

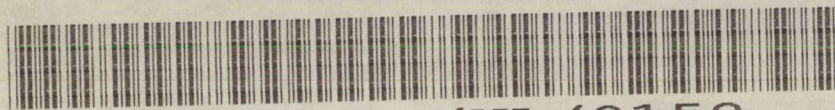
Part A.

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

Begins: 31/12/86

Ends: 11/11/87.



PO -CH /NL/0159



PART A

Chancellor's (Lawson) Papers:

PROPOSALS TO EXPAND
GROUP OF TEN MEMBERSHIP
TO INCLUDE AUSTRIA
AUSTRALIA AND SPAIN

Disposal Directions: 25 years

1/9/95

NL/0159

-CH

PO

PART A

*b/f with
response (or
18/11) A*



FROM: A W KUCZYS

DATE: 31 December 1986

MR WALSH

cc PS/Economic Secretary
Sir G Littler
Mr Lavelle
Mr H P Evans
Miss Life

GROUP OF 10

The Chancellor would like, during his chairmanship, to find a way of admitting Spain and Australia to the G10, and at the same time ensuring that no other new members are henceforth admitted. He would be grateful for advice on how best to achieve this.

A handwritten signature in black ink, appearing to read "A W K".

A W KUCZYS

*I had liked, during my
Chairmanship, to find
a way of admitting
Spain & Australia to the
G10 & at the same time
ensuring that no other
members are henceforth
admitted. Advice, per, on how*



FROM: P D P BARNES
DATE: 31 December 1986

NOTE OF A MEETING HELD AT 10.00 AM IN ROOM 51/2 TREASURY CHAMBERS ON FRIDAY 12 DECEMBER

Those present: Economic Secretary
Mr Walsh
H E The Austrian Ambassador

Some to admit this

VISIT OF THE AUSTRIAN AMBASSADOR

The Austrian Ambassador said that he had come on instructions from his authorities to ask the UK to use the period of the Chancellor's Chairmanship to press for the inclusion of Austria in G10. His Excellency said that Austria, despite some problems on the budgetary side, was economically and politically strong. Austria had had a strong performance in the past year with low unemployment and inflation. The caretaker Government formed after the recent election would have resolved itself into a formal new Administration by the New Year. Whatever its precise components, the new coalition Government would be likely to command the support of 85 per cent of the election. On both political and economic grounds, therefore, his Excellency thought that Austria would be a useful member of G10. His Excellency handed the Economic Secretary a letter from the Austrian Finance Minister to the Chancellor setting out the Austrian case. (below)

2. The Economic Secretary explained that the pressure of business had meant that the Chancellor had been unable to see the Ambassador at short notice. The Economic Secretary said that he understood that the Austrian Finance Minister had himself put the case for Austrian inclusion in G10 to Sir G Littler in the margins of the Washington IMF meetings in October year. The Economic Secretary said that there would probably be no meeting of G10 until April of the

CONFIDENTIAL

following year. The Ambassador was probably aware, that there were one or two members of G10 who had resisted an enlargement of the Group. But of course he would be happy to convey the Ambassador's message to the Chancellor.

RB

P D P BARNES
Private Secretary

cc PS/Chancellor
Sir G Littler
Mr Lavelle
Mr Evans
Mr Walsh
Miss Life

3231/025-DKS

FROM: S W MATTHEWS
 DATE: 9 January 1987

1. Sir Geoffrey Littler
2. CHANCELLOR

*Sir
 covering
 minutes*

cc PS/Economic
 Secretary
 Mr Lavelle
 Mr Evans
 Mr Walsh
 Mr Dolphin
 Mr Sheridan

GROUP OF TEN

You asked whether there was a way of admitting Spain and Australia to the G10, while ensuring that no other new members would thereafter be admitted.

Background

2. Membership of the Group of Ten (G10) is derived from participation in the General Arrangements to Borrow (GAB), which were set up in 1962 to provide the IMF with additional liquidity to supplement its ordinary quota-based reserves should the need arise. It was last renewed in 1983, though it has not been activated since 1978.

3. The GAB contains a clause allowing other countries to give notice that they are willing to participate. But it stresses that the agreement of all current participants and of the Fund is required when accepting any new member.

4. The original ten participants of the GAB (ie the present membership excluding Switzerland) were drawn from a list compiled by the Fund staff, which was based on a number of economic and financial criteria including level of reserves, Fund quotas, the extent to which their currencies were used

in world markets, balance of payments positions and the Fund's likely need for particular currencies. This list was regarded as subject to revision as circumstances changed, but no objective criteria for determining this have ever been established. Switzerland became an associate member of the GAB in 1964, and a full member in 1983. The G10 thus has 11 members in practice.

Admitting Spain and Australia

5. The G10 meeting held on 27 September 1986 discussed expanding membership of the G10 by admitting Spain and Australia. No agreement was possible because Sweden in particular feared that it would be difficult to reject further applications if Spain and Australia were admitted, and refused to agree to any expansion of membership. All present (eleven) members agreed that membership should not be expanded beyond thirteen countries.

6. Other countries would almost certainly seek to join the G10 if the Australia and Spain were admitted. The Austrian Finance Minister spoke to Sir G Littler in the margins of the Annual Meetings about making an application and ^{the} Austrian Ambassador called on the Economic Secretary last month.

7. The perceived need for unanimity among existing members before participation in the G10 can be expanded makes it impossible to force through the admission of Spain and Australia, even from the chair. But it also provides a strong counter-argument against those countries which argue that it is impossible to guarantee that membership will be limited to thirteen in future, since any individual country can veto a further expansion.

8. Examination of comparative economic statistics suggests that they lend some support to the argument that admitting Spain and Australia would be correcting an anomaly and would

CONFIDENTIAL

not set any precedents, - see the attached table comparing levels of GDP, per capita GDP, reserves and IMF quotas.

9. In terms of gross domestic product (not GDP per head) and size of Fund quota the claims of Australia and Spain for membership of the G10 far outweigh those of other OECD countries. In particular, both Australia and Spain have a bigger gross domestic product than four existing G10 members, while no other non-member OECD country has a GDP or IMF quota higher than the smallest existing member (Belgium).

10. It would of course still be possible for objectors to Spain and Australia to argue that their admission would reduce the cohesiveness of the G10: Spain has a significantly lower per capita income, while Australia is a major primary product exporter.

Conclusion

11. In the end, extending the membership of the G10 is not a matter of statistics, but of unanimity among the existing 11 members. To pursue the candidacy of Australia and Spain we would need to lobby the Swedes (and probably Swiss) before the next G10 Ministerial meeting, which will presumably be in the margins of the Spring meetings in Washington in April, pointing out the statistical arguments and that they would still ~~have~~ a veto over any further expansion of the "Group of Ten".

84.

S W MATTHEWS

3231/030-DKS-

Economic and financial position of GAB participants (G10 members)
and potential members

	<u>GDP</u> <u>1985</u>	<u>GDP per</u> <u>capita, 1985</u>	<u>Non-gold</u> <u>reserves</u> <u>Oct 1986</u>	<u>Fund</u> <u>quota</u>	<u>GAB Credit</u> <u>line</u>
	<u>\$bn</u>	<u>\$</u>	<u>SDR bn</u>	<u>SDR bn</u>	<u>SDR bn</u>
<u>Existing GAB participants</u>					
United States	3841	16100	30.4	17.9	4.3
Germany	620	10200	44.6	5.4	3.3
Japan	1329	11000	35.2	4.2	2.1
France	510	9200	27.9	4.5	1.7
United Kingdom	447	7900	15.2	6.2	1.7
Italy	359	6300	16.7	2.9	1.1
Switzerland	92	14100	14.8	-	1.0
Canada	342	13500	2.4	2.9	0.9
Netherlands	124	8600	9.7	2.3	0.9
Belgium	79	8000	4.4	2.1	0.6
Sweden	100	12000	5.9	1.1	0.4
<u>Potential additional participants</u>					
Australia	154	9800	4.4	1.6	
Spain	169	4400	12.5*	1.3	
Austria	66	8800	4.4	0.8	
Denmark	57	11200	4.3	0.7	
Norway	57	13800	11.1	0.7	
Finland	54	11100	1.5	0.6	
New Zealand	23	7000	2.5*	0.5	

* September 1986

CONFIDENTIAL

*White
Spain has
a low GDP
Australia
Spain & Australia*

*draw the
is 'artificial'.
countries
New is New
between
No
The
Spain*

From: Sir G. Littler
Date: 9 January 1987

CHANCELLOR

*Thanks, Sir,
Yr psk, Sir,
basis of X, not Y
I don't agree
after Spain & Australia
A number of
have a smaller
Spain & Australia
a wide gap
& Australia*

cc PS/Economic Secretary
Sir Peter Middleton
Mr Lavelle
Mr Huw Evans
Mr Walsh
Mr Dolphin
Mr Sheridan

*3. ...
You saw
of
counts, ...
No political
all this
the*

GROUP OF TEN

The attached minute from Mr Matthews gives the background on membership. There is a logical case for admitting Spain and Australia - and also for refusing any other OECD applicant on the somewhat artificial ground that nobody with lower GDP than Belgium should be eligible!

or low GDP Australia New Zealand

2. The real problem is the reluctance of some, particularly the non-G7, countries to accept a widening of membership which may mean a weakening of the group.

3. There is a related point. Working Party No 3 of the OECD grew up on something very close to the G10 pattern and now happens to be almost identical in country membership ('almost' because of a blur from the tradition that Sweden has fairly regularly included a Norwegian and a Dane among advisers in the back row). As Chairman and with strong support from members I have been resisting pressure to expand membership or to move to some form of "constituency" representation as a back way in. WP3 derives from the Economic Policy Committee (Sprinkel in Chair and Sir P.Middleton as UK member - they have supported me).

4. I am sure that the non-G7 countries would at official level resist widening G10 even more strongly if they saw it as leading to widening WP3 also; and since WP3 has more substantial meetings generally than G10 I think their Ministers would support them.

CONFIDENTIAL

5. The question is, therefore, whether the non-G7 members would be prepared to agree to admit Spain and Australia if:

- X - all present members, including G7, undertook to stand firm against any further addition beyond those two;
- Y - and (possibly) all agreed to resist any claim from Spain or Australia for parallel membership of WP3.

6. I suggest some discreet soundings on this line as the most promising way towards your objective. I shall have several opportunities over the next few weeks, and could readily talk without committing you. Would you like me to do so?



(Geoffrey Littler)

Geoff Lytton.

2x.



OK for
5 mins!

Ch

Geoff is having his
Sweden opposite
number over to visit
the Treasury on Thursday
25 June. He wondered
whether you would see
him, perhaps as a courtesy,
for 5 minutes.

Could just be worth
you while using the
opportunity to raise G10
over

— and urge Swedes
to reconsider opposition
to Australia & perhaps
Spain.

OK to see if we
can find a slot?

AA



1. Alex
2. RJP

FROM: A W KUCZYS
DATE: 13 January 1987

SIR G LITTLER

cc PS/Economic Secretary
Sir P Middleton
Mr Lavelle
Mr H P Evans
Mr Walsh
Mr S Matthews
Mr Dolphin
Mr Sheridan

GROUP OF TEN

The Chancellor was grateful for your and Mr Matthews' notes of 9 January.

2. You asked whether you should make some discreet soundings as to whether non G7 members of G10 would be prepared to agree to admit Spain and Australia. The Chancellor would be grateful if you would do this, on the basis that:

- all present members, including G7, undertook to stand firm against any further addition beyond those two;

but not:

- any agreement to resist Spanish or Australian membership of WP3.

3. The Chancellor does not agree that the drawing of the line after Spain and Australia is "artificial". A number of existing G10 countries have a smaller GDP than Spain and Australia (while Sweden has a lower Fund quota than either Spain or Australia) - but there is then a huge gap between them and Austria, the next in the batting order.

4. The senior officials whom you sound out must, of course, recognise the political dimension in all this.

AWK

A W KUCZYS



FROM: MRS D C LESTER
DATE: 27 February 1987

SIR G LITTLER

VISIT BY THE AUSTRIAN FINANCE MINISTER

I had a telephone call from the Austrian Embassy today asking if the Chancellor would be prepared to see the Austrian Finance Minister when he is in London for the International Capital Markets Conference on 7 and 8 May. Before putting this to the Chancellor I should be very grateful if you would provide advice please.

Debbie Lester

MRS D C LESTER

✓
Austrian Finance Minister will be in London for
the International Capital Markets Conference on 7/8 May.
He would like to call on you. Diary could
accommodate this.

From: Sir G. Littler

Date: 6 March 1987

shall I arrange?

D
6/3

OK - a busy mtg
ag.

MRS LESTER

VISIT BY AUSTRIAN FINANCE MINISTER

I apologise for not replying at once to your note of 27 February.

