kichline	(Federal Reserve Bank)
Feldstein	(Council of Economic Advisers)

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