2. I am fairly sure that the main purpose of the visit will be to the Chancellor as current Chairman of the Group of Ten, to register Austria's interest in seeking membership. I think it would be courteous for the Chancellor to agree to a visit, even though his line will have to be somewhere between discouraging and flatly negative!

3. The timing will be quite helpful. The Chancellor asked me some time ago to take soundings about the attitudes of other G10 members to the requests of Spain and Australia, with a particular outcome in view which would not help Austria. My first results are pretty negative against any additional members, but I shall be able to report more fully about 23 March.

(Geoffrey Littler)

Minutes. If I am approved in Spain (in Australia) I shall have to put a letter to the G10, whatever the outcome.

CONFIDENTIAL

From: Sir G. Littler
Date: 23 March 1987

CHANCELLOR

*Ch
Bad news for Spain & Australia*

c.c. Economic Secretary
Sir P. Middleton
Mr Lavelle
Mr Huw Evans
Mr Culpin

AA

G10 MINISTERIAL MEETING

At a meeting of G10 deputies in Paris on 20 March one or two points came up which are relevant to the meeting you will be chairing in Washington next month.

Agenda

2. We agreed - and the Secretariat will circulate a note - that the agenda should be simply a catch-all "Exchange of views in preparation for the Interim and Development Committee meetings" plus "Any other business" (none notified).

3. It was also agreed that no attempt should be made to write a substantive communique: we revert to the format of earlier very short meetings with a merely formal press statement recording that we met. The Secretariat will have a draft ready beforehand.

4. I should mention that my Dutch colleague expressed some unhappiness about reverting to a short meeting. He implied that other smaller countries share his view. Ruding may want to raise this with you at the informal ECOFIN. (Incidentally the next two annual chairmen should be Sweden and Switzerland!).

CONFIDENTIAL

Possible Expansion of Membership

5. As you asked some time ago, I took the opportunity of sounding my various G10 colleagues about admitting Spain and Australia and drawing the line firmly there. I am afraid that the response was about as unconstructive as it could have been:

- Tietmeyer is clear that Germany would have to press hard for Austria to be admitted if there is any increase in the membership at all; Switzerland would probably have to support them also; and Belgium (with whom Austria shares an IMF constituency);
- some slight worry among Community members about possible claims of Denmark and Portugal and Greece;
- Sweden would have to argue for Norway;
- a lot of worries about IMF constituency relationships on any expansion;
- nobody felt confident that a line could be held after Spain and Australia.

6. I think the best point was cynically made by Lebegue when I approached him. Foreseeing the kinds of difficulties indicated above, he asked why we should exert ourselves at all - for France and surely the UK and others we had "une position confortable": we would welcome Spain (and Australia if the UK and others wanted) but were prevented by the need for unanimity.

7. There is some reluctance on the part of Netherlands and Belgium to be labelled as opposing Spain, but my impression is that Sweden at least will be prepared to carry the odium, hoping that they will not be publicly isolated.

CONFIDENTIAL

8. One other point. My exploration of the idea of some firm agreement on a stopping-point prompted one suggestion which the Dutch and others may want to pursue - this is an explicit agreement that no question of expansion at all be entertained for 10 years.

9. I think it possible that Ruding may raise this question with you at Knokke. He of course rightly sees a connection between an expanded membership and the threat of diminishing importance of the G10.



(Geoffrey Littler)



FROM: A W KUCZYS

DATE: 25 March 1987

SIR G LITTLER

cc PS/Economic Secretary
Sir P Middleton
Mr Lavelle
Mr H P Evans
Mr Culpin**G10 MINISTERIAL MEETING**

The Chancellor was grateful for your note of 23 March. If he is approached by Spain (or Australia) he will have to put the matter to the G10, whatever the outcome.

A handwritten signature in dark ink, appearing to be 'AWK', written over the typed name.
A W KUCZYS



FROM: A W KUCZYS
DATE: 31 March 1987

Washington
background

Ch/see 'X' below.

SIR G LITTLER

Ruding may raise G10

with you
AWK
2/4

cc PS/Economic Secretary
Sir P Middleton
Mr Lavelle
Mr H P Evans
Mr Walsh
Mr S Matthews

NOTE OF TELEPHONE CONVERSATION

be done

As arranged, the Spanish Finance Minister, Mr Solchaga, telephoned the Chancellor this morning. The subject, as you had predicted, was Spanish membership of the G10. Solchaga reminded the Chancellor that the decision in Washington had been that the G10 would give Spain a definite answer this year.

2. The Chancellor agreed that the G10 had to come back to this question this year. His personal view was that Spain and Australia had a presentable case. But he did not think there would be time at the April ^{meeting} to do more than flag-up the issue. Solchaga accepted this. He did not expect a definitive answer at the forthcoming meeting.

3. In advance of the next G10 meeting, Solchaga would take the opportunity to raise the question at the informal ECOFIN this weekend. He was also writing to the Swedes and the Swiss. The Chancellor agreed that this was a good idea. There was a need for Spain to do some preparatory work if they wanted a favourable answer. As he recalled, the countries most opposed to Spanish membership were Sweden, Switzerland and the Netherlands.

4. Solchaga thanked the Chancellor, and congratulated him on his Budget.

AWK

A W KUCZYS

Alex
(for Washington)
↑
please



FROM: A W KUCZYS
DATE: 2 April 1987

CHANCELLOR

X/KS.
v

cc Sir G Littler
Mr Lankester - Washington
(by fax)

G10: SWEDEN

I had a phone call from the Governor's office this morning. The Governor has been lobbied by his Swedish opposite number. The Swedes do not like the way discussion of exchange rates is being concentrated in G5/G7, and are pressing for discussion in G10 to be reinstated. The Governor will speak to you about this on the plane to Knokke, and it is possible that the Swedish Finance Minister will try and lobby you as well. (We think the Swedish party are flying to Washington on the same Concorde as you).

AWK

A W KUCZYS

April 8, 1987

To: Sir Geoffrey Littler

From: Mr. van Houten *Jvh*

As per telephone conversation. Attached is the expected seating arrangement for the G-10 meeting.

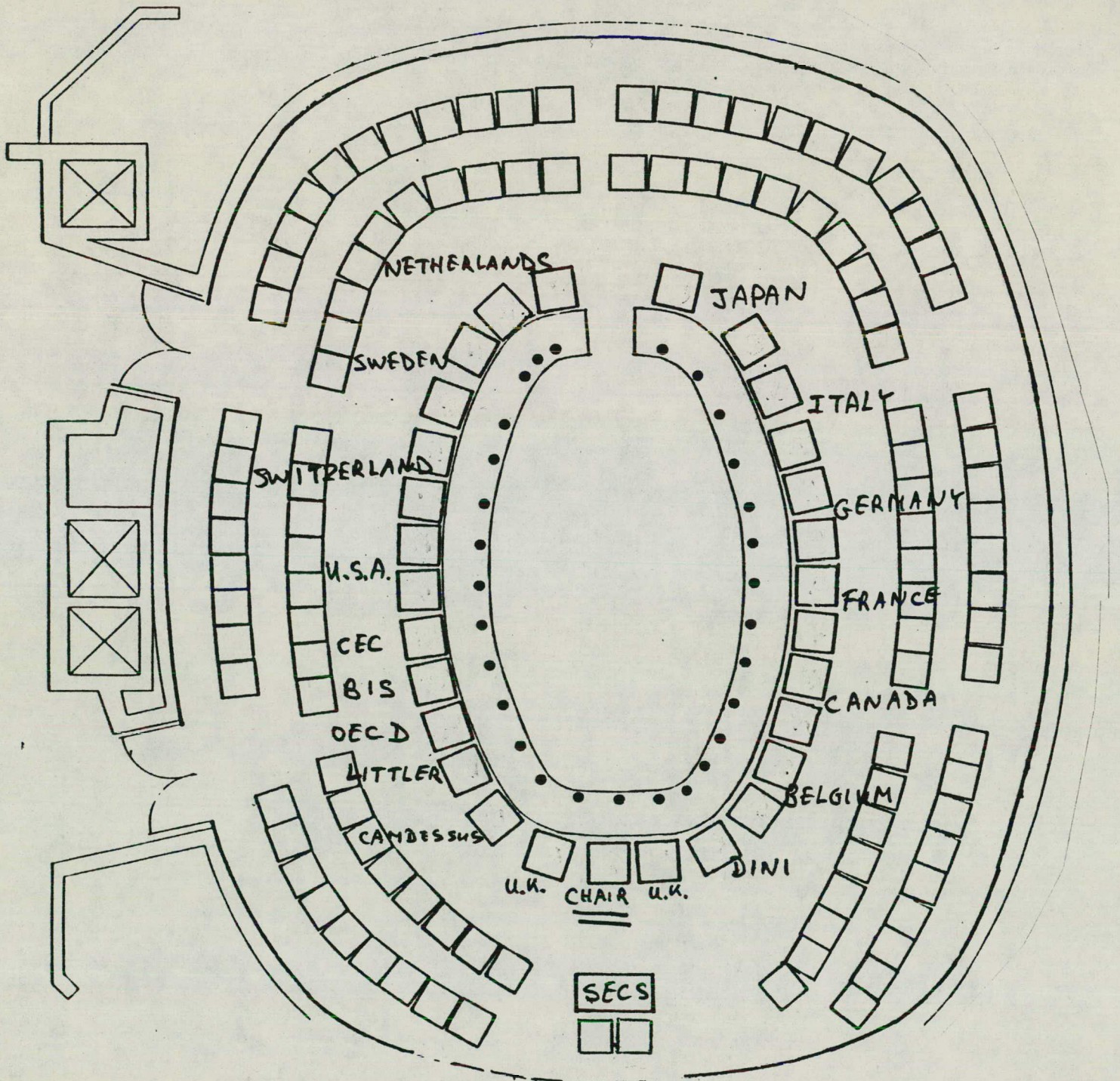
Shortly after the start of the meeting I will pass on to Mr. Evans the final seating arrangement including the names of the participants.

*Copied to Mr. Evans
LH*

Meetings of the Ministers of the Group of Ten

IMF Executive Board Room

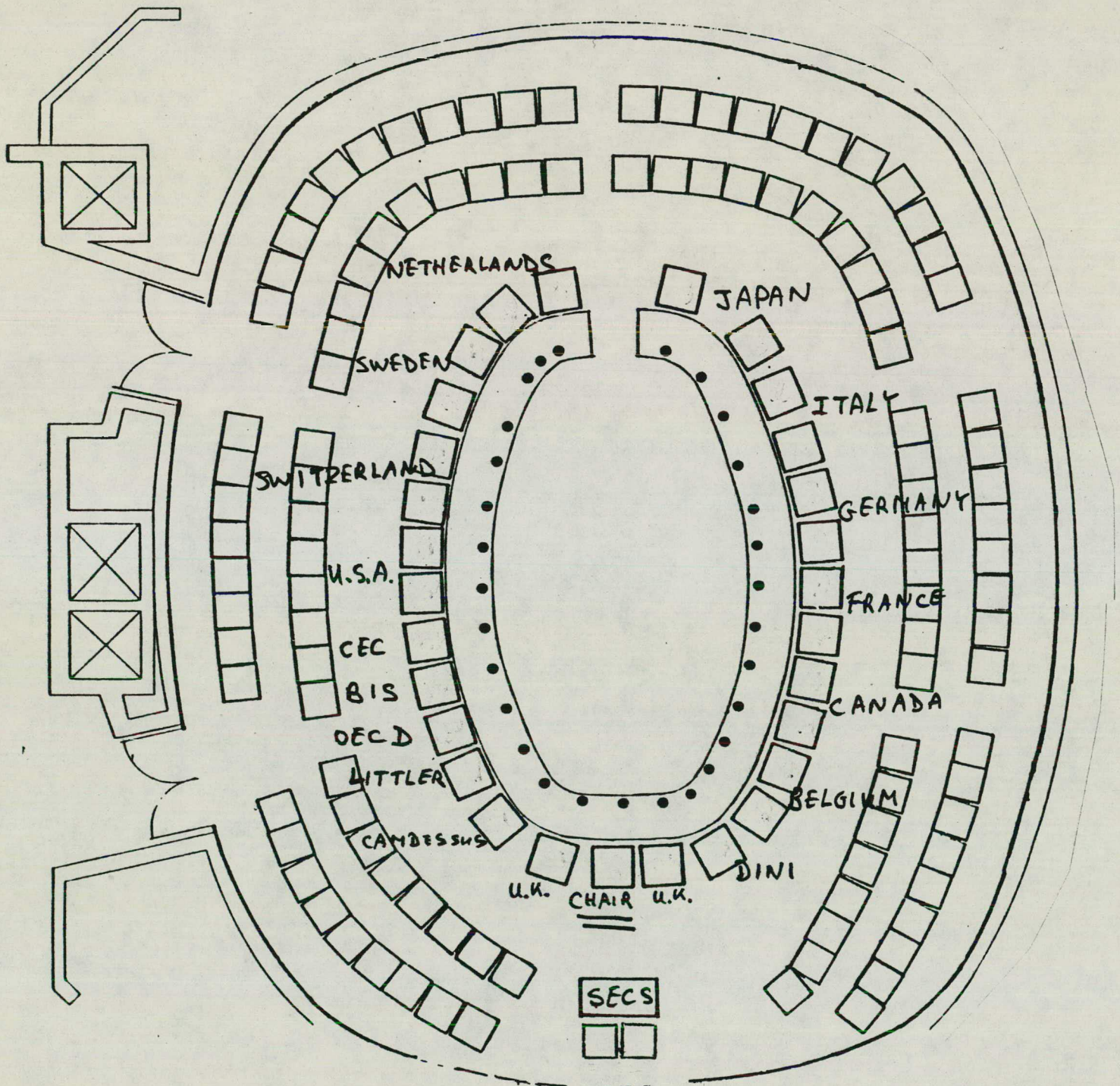
Thursday, April 9, 1987 - 8:15 a.m.



Meetings of the Ministers of the Group of Ten

IMF Executive Board Room

Thursday, April 9, 1987 - 8:15 a.m.



CHANCELLOR

cc: Governor
Sir T. Burns
Mr. Loehnis
Mr. Evans
Mr. Lankester

G10: Chairman's Steering Brief

At 8.15am in the Executive Board Room. The Committee Secretary, whom I will introduce to you, is Jan van Houten. The Governor and Huw Evans will sit by you. (I have my WP3 seat). You will want to finish by 9.00am, which should be no problem.

The Agenda is:

1. Adoption of the Agenda
2. Exchange of Views on items to be discussed in the Interim and Development Committees
3. Other Business
4. Press Communique

1. Adoption of the Agenda

I suggest you should:

- welcome colleagues to first meeting under your chairmanship
- observe that you felt on this occasion that time constraints and convenience of colleagues pointed to the very short meeting planned (you might foreshadow a fuller meeting in September - which I think will be needed)
- (depending on G7 outcome) you might indicate your intention to invite Baker to say something on the G7 meeting - or Balladur to speak of Louvre Accord - as part of item 2. (You could settle at end of G7 meeting tonight).

Then seek formal adoption of the agenda (If Spain question is raised - defer to Other Business).

2. Exchange of Views

You should first invite Dini to report on the recent meeting of G10 Deputies. (Copy of his proposed statement is attached).

As Dini's meeting focussed almost entirely on debt, and my immediately preceding meeting of WP3 (with same cast of people) discussed world imbalances etc, perhaps you could invite me to comment on that. (Copy of what I would offer is attached - I hope it would lead well into the next point).

Summary?
Then ~~invite Baker/Balladur to expand the G7 position/Louvre.~~



FROM: A W KUCZYS
DATE: 8 May 1987

G10
ES

SIR G LITTLER

cc Mr S Matthews
Mr D Savage

VISIT BY THE AUSTRIAN FINANCE MINISTER

The Austrian Finance Minister, accompanied by his Private Secretary and the Austrian Ambassador, called briefly on the Chancellor on Friday, 8 May. You were also present.

2. The main purpose of his call was to raise the question of membership of the G10. The Chancellor said that expanding the membership of the G10 required the unanimous agreement of the existing members. This had never been forthcoming, except in the very special case of Switzerland, which had been a member in all but name from the outset. As Mr Lacina knew, the question of Spanish and Australian membership had been considered last year, and OECD would be returning to the subject this September. Arguably, those two countries had a stronger case than Austria; but even there there was opposition from some of the smaller existing members. There was also a feeling that, if you once started expanding the membership, there was no logical point at which to stop.

3. Mr Lacina said that he recognised the difficulties, and the danger of ending up with a group of around twenty. If the decision were to admit no new members, Austria would understand and accept that. But so long as other countries like Spain and Australia were applying, Austria felt she had to make an application too. But their main need was to improve the supply of information from OECD, rather than formal membership.

4. The Chancellor noted that, already, ECOFIN provided an opportunity to keep non-OECD members of the EC informed of developments in the OECD; and the same happened within the Nordic

UNCLASSIFIED



group. He would consider further whether there was anything that could be done in Austria's case; he agreed that such an arrangement would be sensible, if a way could be found.

Privatisation

5. Finally, the Chancellor enquired about the progress of Austria's privatisation programme. Mr Lacina said that both Parties in the Coalition had a pragmatic attitude towards the State sector of industry. But, as compared with the UK, Austria did not have such a highly developed Stock Exchange. They were looking at industries case by case, and in some cases adopting the route of a joint venture rather than a share offer. It was likely that the State airline and the electricity industry would be sold off.

A handwritten signature in black ink, appearing to be "AWK".

A W KUCZYS

Membership of G10

1. The Austrians may wish to discuss their membership of G10 with the Chancellor.
2. Over the past twenty five years, since its inception in 1962, G10 has been reluctant to enlarge itself despite requests by several countries to join. The only change in membership was in 1983 when Switzerland (previously an associate member) became a full member.
3. Spain made a determined application for membership in 1986. Australia followed. Membership of these countries was ruled out at the G10 meeting in Washington last October, when Sweden made it clear that it would object.
4. Admission into the GAB (presumed a prerequisite for G10 membership) requires the consent of all existing participants.
5. On objective criteria (GDP, Fund quotas) Austria has a weaker claim than either Spain or Australia. The attached table gives comparative statistics.
6. Germany feels it has to support Austrian claims. There is likely therefore to be considerable difficulty in reaching agreement on any expansion of G10.

Economic and financial position of GAB participants (G10 members)
and potential members

	<u>GDP</u> <u>1985</u>	<u>GDP per</u> <u>capita, 1985</u>	<u>Non-gold</u> <u>reserves</u> <u>Oct 1986</u>	<u>Fund</u> <u>quota</u>	<u>GAB Credit</u> <u>line</u>
	<u>\$bn</u>	<u>\$</u>	<u>SDR bn</u>	<u>SDR bn</u>	<u>SDR bn</u>
<u>Existing GAB participants</u>					
United States	3841	16100	30.4	17.9	4.3
Germany	620	10200	44.6	5.4	3.3
Japan	1329	11000	35.2	4.2	2.1
France	510	9200	27.9	4.5	1.7
United Kingdom	447	7900	15.2	6.2	1.7
Italy	359	6300	16.7	2.9	1.1
Switzerland	92	14100	14.8	-	1.0
Canada	342	13500	2.4	2.9	0.9
Netherlands	124	8600	9.7	2.3	0.9
Belgium	79	8000	4.4	2.1	0.6
Sweden	100	12000	5.9	1.1	0.4
<u>Potential additional participants</u>					
Australia	154	9800	4.4	1.6	
Spain	169	4400	12.5*	1.3	
Austria	66	8800	4.4	0.8	
Denmark	57	11200	4.3	0.7	
Norway	57	13800	11.1	0.7	
Finland	54	11100	1.5	0.6	
New Zealand	23	7000	2.5*	0.5	

* September 1986



NOTE OF A MEETING HELD IN HM TREASURY
ON TUESDAY 14 JULY

Present: Chancellor
Sir G Littler
Sir T Burns
Mr H P Evans
Mrs Case
Mr Culpin
Mr Walsh
Mrs Lester

STRATEGY FOR THE ANNUAL MEETINGS

Papers: Mr Allan of 22 June; Mr Evans of 7 July.

World economy

The time was right for a UK initiative on the lines suggested by Sir T Burns - "post-Louvre: the next steps". It was for decision whether this should be unveiled in Washington, or whether some preparing the ground in advance was needed. Mr Evans was doing further work on this. The Chancellor asked to receive a paper by Friday 24 July, so as to leave open the possibility of a further meeting before the holidays.

The UK economy

2. The Chancellor would decide much nearer the time what to say on this subject.

Debt

3. Sir G Littler reported that we were not making good progress at official level. He did not see much chance of doing so before September. So the Chancellor would need to do some "selling" of



our initiative - both at the annual meetings, and before then at his bilateral with Monsieur Balladur at the end of this month. Meanwhile, Mr Evans and Mr Hudson would be producing a draft of the Chancellor's speech for 22 July.

Agriculture

4. It was very important not to let the United States make all the running. The GATT timetable involved discussions shortly after the annual meetings; so the annual meetings provided an opportunity to guide the GATT discussions.

Fund and Bank issues

5. The US Administration made great play of the proposition that Congress would not sanction subsidised interest rates. The Chancellor wondered whether this was really true, since the change in the composition of the Congress last year, and in particular on Sub-Saharan Africa. He would welcome Mr Lankester's advice on this point.

6. As part of one of his speeches in September, it would be worth setting out what the UK believed the proper roles of the Fund and Bank, respectively, to be.

Press coverage

7. The three issues we would want to stress in press briefing were:

- (i) the new "initiative" on "post-Louvre: the next steps".
- (ii) Debt (at the Commonwealth Finance Ministers as well as in Washington).
- (iii) Agriculture.

G10

8. The Chancellor would speak to the Foreign Secretary about the subject of G10 membership. The Foreign Secretary could help win



over the smaller G10 countries (Sweden, Switzerland, and the Netherlands) who were resisting any enlargement of membership.

A handwritten signature in dark ink, appearing to be "A W Kuczys".

A W KUCZYS

Circulation

Those present
PS/Economic Secretary
Sir P Middleton
Mr Mountfield
Mr S Matthews
Ms Life
Mr Lankester - Washington

FROM: D SAVAGE

DATE: 17 July 1987

1. SIR G LITTLER
2. THE CHANCELLOR

cc Mr Evans
Mr Matthews

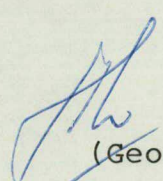
MEMBERSHIP OF G10

I attach a background note on this topic, for the meeting, on ^{11.00 am Wednesday 22 July} ~~10.45 am Tuesday, 21 July~~, with the Secretary of State for Foreign and Commonwealth Affairs.

ds.

D SAVAGE

To persuade the four non-G7 members, you will need to try to get convincing assurances from the G7 that they will draw a line after Spain and Australia. I see no problem with US, Canada, Japan. You will need to work on the other three Europeans (the September ECOFIN is the obvious opportunity). At official level, I fear that Tietmeyer is very conscious of Austrian pressure; while Lebegue is much inclined to enjoy watching Sweden, etc, continue to blackball any additional members.


(Geoffrey Littler)

MEMBERSHIP OF G10

1. Over the past twenty five years, since its inception in 1962, G10 has been reluctant to enlarge itself despite requests by several countries to join. Admission into the GAB (presumed a prerequisite for G10 membership) requires the agreement of all existing participants. This has been forthcoming only once, in 1983, when Switzerland, previously an associate member, was accepted as a full member.

2. Spain made a determined application for membership in 1986. Australia followed. Membership of these countries was ruled out at the G10 meeting in Washington last October, when Sweden made it clear that it would object.

3. As the attached table of comparative statistics shows, in terms of GDP (though not GDP per head) and fund quotas the claims of Australia and Spain for membership are much stronger than those of other OECD countries. Both countries have a GDP bigger than four existing members and much bigger than Austria, the next largest OECD non-member. Both have higher IMF fund quotas than Sweden. No other non-member OECD country has a GDP or IMF quota higher than any member country.

4. These are good grounds on which to argue that admitting Spain and Australia would be correcting an anomaly and not establishing any precedents.

5. Securing unanimous agreement among the present membership on a limited expansion in G10 is unlikely to be easy however. It would mean lobbying some of the smaller (non-G7) countries (Sweden, and probably the Netherlands, Belgium and ^{Switzerland} Spain), who have tended in the past to oppose any expansion. If Australia and Spain apply, other countries would probably follow. Germany would support an Austrian claim, as might Switzerland and Belgium (with whom Austria shares an IMF constituency). Sweden would support a claim from Norway. If other countries were applying, Denmark, Portugal and Greece might feel they had to make applications as well.

GDP and Fund Quotas of G10 Members and Potential Members

	<u>GDP</u> <u>1986</u>	<u>Fund</u> <u>quota</u>
	<u>\$bn</u>	<u>SDR bn</u>
<u>Existing GAB participants</u>		
United States	4167	17.9
Germany	890	5.4
Japan	1959	4.2
France	706	4.5
United Kingdom	545	6.2
Italy	504	2.9
<i>Canada</i>	<i>359</i>	<i>2.0</i>
Switzerland	134	-
Canada	359	2.9
Netherlands	171	2.3
Belgium	111	2.1
Sweden	132	1.1
<u>Potential additional participants</u>		
Australia	161	1.6
Spain	227	1.3
Austria	94	0.8
Denmark	80	0.7
Norway	69	0.7
Finland	71	0.6
New Zealand	26	0.5

CONFIDENTIAL

GRS 135

CONFIDENTIAL
FM CANBERRA
TO PRIORITY FCO
TELNO 478
OF 300546Z JULY 1987

YOUR TELNO 123 TO BERNE: EXPANSION OF G10

1. WE HAVE SPOKEN AS INSTRUCTED TO APPROPRIATE SENIOR OFFICIALS IN THE TREASURY AND DFA. THEY WERE VERY PLEASED TO HEAR OF OUR SUPPORT FOR AUSTRALIA'S APPLICATION AND OF THE ACTION WE ARE TAKING. COSGROVE (HEAD OF THE OVERSEAS DIVISION OF TREASURY) ASKED THAT AUSTRALIAN APPRECIATION SHOULD BE CONVEYED TO THOSE CONCERNED IN LONDON.
2. COSGROVE ALSO TOLD US THAT A LETTER FROM MR KEATING TO THE CHANCELLOR OF THE EXCHEQUER IN HIS CAPACITY AS CURRENT CHAIRMAN OF G10, SETTING OUT THE REASONS WHY THE AUSTRALIANS CONSIDER THEY HAVE A STRONG CLAIM TO ADMISSION, IS CURRENTLY BEING DRAFTED. WHEN APPROVED THIS WILL BE COMMUNICATED THROUGH AUSTRALIA HOUSE, AND COPIES WILL BE DELIVERED TO OTHER G10 MEMBERS.

LEAHY

YYYY

CEHPAN 2831

MONETARY/
ERD

CONFIDENTIAL

Restricted

RESTRICTED

FM BERNE

TO PRIORITY FCO

TELNO 148

OF 311000Z JULY 87

INFO ROUTINE BRUSSELS, THE HAGUE STOCKHOLM, MADRID, CANBERRA
INFO ROUTINE WASHINGTON, UKDEL IMF, BONN, PARIS, TOKYO, OTTAWA
INFO ROUTINE ROME

YOUR TELNO 123: EXPANSION OF G10

1. I TOOK A COPY OF THE MESSAGE IN YOUR PARA 2 TO LAUTENBERG, HEAD OF THE FINANCE AND ECONOMIC SERVICE IN THE FEDERAL DEPARTMENT OF FOREIGN AFFAIRS. LAUTENBERG COMMENTED THAT THE CHIEF SWISS CONCERNS WERE THAT:

(A) THE FUNCTION OF THE G10 IN ITS RELATIONSHIP TO THE G5 SHOULD NOT BE ERODED SEMICOLON

(B) THE EFFICIENCY OF THE WORK OF THE G10 SHOULD NOT BE DISADVANTAGED BY AN ENLARGEMENT IN ITS MEMBERSHIP SEMICOLON

(C) THEREFORE SPECIFIC ASSURANCES WOULD BE REQUIRED FROM THE G5 THAT THE ROLE AND THE IMPORTANCE OF THE G10 WOULD NOT SUFFER, BUT POSSIBLY BE STRENGTHENED.

2. LAUTENBERG SAID THE SWISS WERE NOT NECESSARILY OPPOSED TO EXPANSION. BUT ATTENTION MUST BE ADDRESSED TO OBJECTIVE CRITERIA FOR DEALING WITH SUCH APPLICATIONS. THERE WERE SIGNS THAT AUSTRIA MIGHT BE NEXT. WHERE WOULD THIS END AND WHAT WOULD THE IMPLICATIONS BE FOR THE ENLARGED GROUP? HE COMMENTED THAT SWITZERLAND COULD SEE VALUE IN SPAIN JOINING AS A REGIONAL LINK TO SOUTH AMERICA. THEY HAD FOCUSSED LESS ON THE AUSTRALIAN APPLICATION AND ITS MOTIVATION. BUT CONSIDERATION OF THESE APPLICATIONS SHOULD BE SEEN IN THE LIGHT OF OBJECTIVE CONSIDERATION OF THE PROPER CRITERIA.

3. SPEAKING PERSONALLY, LAUTENBERG SAID HE WAS ALSO WORRIED ABOUT THE IMPLICATIONS FOR WORKING PARTY 3. ALREADY THIS BODY SUFFERED FROM TAKING TOO THEORETICAL A LINE ON QUESTIONS BEFORE IT SEMICOLON ENLARGEMENT MIGHT WORSEN THE SITUATION AND DISCOURAGE HIGH-LEVEL REPRESENTATION AT WP3 MEETINGS.

4. GIVEN THAT OTHER SMALLER COUNTRIES MIGHT HAVE GREATER RESERVATIONS ABOUT ENLARGEMENT AND TAKE A HARDER LINE THAN THE SWISS, LAUTENBERG WONDERED WHETHER IT MIGHT NOT BE BEST FOR THE G5 TO DISCUSS THE MATTER AND SUGGEST AT THE SEPTEMBER MEETING A PAUSE FOR CONSIDERING THE APPLICATIONS WHILE A WORKING GROUP STUDIED THE QUESTION OF CRITERIA. THIS DELAY WOULD BE FAR PREFERABLE TO A NEGATIVE VOTE BY ONE OR OTHER OF THE SMALLER COUNTRIES.

*Para 4,
Implications
2. Has we see
one 6 points
(u x) Nat
Spain + Australia
G10
some base
united,
Nat in
is clear
unstable
Nat after
Sp + Australia
was pulled up
No standard
Can clear
Dyzel
Australia?*

X |

1
Restricted

5. LAUTENBERG ASKED TO BE KEPT INFORMED OF THE UK'S POSITION.

HOPE

YYYY
BKLNAV 2817

NNNN

MONETARY
ERD

²
Restricted

GRS 140

Confidential

CONFIDENTIAL

FM BRUSSELS

TO IMMEDIATE FCO

TELNO 240

OF 041507Z AUGUST 87

INFO ROUTINE BERNE, THE HAGUE, STOCKHOLM, MADRID, CANBERRA

INFO ROUTINE WASHINGTON, UKDEL IMF, BONN, PARIS, TOKYO, OTTAWA, ROME

YOUR TELNO 123: EXPANSION OF G10

SUMMARY

1. IN INITIAL REACTION, BELGIUM WILL SUPPORT ENLARGEMENT TO INCLUDE SPAIN AND AUSTRALIA.

DETAIL

2. A COPY OF LETTER DELIVERED TO TINDEMANS' CABINET. FOREIGN MINISTRY HAVE NOT YET GIVEN ANY FORMAL OR INFORMAL REACTION. COPY ALSO DELIVERED TO CABINET OF FINANCE MINISTER. PETIT (MEMBER OF EYSKENS' CABINET RESPONSIBLE FOR INTERNATIONAL MONETARY QUESTIONS) SAID IMMEDIATELY THAT BELGIUM WOULD SUPPORT THE MEMBERSHIP OF SPAIN AND AUSTRALIA. HE RECOGNISED THAT BELGIAN SUPPORT AND EYSKENS' FLUENCY MIGHT ALSO HAVE SOME VALUE IN BRINGING ROUND SWEDEN AND THE NETHERLANDS. IT WAS UNLIKELY, HOWEVER, THAT BELGIUM WOULD OPENLY LOBBY OR SUPPORT BEFORE THE MEETING.

3. WE WILL REPORT ANY FURTHER CONSIDERED REACTIONS FROM THE FOREIGN MINISTRY.

EVANS

YYYY

BWLNAN 3417

MONETARY
WED
SPD
SEP
WAD

Confidential



FROM: J M G TAYLOR
DATE: 4 August 1987

SIR G LITTLER

cc: Mr H Evans
Mr Walsh

EXPANSION OF G10

... The Chancellor has seen Berne tel no 148 (attached).

2. He has noted Lautenberg's suggestion that it might be best for the G5 for discuss enlargement. He has commented on this point: "Emphatically, no".

3. He has also noted Lautenberg's rhetorical question (para 2) about where enlargement would end and what the implications might be for the enlarged group. He has asked whether the FCO has not pointed out to posts that Spain and Australia are bigger than some existing G10 members, and that it is clearly understood that after Spain and Australia we pull up the drawbridge (on clear objective criteria).

A handwritten signature in black ink, appearing to be 'JMG'.

J M G TAYLOR

Restricted

RESTRICTED

FM BERNE

TO PRIORITY FCO

TELNO 148

OF 311000Z JULY 87

INFO ROUTINE BRUSSELS, *THE HAGUE* STOCKHOLM, MADRID, CANBERRA
INFO ROUTINE WASHINGTON, UKDEL IMF, BONN, PARIS, TOKYO, OTTAWA
INFO ROUTINE ROME

YOUR TELNO 123: EXPANSION OF G10

1. I TOOK A COPY OF THE MESSAGE IN YOUR PARA 2 TO LAUTENBERG, HEAD OF THE FINANCE AND ECONOMIC SERVICE IN THE FEDERAL DEPARTMENT OF FOREIGN AFFAIRS. LAUTENBERG COMMENTED THAT THE CHIEF SWISS CONCERNS WERE THAT:

(A) THE FUNCTION OF THE G10 IN ITS RELATIONSHIP TO THE G5 SHOULD NOT BE ERODED SEMICOLON

(B) THE EFFICIENCY OF THE WORK OF THE G10 SHOULD NOT BE DISADVANTAGED BY AN ENLARGEMENT IN ITS MEMBERSHIP SEMICOLON

(C) THEREFORE SPECIFIC ASSURANCES WOULD BE REQUIRED FROM THE G5 THAT THE ROLE AND THE IMPORTANCE OF THE G10 WOULD NOT SUFFER, BUT POSSIBLY BE STRENGTHENED.

2. LAUTENBERG SAID THE SWISS WERE NOT NECESSARILY OPPOSED TO EXPANSION. BUT ATTENTION MUST BE ADDRESSED TO OBJECTIVE CRITERIA FOR DEALING WITH SUCH APPLICATIONS. THERE WERE SIGNS THAT AUSTRIA MIGHT BE NEXT. WHERE WOULD THIS END AND WHAT WOULD THE IMPLICATIONS BE FOR THE ENLARGED GROUP? HE COMMENTED THAT SWITZERLAND COULD SEE VALUE IN SPAIN JOINING AS A REGIONAL LINK TO SOUTH AMERICA. THEY HAD FOCUSED LESS ON THE AUSTRALIAN APPLICATION AND ITS MOTIVATION. BUT CONSIDERATION OF THESE APPLICATIONS SHOULD BE SEEN IN THE LIGHT OF OBJECTIVE CONSIDERATION OF THE PROPER CRITERIA.

3. SPEAKING PERSONALLY, LAUTENBERG SAID HE WAS ALSO WORRIED ABOUT THE IMPLICATIONS FOR WORKING PARTY 3. ALREADY THIS BODY SUFFERED FROM TAKING TOO THEORETICAL A LINE ON QUESTIONS BEFORE IT SEMICOLON ENLARGEMENT MIGHT WORSEN THE SITUATION AND DISCOURAGE HIGH-LEVEL REPRESENTATION AT WP3 MEETINGS.

4. GIVEN THAT OTHER SMALLER COUNTRIES MIGHT HAVE GREATER RESERVATIONS ABOUT ENLARGEMENT AND TAKE A HARDER LINE THAN THE SWISS, LAUTENBERG WONDERED WHETHER IT MIGHT NOT BE BEST FOR THE G5 TO DISCUSS THE MATTER AND SUGGEST AT THE SEPTEMBER MEETING A PAUSE FOR CONSIDERING THE APPLICATIONS WHILE A WORKING GROUP STUDIED THE QUESTION OF CRITERIA. THIS DELAY WOULD BE FAR PREFERABLE TO A NEGATIVE VOTE BY ONE OR OTHER OF THE SMALLER COUNTRIES.

Restricted

5. LAUTENBERG ASKED TO BE KEPT INFORMED OF THE UK'S POSITION.

HOPE

YYYY

BKLNAN 2817

NNNN

MONETARY
ERD

²
Restricted



TREASURER

PARLIAMENT HOUSE
CANBERRA 2600

4 AUG 1987

The Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
11 Downing Street
LONDON SW1
UNITED KINGDOM

My dear Chancellor

I am writing to you in your capacity as Chairman of the G10.

As you know, Australia has expressed interest on several occasions in becoming a participant in the General Arrangements to Borrow and a member of the G10. I now do again, not only on the basis of the benefits which membership might bring to Australia but also to the Group as a whole, having regard to the extent that Australia and the \$A are now integrated into the international financial system.

When the G10 last considered the issue of an expansion of its membership, it decided to defer substantive consideration until the next review of the GAB, which is to take place shortly. Australia wishes to be considered in the context of those processes for inclusion as a participant in the GAB and a member of the G10. I believe that Australia has exceptionally strong claims to these positions, particularly given the major policy changes which have occurred since 1983 when the GAB were last reviewed. These policy actions have completely transformed Australia's financial system, and the way it interacts with the international financial system.

In the period since 1983 Australia has floated its exchange rate and abolished exchange controls on private transactions. Similarly, there are now no controls of any kind on interest rates on official paper and bank interest rates have been virtually deregulated. Australia's professional money markets and its foreign exchange markets are therefore fully functioning free markets and have deepened rapidly. Sixteen foreign banks have been permitted to establish subsidiaries in Australia and entry to the merchant banking sector derestricted. Restrictions on investments at interest in Australia by official foreign monetary institutions have been removed. Australia's foreign investment policy also has been liberalised substantially, so that there are now very few impediments to overseas investment in Australia.

As a result of these policy decisions, Australia now has one of the most open financial systems in the world. There are now very well-developed and efficient on-shore and off-shore foreign exchange markets for the Australian dollar, with significant trading on a 24 hour basis around the world. Other major currencies are actively traded in Australia. The Australian foreign exchange market is now among the top six or seven in the world in terms of turnover, and the Australian dollar is estimated to be the sixth or seventh most traded currency. Australia's position in global time zones makes our market an important link between New York, Tokyo and London. Trading in the Australian market has become increasingly important to conditions in the major markets. The Australian dollar is currently among the top five currency denominations used in the Eurobond market. Commercial banks from G10 countries have established banking and/or merchant banking operations in Australia, and Australian banks have taken on an increasingly global orientation. Foreign central banks and international institutions have begun to include Australian dollars in their reserve holdings. Such \$A holdings presently total \$US1.5 billion and have been growing quickly since the removal of restrictions on such investments.

In short, Australia is now fully integrated into the international financial system and the Australian dollar has assumed an important international role. As a result, developments in Australian financial markets, together with Australian Government policy attitudes, are of increased relevance to G10 countries. In these respects, in particular, I believe that Australia's claims to membership of the G10 surpass those of any other prospective members.

Another important consideration, in my view, is the fact that Australia has much in common with G10 countries in terms of its approach to economic policy. In policy terms we have seen responsible domestic economic management aimed at containing inflation and structural adjustment as being essential to sustaining acceptable rates of growth in output and employment in the longer run.

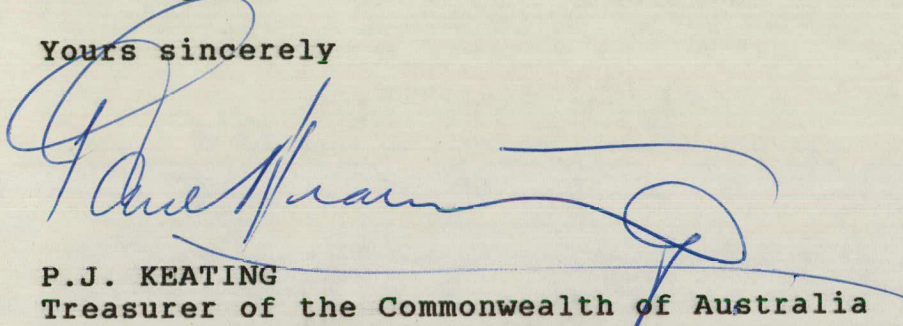
Australia has always taken a detailed and responsible interest in international monetary and financial matters. This is reflected in our active role in the IMF and IBRD, where we lead substantial constituencies. It also explains our keenness to be able to participate in G10 discussions on these matters.

The Australian economy is larger than those of four countries which are presently G10 members. Based on OECD GDP data, Australia is the ninth largest OECD economy. I also observe that the present G10 membership has a very limited non-Atlantic representation. Australia, while very much identifying with the industrial countries, would be able to increase the Group's awareness of relevant developments in the dynamic Asian Pacific region.

You have my assurance that the Australian Government is prepared to provide a GAB credit line to the IMF that is fully in accordance with the relative size of the Australian economy and Australia's external position. We are also ready to provide the necessary high level representation to enable us to play a responsible role in the G10. In the light of these assurances and the developments outlined in this letter, I should be most grateful if you and the other G10 Finance Ministers would give favourable consideration to the Australian Government's request to be included as a participant in the GAB and a member of the G10. With a view to facilitating consideration of that request, I am forwarding a copy of this letter to the Finance Minister of each of the G10 countries.

Kind regards

Yours sincerely

A handwritten signature in blue ink, appearing to read 'P.J. Keating', with a long horizontal flourish extending to the right.

P.J. KEATING
Treasurer of the Commonwealth of Australia



TREASURER

PARLIAMENT HOUSE
CANBERRA 2600

4 AUG 1987

The Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
11 Downing Street
LONDON SW1
UNITED KINGDOM

My dear Chancellor

Since the preparation of the attached letter to you, seeking your favourable consideration of the Australian Government's request to be included as a participant in the GAB and a member of the G10, I have been informed via the British High Commission in Canberra that Australian membership of the G10 would be warmly supported by the United Kingdom. I understand that Sir Geoffrey Howe has written to his counterparts in Belgium, Sweden, Switzerland and the Netherlands stating that the United Kingdom will support the admission of Australia, and Spain, to the G10.

I wish to thank you for this most appreciated support of Australia's interests in the matter. As you will see when you read my attached letter, Australia has a strong claim to G10 membership, which I trust will be accepted by all members of the G10.

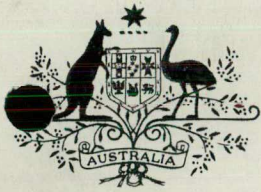
I look forward to discussing this and other matters of mutual interest with you during the forthcoming meetings of the IMF and World Bank in Washington.

With kind regards

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Paul Keating', written over a horizontal line.

P.J. KEATING
Treasurer of the
Commonwealth of Australia



AUSTRALIAN HIGH COMMISSION

Pse. withon yesterday's minute from Colenutt, + return.

AUSTRALIA HOUSE
STRAND
LONDON WC2B 4LA
01-438 8000
438 8271

CH/EXCHEQUER	
REC.	- 4 AUG 1987
ACTION	SIR G. LITTLER
COPIES TO	EST
	SIR P. MIDDLETON
	MR H.P. EVANS
	MR WALSH.

4 August 1987.

A good letter is x time?
for Walsh.

Dear Mr. Taylor,

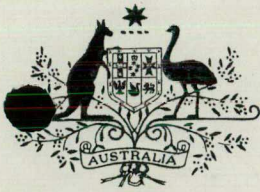
Please find attached two letters from the Treasurer to the Chancellor relating to Australia's bid for membership of the Group of Ten. Please note that the letters are unsigned copies, the text of which was communicated by cable earlier today; we will pass the originals on to you when they are received. I understand from your earlier conversation with Miss Gearon of my office that the Chancellor is effectively on holidays but that, nevertheless, you undertook to arrange to have the letters sent on to him. I would like to express my appreciation of your undertaking; this matter is clearly of the highest importance to the Australian Government.

Yours sincerely,

E. F. Delofski

(E. F. Delofski)
MINISTER (ECONOMIC)

Mr. J. M. G. Taylor,
Private Secretary
to the Chancellor of the Exchequer,
HM Treasury,
Parliament Street,
London SW1P 3AG.



AUSTRALIAN HIGH COMMISSION

CH/EXCHEQUE	
REC.	- 4 AUG 1987
ACTION	
COPIES TO	

AUSTRALIA HOUSE
STRAND
LONDON WC2B 4LA
01-438 8000
438 8271

4 August 1987.

My Dear Chancellor,

Since the preparation of the attached letter to you, seeking your favourable consideration of the Australian Government's request to be included as a participant in the GAB and a member of the G10, I have been informed via the British High Commission in Canberra that Australian membership of the G10 would be warmly supported by the United Kingdom. I understand that Sir Geoffrey Howe has written to his counterparts in Belgium, Sweden, Switzerland and the Netherlands stating that the United Kingdom will support the admission of Australia, and Spain, to the G10.

I wish to thank you for this most appreciated support of Australia's interests in the matter. As you will see when you read my attached letter, Australia has a strong claim to G10 membership, which I trust will be accepted by all members of the G10.

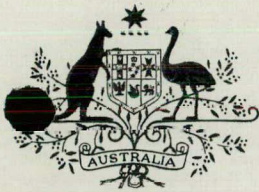
I look forward to discussing this and other matters of mutual interest with you during the forthcoming meetings of the IMF and World Bank in Washington.

With kind regards,

Yours sincerely,

(P. J. Keating)
TREASURER OF THE COMMONWEALTH OF AUSTRALIA

The Rt. Hon. Nigel Lawson, MP,
Chancellor of the Exchequer,
11 Downing Street,
London SW1.



AUSTRALIAN HIGH COMMISSION

CH/EXCHEQUER	
REC.	- 4 AUG 1987
ACTION	
COPIES TO	

AUSTRALIA HOUSE
STRAND
LONDON WC2B 4LA
01-438 8000
438 8271

4 August 1987.

My Dear Chancellor,

I am writing to you in your capacity as Chairman of the G10.

As you know, Australia has expressed interest on several occasions in becoming a participant in the General Arrangements to Borrow and a member of the G10. I now do again, not only on the basis of the benefits which membership might bring to Australia but also to the group as a whole, having regard to the extent that Australia and the \$A are now integrated into the international financial system.

When the G10 last considered the issue of an expansion of its membership, it decided to defer substantive consideration until the next review of the GAB, which is to take place shortly. Australia wishes to be considered in the context of those processes for inclusion as a participant in the GAB and a member of the G10. I believe that Australia has exceptionally strong claims to these positions, particularly given the major policy changes which have occurred since 1983 when the GAB were last reviewed. These policy actions have completely transformed Australia's financial system, and the way it interacts with the international financial system.

In the period since 1983 Australia has floated its exchange rate and abolished exchange controls on private transactions. Similarly, there are now no controls of any kind on interest rates on official paper and bank interest rates have been virtually deregulated. Australia's professional money markets and its foreign exchange markets are therefore fully functioning free markets and have deepened rapidly. Sixteen foreign banks have been permitted to establish subsidiaries in Australia and entry to the merchant banking sector derestricted. Restrictions on investments at interest in Australia by official foreign monetary institutions have been removed. Australia's foreign investment policy also has been liberalised substantially, so that there are now very few impediments to overseas investment in Australia.

As a result of these policy decisions, Australia now has one of the most open financial systems in the world. There are now very well-developed and efficient on-shore and off-shore foreign exchange markets for the Australian dollar, with significant trading on a 24 hour basis around the world. Other major currencies are actively traded in Australia. The Australian foreign exchange

X | market is now among the top six or seven in the world in terms of turnover, and the Australian dollar is estimated to be the sixth or seventh most traded currency. Australia's position in global time zones makes our market an important link between New York, Tokyo and London. Trading in the Australian market has become increasingly important to conditions in the major markets. The Australian dollar is currently among the top five currency denominations used in the Eurobond market. Commercial banks from G10 countries have established banking and/or merchant banking operations in Australia, and Australian banks have taken on an increasingly global orientation. Foreign central banks and international institutions have begun to include Australian dollars in their reserve holdings. Such \$A holdings presently total \$US1.5 billion and have been growing quickly since the removal of restrictions on such investments.

In short, Australia is now fully integrated into the international financial system and the Australian dollar has assumed an important international role. As a result, developments in Australian financial markets, together with Australian Government policy attitudes, are of increased relevance to G10 countries. In these respects, in particular, I believe that Australia's claims to membership of the G10 surpass those of any other prospective members.

Another important consideration, in my view, is the fact that Australia has much in common with G10 countries in terms of its approach to economic policy. In policy terms we have seen responsible domestic economic management aimed at containing inflation and structural adjustment as being essential to sustaining acceptable rates of growth in output and employment in the longer run.

Australia has always taken a detailed and responsible interest in international monetary and financial matters. This is reflected in our active role in the IMF and IBRD, where we lead substantial constituencies. It also explains our keenness to be able to participate in G10 discussions on these matters.

The Australian economy is larger than those of four countries which are presently G10 members. Based on OECD GDP data, Australia is the ninth largest OECD economy. I also observe that the present G10 membership has a very limited non-Atlantic representation. Australia, while very much identifying with the industrial countries, would be able to increase the group's awareness of relevant developments in the dynamic Asian Pacific region.

You have my assurance that the Australian Government is prepared to provide a GAB credit line to the IMF that is fully in accordance with the relative size of the Australian economy and Australia's external position. We are also ready to provide the necessary high level representation to enable us to play a responsible role in the G10. In the light of these assurances and the developments outlined in this letter, I should be most

grateful if you and the other G10 Finance Ministers would give favourable consideration to the Australian Government's request to be included as a participant in the GAB and a member of the G10. With a view to facilitating consideration of that request, I am forwarding a copy of this letter to the Finance Minister of each of the G10 countries.

Kind regards,

Yours sincerely,

(P. J. Keating)

TREASURER OF THE COMMONWEALTH OF AUSTRALIA

The Rt. Hon. Nigel Lawson, MP,
Chancellor of the Exchequer,
11 Downing Street,
London SW1.

RESTRICTED

*At X, Plac 2
cancel the proposal
Plac 6 to G10 a step
2. I agree with
Plac (4(ii))
conveys the
I should both
publish this @
beginning of
a get this all
straight up @
the step G10
nr.*

Ch. To note esp. 'X'

From: Sir G. Littler
Date: 5 August 1987

c.c. Mr Evans
Mr Walsh

MR J M G TAYLOR

EXPANSION OF G10

Thank you for your minute of 4 August. I have two comments.

2. FCO have indeed drawn the attention of posts to the fact that Spain and Australia are bigger than some existing members, and alone among potentially interested countries in having this 'qualification'. (Their initial message was thin on briefing and at my suggestion they supplemented it with more material which included this point among others).

3. I am a little uneasy about the Chancellor's comment at the end of your minute: "that it is clearly understood that after Spain and Australia we pull up the drawbridge". This is a good position to adopt, and the UK has adopted it. I know that the Chancellor feels confident that others would share it. But I have to say that my impression from conversations with individual other G10 deputies is that we are well short of 'clear understanding'. For example: Tietmeyer regularly says that they would be in great embarrassment vis-a-vis Austria; and the Swedes worry about Norway and Denmark. The statistical argument is certainly clear. But I do not think there is any sense of commitment to it yet.

4. I very much agree with the Chancellor in rejecting the idea of a G5 discussion on this topic. But I think he may need during September, specifically on the 'limit to enlargement' concept:

- (i) - to canvass / re-canvass EC members of G10;
- (ii) - to encourage explicit discussion at the G10 meeting.

We can discuss at some stage during September briefing talks.

[Signature]
(Geoffrey Littler)

X

X

RESTRICTED



FROM: J M G TAYLOR

DATE: 4 August 1987

SIR G LITTLER

cc: Mr H Evans
Mr Walsh**EXPANSION OF G10**

... The Chancellor has seen Berne tel no 148 (attached).

2. He has noted Lautenberg's suggestion that it might be best for the G5 for discuss enlargement. He has commented on this point: "Emphatically, no".

3. He has also noted Lautenberg's rhetorical question (para 2) about where enlargement would end and what the implications might be for the enlarged group. He has asked whether the FCO has not pointed out to posts that Spain and Australia are bigger than some existing G10 members, and that it is clearly understood that after Spain and Australia we pull up the drawbridge (on clear objective criteria).

A handwritten signature, likely of J M G Taylor, consisting of stylized initials.

J M G TAYLOR

Restricted

RESTRICTED

FM BERNE

TO PRIORITY FCO

TELNO 148

OF 311000Z JULY 87

INFO ROUTINE BRUSSELS, ~~THE HAGUE~~ STOCKHOLM, MADRID, CANBERRA
INFO ROUTINE WASHINGTON, UKDEL IMF, BONN, PARIS, TOKYO, OTTAWA
INFO ROUTINE ROME

YOUR TELNO 123: EXPANSION OF G10

1. I TOOK A COPY OF THE MESSAGE IN YOUR PARA 2 TO LAUTENBERG, HEAD OF THE FINANCE AND ECONOMIC SERVICE IN THE FEDERAL DEPARTMENT OF FOREIGN AFFAIRS. LAUTENBERG COMMENTED THAT THE CHIEF SWISS CONCERNS WERE THAT:

(A) THE FUNCTION OF THE G10 IN ITS RELATIONSHIP TO THE G5 SHOULD NOT BE ERODED SEMICOLON

(B) THE EFFICIENCY OF THE WORK OF THE G10 SHOULD NOT BE DISADVANTAGED BY AN ENLARGEMENT IN ITS MEMBERSHIP SEMICOLON

(C) THEREFORE SPECIFIC ASSURANCES WOULD BE REQUIRED FROM THE G5 THAT THE ROLE AND THE IMPORTANCE OF THE G10 WOULD NOT SUFFER, BUT POSSIBLY BE STRENGTHENED.

2. LAUTENBERG SAID THE SWISS WERE NOT NECESSARILY OPPOSED TO EXPANSION. BUT ATTENTION MUST BE ADDRESSED TO OBJECTIVE CRITERIA FOR DEALING WITH SUCH APPLICATIONS. THERE WERE SIGNS THAT AUSTRIA MIGHT BE NEXT. WHERE WOULD THIS END AND WHAT WOULD THE IMPLICATIONS BE FOR THE ENLARGED GROUP? HE COMMENTED THAT SWITZERLAND COULD SEE VALUE IN SPAIN JOINING AS A REGIONAL LINK TO SOUTH AMERICA. THEY HAD FOCUSED LESS ON THE AUSTRALIAN APPLICATION AND ITS MOTIVATION. BUT CONSIDERATION OF THESE APPLICATIONS SHOULD BE SEEN IN THE LIGHT OF OBJECTIVE CONSIDERATION OF THE PROPER CRITERIA.

3. SPEAKING PERSONALLY, LAUTENBERG SAID HE WAS ALSO WORRIED ABOUT THE IMPLICATIONS FOR WORKING PARTY 3. ALREADY THIS BODY SUFFERED FROM TAKING TOO THEORETICAL A LINE ON QUESTIONS BEFORE IT SEMICOLON ENLARGEMENT MIGHT WORSEN THE SITUATION AND DISCOURAGE HIGH-LEVEL REPRESENTATION AT WP3 MEETINGS.

4. GIVEN THAT OTHER SMALLER COUNTRIES MIGHT HAVE GREATER RESERVATIONS ABOUT ENLARGEMENT AND TAKE A HARDER LINE THAN THE SWISS, LAUTENBERG WONDERED WHETHER IT MIGHT NOT BE BEST FOR THE G5 TO DISCUSS THE MATTER AND SUGGEST AT THE SEPTEMBER MEETING A PAUSE FOR CONSIDERING THE APPLICATIONS WHILE A WORKING GROUP STUDIED THE QUESTION OF CRITERIA. THIS DELAY WOULD BE FAR PREFERABLE TO A NEGATIVE VOTE BY ONE OR OTHER OF THE SMALLER COUNTRIES.

Restricted

5. LAUTENBERG ASKED TO BE KEPT INFORMED OF THE UK'S POSITION.

HOPE

YYYY
BKL NAW 2817

NNNN

MONETARY
FRD

²
Restricted

5-332

RESTRICTED



FROM: J M G TAYLOR

DATE: 10 August 1987

Bf. with Leifm 6/2/87/9
(check)
(die/ing)

SIR G LITTLER

cc: Mr Evans
Mr Walsh**EXPANSION OF G10**

The Chancellor has seen your minute of 5 August.

2. He has commented that the proposition "that it is clearly understood that after Spain and Australia we pull up the drawbridge" is certainly one that he would intend to put to the G10 in September.

3. He agrees with you that he should both canvass EC members of G10 and probably raise this at the September informal ECOFIN, and try very hard to get this all sewn up at the September G10.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR

Ch
This is a response to your question
about Mr Keating's letter.

FROM: J E B COLENUTT
DATE: 10 AUGUST 1987

JF
11/8

cc Mr Matthews (OR)
Mr. Savage

MR TAYLOR

12/2.

There:-

IMPORTANCE OF THE AUSTRALIAN DOLLAR

You asked David Savage about the relative importance of the Australian dollar and foreign exchange market.

2. At the end of 1986 the average turnover of the Australian foreign exchange market was US \$10 billion a day. This put it in eighth place after London (\$90 billion), New York (\$60 billion) and Tokyo (\$50 billion) and on a par with Hong Kong and Singapore. It is considerably larger than the Paris market.
3. After recent deregulation of foreign exchange dealing transactions are growing at an annual rate of over 60 per cent (compared to 50 per cent in the UK and 35 per cent in New York).
4. The statement that the Australian dollar is the 'sixth or seventh most traded currency' must be an exaggeration if it refers to merchandise trade. Australia exports and imports were 1½ per cent of OECD exports and imports in 1986 - a share which ranks thirteenth amongst OECD countries. The Australian dollar is not much used for third country trade, and less than 1 per cent of total world trade may be denominated in Australian dollars.
5. The statement may refer to the total volume of foreign exchange business, but there seems little information on this. A survey carried out by the Bank of England in March 1986 showed that on the London market the most important currencies were the US

dollar, sterling, Deutsch^emark, yen, Swiss franc, French franc, Lira
and Canadian dollar. It seems unlikely that the Australian dollar
is involved in a higher volume of business worldwide than any one
of these eight currencies.

J. Colenutt

J COLENUTT



Circ 4/8

AUSTRALIAN HIGH COMMISSION · LONDON

THE HIGH COMMISSIONER

24 August 1987.

My dear Chancellor,

I am attaching two letters to you from the Australian Treasurer, advanced copies of which I understand were passed to your office earlier this month.

As is made clear in the letters, the Australian Government attaches great importance to membership of the G10 and warmly welcomes and appreciates your efforts in support of Australia's interests in this matter.

Yours sincerely,

Douglas McClelland

The Rt. Hon. Nigel Lawson, MP,
Chancellor of the Exchequer,
11 Downing Street,
London SW1.

CONFIDENTIAL

017272
MDLIAN 1635

CONFIDENTIAL AMENDED DISTRIBUTION 29/8/87
FM CANBERRA
TO PRIORITY FCO
TELNO 541
OF 280404Z AUGUST 1987
INFO ROUTINE STOCKHOLM

MY TELNO 478 (NOT TO STOCKHOLM): EXPANSION OF G10

1. COSGROVE (HEAD OF OVERSEAS DIVISION AT THE TREASURY) MENTIONED TO ECONOMIC COUNSELLOR YESTERDAY THAT CONTACTS WHICH THE AUSTRALIANS HAVE HAD WITH THE SMALLER MEMBERS OF G10 INDICATED THAT THE SWEDES APPEARED TO BE THE ONLY GOVERNMENT STRONGLY OPPOSED TO EXPANSION OF THE GROUP TO INCLUDE AUSTRALIA AND SPAIN. COSGROVE SAID THAT THE AUSTRALIANS ARE CONSIDERING WHAT FURTHER ACTION TO TAKE DESIGNED TO SOFTEN UP THE SWEDES, SUCH AS SENDING THEIR AMBASSADOR AT STOCKHOLM IN AT A HIGHER LEVEL THAN HITHERTO OR CALLING IN THE SWEDISH AMBASSADOR HERE.
2. YOU MAY WISH TO CONSIDER WHETHER THERE IS ANY FURTHER ACTION WE COULD OURSELVES USEFULLY TAKE WITH THE SWEDES.

LEAHY

YYYY

DISTRIBUTION

183

MAIN 183

MONETARY	SED
ERD [-]	NAD
SPD	SEAD
WED	

NNNN

CONFIDENTIAL

From: Sir G. Littler
Date: 1 September 1987

CHANCELLOR

Good idea. (See draft) [Signature]

c.c. Mr Huw Evans
Mr Walsh
Mr Batt

EXPANSION OF GAB/G10

The Bank and IF Group have been looking at the Spain/Australia problem on the basis: how would we fix their GAB quotas if they joined? and could we create a defensible cut-off point.

2. The results are quite helpful. I am tempted to embody them in a note which Mr Loehnis and I (as G10 Deputies) could circulate to our colleagues at the meeting of Deputies we are to attend next week. The advantage would be that your Ministerial colleagues would then all be briefed on this common and helpful basis.

3. What do you think? If you are disinclined to have us take a position in writing in this way, the material will still be useful (for us at the meeting, for you at ECOFIN, etc).

a
Also teleg. [unclear]
AA

[Signature]
(Geoffrey Littler)

C O N F I D E N T I A L

POSSIBLE EXPANSION OF G.A.B. MEMBERSHIP

(Aide-Memoire by U.K. Deputies)

At their meeting in Washington D.C. on 27 September 1987 G10 Ministers and Central Bank Governors are to consider together how to respond to requests from Spain and Australia for admission to membership of the Group and the General Arrangements to Borrow.

2. In preparation for this discussion, the U.K. Deputies have been examining possible criteria for a strictly limited expansion. It seems to them that the following guide-lines would be sensible in themselves, and could be helpful towards a decision:

- Group and G.A.B. membership must be identical;
- the Group consists of willing industrial countries with the ~~strongest~~ economies;
- *largest?* *most substantial* economic ~~strength~~ *substance* for this purpose can appropriately be measured by gross domestic product and IMF quota share;
- membership should continue to be restricted: new members should not be admitted unless their economies are clearly stronger than those of the smallest existing members; to qualify they should clearly outrank one or more existing members in both g.d.p. and IMF quota share;
- GAB quotas for new members should be settled on the basis of IMF quota shares in relation to those of other members of similar size.

3. The Annex gives relevant figures. It suggests that, on the criteria set out above, Spain and Australia could both be regarded as qualifying for membership, while no other countries would do so or be likely to do so in the foreseeable future.

4. Approximate suitable GAB shares for Spain and Australia could be around SDR 430 million and 500 million respectively.

(Geoffrey Littler)
(Anthony Loehnis)

GDP, FUND QUOTAS AND GAB SHARES OF G10 MEMBERS
GDP AND FUND QUOTAS OF OTHER OECD

Participants (ii)	<u>GDP</u> <u>1986</u>		<u>Fund</u> <u>quota</u>		<u>GAB</u> <u>share</u>		
	\$bn	%	SDR bn	%	%	SDR bn	%
United States	4167	(43)	17.9	20.1	(36.2)	4.25	(25)
Germany	890	(9.2)	5.4	6.1	(10.9)	4.38	(14)
Japan	1959	(20.2)	4.2	4.7	(8.5)	2.125	(12.5)
France	706	(7.3)	4.5	5.0	(9.1)	1.7	(10)
UK	545	(5.6)	6.2	6.9	(12.5)	1.7	(10)
Italy	504	(5.2)	2.9	3.3	(5.9)	1.105	(6.5)
Switzerland	134	(1.4)	-			1.020	(6)
Canada	359	(3.7)	2.9	3.3	(5.9)	0.892	(5.25)
Netherlands	171	(1.8)	2.3	2.5	(4.6)	0.850	(5)
Belgium	111	(1.1)	2.1	2.3	(4.2)	0.595	(3.5)
Sweden	132	(1.4)	1.1	1.2	(2.2)	0.382	(2.25)
		(100)			100		100
<u>Applicants (2)</u>							
Australia	161		1.6	1.8			
Spain	227		1.3	1.4			
<u>Other OECD (11)</u>							
Austria	94		0.77	0.87			
Denmark	80		0.71	0.80			
Norway	69		0.70	0.78			
Finland	70		0.57	0.64			
New Zealand	26		0.46	0.52			
Turkey	59		0.43	0.48			
Greece	39		0.40	0.45			
Portugal	29		0.38	0.42			
Ireland	25		0.34	0.38			
Luxembourg	5		0.08	0.09			
Iceland	4		0.06	0.07			
<u>Other</u>							
South Africa	62		0.91	1.03			

*ps1*

FROM: A C S ALLAN

DATE: 2 September 1987

SIR G LITTLER

cc Mr H P Evans
Mr Walsh
Mr Batt**EXPANSION OF GAB/G10**

The Chancellor was grateful for your minute of 1 September, and thought it was a good idea for you and Mr Loehnis to circulate the note to your colleagues on G10 Deputies.

2. He suggests two small amendments: instead of "strongest economies" in the second indent of the second paragraph, substitute "most substantial economies". And make a consequential substitution of "economic substance" for "economic strength" in the third indent.

A handwritten signature in black ink that reads "ACSA".

A C S ALLAN



MANAGING DIRECTOR

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

CH/ JGL has, incidentally, confirmed that there is no need for any reply to Keating's original letter to you of 4 August.

CABLE ADDRESS
INTERFUND

??
Sandy at least
in acknowledgment.

September 2, 1987

15/9
you know, P&Q.
JGL

Dear Mr. Chancellor,

The Treasurer of the Commonwealth of Australia has sent me a copy of the letter he addressed to you dated August 4, 1987, concerning Australia's interest in joining the General Arrangements to Borrow. Please find attached a copy of my reply to Treasurer Keating.

With kind regards.

Yours sincerely,

Michael
Michael Camdessus

The Rt. Hon. Nigel Lawson, MP
Chancellor of the Exchequer
11 Downing Street
London SW 1, UNITED KINGDOM

?!
-!

CH/EXCHEQUER	
REC.	15SEP 1987
ACTION	SIR G. LITTLE
COPIES TO	EST
	SIR P. MIDDLETON
	MR HP BLANS
	MR WASH.

SEP - 3 1987

11-120

GAB

7/28/87



INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

Handwritten initials: JL, MK

September 2, 1987

Handwritten initials: SK, DJ, CC

9/11/87

Dear Mr. Keating,

I wish to thank you very much for the letter you sent to me on August 4, 1987, and the enclosed copy of your communication to the Chancellor of the Exchequer, Mr. Nigel Lawson, concerning Australia's continuing interest in becoming a participant in the General Arrangements to Borrow. As you know, this requires the concurrence of all the participants of the GAB. I understand the Deputies of the Group of Ten will discuss your country's desire shortly.

With kind regards.

Yours sincerely,

Handwritten signature of Michael Candessus

Michael Candessus

Mr. P. J. Keating
Treasurer
Commonwealth of Australia
Parliament House
Canberra, A.C.T. 2600
AUSTRALIA

cc: MD
DMD
Mr. Lankester
Mr. Rye
ASD
ETR
EUR
TRE
WHD
Mr. Brown

4 August 1987

Mr Michael Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr Camdessus

I have today written to the Chairman of the Group of Ten to request that consideration be given to admitting Australia to the Group.

A copy of my letter to the G10 Chairman, which has also been sent to the Finance Minister of each G10 country, is attached for your information.

In the past, a concomitant of G10 membership has been participation in the general arrangements to borrow. Australia is prepared to fulfil its obligation in that respect and I should appreciate your support for Australia's request to be admitted as a GAB participant and a member of the G10.

With kind regards.

Yours sincerely,

P.J. KEATING
Treasurer of the Commonwealth of Australia

4 August 1987

Mr Michael Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr Camdessus

I have today written to the Chairman of the Group of Ten to request that consideration be given to admitting Australia to the Group.

A copy of my letter to the G10 Chairman, which has also been sent to the Finance Minister of each G10 country, is attached for your information.

In the past, a concomitant of G10 membership has been participation in the general arrangements to borrow. Australia is prepared to fulfil its obligation in that respect and I should appreciate your support for Australia's request to be admitted as a GAB participant and a member of the G10.

With kind regards.

Yours sincerely,

P.J. KEATING
Treasurer of the Commonwealth of Australia

SEP - 3 1987

78864

11-120

GAB



INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

TL
AW

September 2, 1987

SK
DJ
CC

9/ix/87

Dear Mr. Keating,

I wish to thank you very much for the letter you sent to me on August 4, 1987, and the enclosed copy of your communication to the Chancellor of the Exchequer, Mr. Nigel Lawson, concerning Australia's continuing interest in becoming a participant in the General Arrangements to Borrow. As you know, this requires the concurrence of all the participants of the GAB. I understand the Deputies of the Group of Ten will discuss your country's desire shortly.

With kind regards.

Yours sincerely,

Michael Candessus

Mr. P. J. Keating
Treasurer
Commonwealth of Australia
Parliament House
Canberra, A.C.T. 2600
AUSTRALIA

cc: MD
DMD
Mr. Lankester
Mr. Rye
ASD
ETR
EUR
TRE
WHD
Mr. Brown

G10



CC Sir G Little
Mr Evans
Mr Walsh

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

18 September 1987

Hon P J Keating
Treasurer
Commonwealth of Australia
Parliament House
Canberra A.C.T. 2600
Australia

I am sorry not to have written sooner to thank you for your two letters of 4 August.

As you know, I myself favour admitting Spain and Australia to the group. A canvass of other members so far leaves the outcome at best uncertain: several are worried about the risk of creeping expansion in future. The material in your longer letter could be useful on that point.

I look forward to seeing you again in Washington.

NIGEL LAWSON

Use type letter (X) behind for
Ch

Content? (One suggested amendment, to avoid
the impression that you're only just
seen the Keating letters).

From: Sir G. Littler
Date: 17 September 1987

MR TAYLOR

c.c. Mr Evans
Mr Walsh

AUSTRALIA AND G10

You asked for a draft letter for the Chancellor to send to Keating
in reply to his letters which arrived over the holiday period (but
for which I conveyed via the High Commission here the Chancellor's
appreciation). I suggest the draft below:

OK in ...

(Geoffrey Littler)

[Dear Paul]

I am sorry not to have written sooner to thank
you for your two letters of 4 August, ~~which arrived when I
was taking a short holiday.~~

As you ~~realise I do myself see a good case for~~
admitting Spain and Australia to the group. A canvass of
other members so far leaves the outcome ~~uncertain:~~ several
are ~~very~~ worried about the risk of creeping expansion in
future. The material in your longer letter could be
useful on that point.

I look forward to seeing you again in Washington.

(N.L.)

X

/stat

Ch / Content?

25

2/10

From: Sir G.Littler
Date: 2 October 1987

CHANCELLOR

c.c. Mr Walsh

G10 NON-EXPANSION

For the record, I think we need a letter from you to all three applicants - in identical terms and copied to the secretariat. I attach a draft. I suggest you send the versions to Spain and Australia under cover of a more informal letter (inappropriate to Austria), which would not be copied to the secretariat. I attach a draft of this also.

(Geoffrey Littler)

CONFIDENTIAL

Pre type (ij)

DRAFT LETTERS FROM CHANCELLOR TO:

- (1) Hon. P.J.Keating, M.P.
Treasurer
Commonwealth of Australia
CANBERRA.
- (2) Mr D. Carlos Solchaga
Minister of Finance of Spain
MADRID.
- (3) Dr Ferdinand Lacina
Bundesminister fur Finanzen
VIENNA.

Copies of all 3 to:

J van Houten
G10 Secretariat
IMF Office in Europe
64/66 Avenue d'Iena
75116 PARIS.

I am writing to you as Chairman of the meeting of the Group of Ten Finance Ministers and Central Bank Governors which was held in Washington DC on 27 September. Kjell-Olof Feldt of Sweden has assumed the Chairmanship for the coming year.

This meeting was the occasion for the five-yearly review of the General Arrangements to Borrow, and as you know it was decided to take that opportunity to consider the three applications for membership of the Group and of the GAB which had been put forward: by Australia, Austria and Spain.

I have to inform you that, after a thorough debate, the decision was that the membership should remain unchanged. The GAB was renewed without any amendment for a further five years. The fact that membership had been discussed was not mentioned in our brief communique.

I am sorry to disappoint you.

(Nigel Lawson)

DRAFT LETTERS FROM CHANCELLOR TO:

- (1) Hon. P.J. Keating, M.P.
Treasurer
Commonwealth of Australia
CANBERRA.
- (2) Mr D. Carlos Solchaga
Minister of Finance of Spain
MADRID.

I am enclosing a formal letter to you on the question of G10 membership.

I thought you might like to know on a personal basis that there was in fact ~~quite a~~ ^{clear} majority of ~~opinion~~ ^{which} in the Group recognising the claims of Australia and Spain on grounds of their economic substance, and ~~seeing~~ ^{accepting} the possibility of drawing a definitive line on membership after their inclusion. However the rules require unanimity for ~~any addition of~~ ^{the acceptance of} members, and that ~~was~~ ^{now} not obtainable. ^{regrettably}

[1 only] I am sorry not to have had the chance of talking with you in Barbados and Washington. ~~I hope the 'flu' is well over!~~

[2 only] I am sorry not to have had the chance of talking with you in Washington.

(Nigel Lawson)

I gather we
may be meeting
soon in London.

cc Sir G Litter
Mr Walsh

A handwritten signature in ink, appearing to be 'mg'.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

5 October 1987

Hon P J Keating MP
Treasurer
Commonwealth of Australia
CANBERRA

A handwritten signature in ink, appearing to be 'Alan Paul'.

... I am enclosing a formal letter to you on the question of G10 membership.

I thought you might like to know on a personal basis that there was in fact a clear majority in the Group which recognised the claims of Australia and Spain on grounds of their economic substance, and accepted the possibility of drawing a definitive line on membership after their inclusion. However the rules require unanimity for the acceptance of any new members, and that, regrettably, was not obtainable.

I am sorry not to have had the chance of talking with you in Barbados and Washington. I gather we may be meeting soon in London.

A handwritten signature in ink, appearing to be 'Nigel Lawson'.

NIGEL LAWSON



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

5 October 1987

Hon P J Keating MP
Treasurer
Commonwealth of Australia
CANBERRA

A handwritten signature in dark ink, appearing to read 'Kjell-Olof Feldt'.

I am writing to you as Chairman of the meeting of the Group of Ten Finance Ministers and Central Bank Governors which was held in Washington DC on 27 September. Kjell-Olof Feldt of Sweden has assumed the Chairmanship for the coming year.

This meeting was the occasion for the five-yearly review of the General Arrangements to Borrow, and as you know it was decided to take that opportunity to consider the three applications for membership of the Group and of the GAB which had been put forward: by Australia, Austria and Spain.

I have to inform you that, after a thorough debate, the decision was that the membership should remain unchanged. The GAB was renewed without any amendment for a further five years. The fact that membership had been discussed was not mentioned in our brief communique.

I am sorry to disappoint you.

A handwritten signature in dark ink, appearing to read 'Nigel Lawson'.

NIGEL LAWSON



cc Sir G Lither
Mr Walsh

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

5 October 1987

Dr Ferdinand Lacina
Bundesminister für Finanzen
VIENNA

John Major

I am writing to you as Chairman of the meeting of the Group of Ten Finance Ministers and Central Bank Governors which was held in Washington DC on 27 September. Kjell-Olof Feldt of Sweden has assumed the Chairmanship for the coming year.

This meeting was the occasion for the five-yearly review of the General Arrangements to Borrow, and as you know it was decided to take that opportunity to consider the three applications for membership of the Group and of the GAB which had been put forward: by Australia, Austria and Spain.

I have to inform you that, after a thorough debate, the decision was that the membership should remain unchanged. The GAB was renewed without any amendment for a further five years. The fact that membership had been discussed was not mentioned in our brief communique.

I am sorry to disappoint you.

Nigel Lawson

NIGEL LAWSON



cc Sir G Litter
Mr Walsh

[Handwritten initials]

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

5 October 1987

Senor D Carlos Solchaga
Minister of Finance of Spain
MADRID

[Handwritten signature: D Carlos]

... I am enclosing a formal letter to you on the question of G10 membership.

I thought you might like to know on a personal basis that there was in fact a clear majority in the Group which recognised the claims of Australia and Spain on grounds of their economic substance, and accepted the possibility of drawing a definitive line on membership after their inclusion. However the rules require unanimity for the acceptance of any new members, and that, regrettably, was not obtainable.

I am sorry not to have had the chance of talking with you in and Washington.

[Handwritten signature: Nigel Lawson]

NIGEL LAWSON



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

5 October 1987

Senor D Carlos Solchaga
Minister of Finance of Spain
MADRID

San Carlos

I am writing to you as Chairman of the meeting of the Group of Ten Finance Ministers and Central Bank Governors which was held in Washington DC on 27 September. Kjell-Olof Feldt of Sweden has assumed the Chairmanship for the coming year.

This meeting was the occasion for the five-yearly review of the General Arrangements to Borrow, and as you know it was decided to take that opportunity to consider the three applications for membership of the Group and of the GAB which had been put forward: by Australia, Austria and Spain.

I have to inform you that, after a thorough debate, the decision was that the membership should remain unchanged. The GAB was renewed without any amendment for a further five years. The fact that membership had been discussed was not mentioned in our brief communique.

I am sorry to disappoint you.

*Yours sincerely
Nigel Lawson*

NIGEL LAWSON



El Ministerio de Economía y Hacienda

26 October 1987

Cathy
ppp pl.
Myf

The Right Hon. Nigel Lawson
M.P. Chancellor of the Exchequer
Treasury Chambers, Parliament Street
LONDON

✓

Dear Nigel,

Thank you for your letter of 5 October,
and your comments about the outcome of the G 10
meeting on the membership of Spain.

I had already a detailed report about
what happened at the meeting, and obviously I regret
the decision taken.

ls

Carlos Solchaga

Le Secrétaire général
The Secretary-General

2, rue André-Pascal
75775 PARIS CEDEX 16
Tél. 45 24 82 00

JCP/87.3135.3142h

4th November 1987

Dear Chancellor,

The crisis which has affected the stock markets, over the past two weeks, and more recently the exchange markets, could, given its turbulence and worldwide character, have serious economic repercussions. It demands a concerted response by the major Western economic powers.

It seems to me that it is very much part of the OECD Secretariat's role to make a contribution to consideration of these issues.

I am therefore taking the liberty of sending you the enclosed short paper. It is also being sent under the same seal of confidentiality to the other Ministers and Central Bank governors of the Group of Ten.

Underlying this note is the conviction that the turmoil on markets is essentially attributable to three fears: the fear of a continuing rise in interest rates; the fear of a surge in protectionism; and the fear of an uncontrolled dollar fall. These fears are generated by the persistence of serious imbalances in the world economy. If these imbalances are reduced too slowly, the calm that could be restored to the markets will remain deceptive. It would not remove the need, quite the contrary, to tackle these imbalances even more energetically.

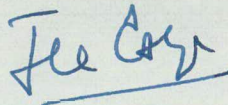
. . / .

Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
London SW1 3AG,
United Kingdom

The suggestions put forward in this paper are based on the idea that, over and above immediate measures to maintain liquidity, it is crucial to accelerate efforts to tackle convincingly the root causes - the United States' budget and trade deficits, slow growth in Europe, structural propensity to excess saving in Japan, threats of protectionism, the large trade surpluses of newly industrialising countries and the responsibilities that these imply, and Third World debt.

In order to restore confidence, set financial markets on a calmer course, keep control of the evolution of exchange rates and avoid the danger of world recession, it is imperative to act speedily, effectively and in concert. Interdependence today is such that each country must now devise its policies in order to achieve the optimum outcome for all.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Jean-Claude Paye", with a horizontal line underneath the name.

Jean-Claude Paye

4th November 1987

Note

The prime cause of the stockmarket crisis was a rather abrupt change in market sentiment. The conviction took hold that the imbalances afflicting the world economy could well push up interest rates steeply, and/or lead to increased protectionism, and/or make it increasingly difficult for monetary authorities to control the evolution of foreign exchange markets -- in other words, lead sooner or later to recession. These same factors account for the pressure on the dollar over the past few days.

Quite apart from the ensuing liquidity problems for many financial intermediaries, the plunge in stockmarket prices is considerably limiting prospects for growth, particularly in the United States, though it will also have direct and knock-on effects in other countries. The size of these effects is of course uncertain; and so the provisional projections that the OECD Secretariat is now preparing need to be seen as no more than a point of departure. The principal features of these projections are summarised in the following paragraphs.

Assuming that financial markets now stabilize -- with no further large shocks to equity prices, a confirmation of the recent decline in interest rates, and a stabilization of exchange rates at the levels observed at end October -- and assuming further that confidence of consumers and investors is not fundamentally shaken by recent developments, the Secretariat's analysis would point to the following broad picture:

- a) The principal direct impact of the stock market fall, and related developments, is felt in the United States, where the rate of growth of domestic demand may average 1-1 1/2 percentage points lower than otherwise during the course of the next two years. GNP growth in the United States would as a result decelerate markedly to a rate of about 1 1/4 per cent by the second half of next year before beginning to recover. For most other countries, direct impacts are judged to be very much less significant. Weaker U.S. demand growth, however, and the resulting marked reduction in U.S. imports, will have important secondary effects on other countries' exports and, through this, on growth. Growth of domestic demand in Europe over the next two years may average 2 per cent, with GNP growth about 1/2 percentage point below that. Japan may maintain its growth of domestic demand around 3 1/2 per cent, with GNP growing slightly less.
- b) Thus, for the OECD as a whole, instead of growth at around 2 1/2 per cent per year as had been projected by the Secretariat before the turmoil, it may average a bit below 2 per cent -- with a trough at 1 1/2 per cent in the second half of next year. Other key features:
- Unemployment will in general begin to rise again, including in the United States, where it may approach 7 per cent by end-1989.
 - The inflation outlook is generally better, especially in the United States, where it may stabilize at just above 3 per cent instead of rising towards 5 per cent.

-- Current-account imbalances will be reduced somewhat more than envisaged earlier, especially in the United States; but even so the U.S. deficit will not fall below \$100 billion.

c) Projections such as the ones summarised here are of course particularly uncertain in view of the difficulty of assessing how confidence has been affected, and will be affected; and outturns will depend on how other variables behave. In this regard, exchange rates are particularly relevant. For illustration, if (instead of remaining stable as assumed in these projections) the dollar were to decline by 10 per cent from October 29th levels against the European currencies and the yen, this would raise the U.S. growth rate by over 1/2 percentage point, in each of the next two years (but also boost inflation to around 4 1/2 percent by 1989); it would lower growth in Europe and Japan by comparable amounts. Current-account imbalances in dollar terms would not show further improvement over the next year because of J-curve effects; but by the second half of 1989, the U.S. deficit would be below \$100 billion and still falling.

Given the present situation and its attendant risks, the responsible authorities must focus their action on two objectives:

-- ensuring the maintenance of adequate liquidity;

-- taking more vigorous steps to tackle the root causes of instability.

I. Maintaining liquidity

The immediate need is to maintain liquidity and the central banks are already doing so. But action of this kind is not easy to direct:

- . Action must be based on as accurate an evaluation as possible of liquidity requirements. Just before the crisis broke liquidity was abundant due to the considerable expansion of financial activity. It is important now to prevent a chain reaction of bankruptcies among financial intermediaries and be ready to deal with any contingency. In so doing, however, care must be taken to avoid any subsequent rekindling of inflation.
- . Closely concerted action by monetary authorities is necessary to prevent turmoil on foreign exchange markets. The easing of US monetary policy increases pressure on the dollar. If this is to be moderated, other countries' actions will have to be adjusted accordingly.

II. Tackling the root causes of instability more vigorously

These causes have long been identified. Patently, corrective efforts over the past two years have not been sufficient to convince market participants. Much more must therefore be done.

a. The US budget deficit

There may be room for theoretical debate about the effect of a further reduction in the US budget deficit but, the fact is that, psychologically, it is necessary to go further in the effort to eliminate the structural budget deficit over a few years - even if this implies increasing revenues. Markets are convinced that reducing the deficit more sharply will help bring down interest

rates and that increasing tax revenue will help the American people to realize that they cannot go on "living beyond their means". Failing significant agreement soon between Congress and the Administration, it will remain difficult not only to reassure markets but also to convince the trading partners of the United States to make further efforts.

b. The US trade deficit

It would be unwise to underestimate the strength of protectionist pressures in Congress and American public opinion. It is therefore not enough to remind American legislators of the catastrophic effects of the Smoot-Hawley Act, or to point out to them that American exports are now growing very rapidly, or to draw their attention to the inflationary consequences of protectionist measures. It would be helpful if the United States' trading partners -- both inside and outside the OECD area -- recognised that it was in their own immediate interest to:

- do their utmost, consistent with their international commitments, to contribute to a substantial improvement in US foreign trade;
- speed up the pace of the Uruguay Round negotiations in the GATT.

The US Congress, for its part, would do well to shelve its plans for protectionist legislation which have contributed not a little to current market jitters.

c. Growth in Europe and Japan

Even if the expected favourable impact on the US trade balance is fairly small and slow to materialise, higher domestic demand in Japan and even more so in Europe would help both to reduce unemployment in those many countries where it remains very high and to restore market confidence.

In Europe, special responsibility falls on Germany because of its economic importance and because, at the present time, its growth is currently weaker than most other countries, and is likely to remain so. The size of its trade surplus as well as its very low inflation and high unemployment afford the German authorities - without jeopardising the medium and long term credibility of their monetary and fiscal policies - a degree of freedom of action which should be exploited without delay and backed by a significant programme of structural reform. This would in turn provide the other European countries with slightly more scope for supporting growth.

In Japan, which is in the process of substantially increasing budget expenditure, it is important to speed up the structural reforms that will help to reduce its current account surplus. The very recent easing of monetary policy could be extended if upward pressure on the yen and the recessionary repercussions of the world stockmarket crisis durably reduced the risk of a resurgence of inflation, which had been engendered by the rapid growth of money supply.

d. The developing countries

- . It would be useful if the newly industrialising Asian countries, which have considerable trade surpluses, could provide tangible proof of their co-operation in reducing present imbalances. Their involvement could take the form of allowing their currencies to appreciate, systematically expanding their imports, and making an increased contribution to the development of the Third World.
- . The debt problem continues to add to uncertainty and instability at the present time. Visible progress towards a solution must be sought. Special responsibility falls, in this respect too, on countries that have substantial current account surpluses.

Le Secrétaire général
The Secretary-General

2, rue André-Pascal
75775 PARIS CEDEX 16
Tél. 45 24 82 00

JCP/87.3135.3142h

Le 4 novembre 1987

Monsieur le Chancelier de l'Echiquier,

La crise qui frappe depuis une quinzaine de jours les marchés financiers et, plus récemment le marché des changes, peut avoir, en raison de sa violence et de son caractère mondial, des conséquences économiques sérieuses. Elle appelle une réponse coordonnée des principales puissances économiques occidentales.

Il me paraît entrer dans le rôle du Secrétariat de l'OCDE de contribuer à la réflexion sur ces problèmes.

Je me permets donc de vous adresser ci-joint un bref document à cette fin. Je fais le même envoi, et dans les mêmes conditions de confidentialité, aux autres ministres membres du groupe des Dix ainsi qu'aux gouverneurs des banques centrales des mêmes pays.

Ce document se fonde sur la conviction que trois craintes expliquent, pour l'essentiel, l'agitation des marchés : la crainte d'une hausse continue des taux d'intérêt ; la crainte d'une flambée protectionniste ; la crainte d'une baisse non contrôlable du dollar. La persistance de déséquilibres profonds dans l'économie internationale est à l'origine de ces craintes. Si la réduction de ces déséquilibres est trop lente le calme qui pourrait revenir sur les marchés demeurerait trompeur. Il ne dispenserait pas, bien au contraire, de s'attaquer plus vigoureusement encore à ces déséquilibres.

Les suggestions présentées dans ce document partent donc de l'idée qu'au-delà des mesures immédiates visant au maintien de la liquidité de l'économie, il faut accélérer de manière convaincante le traitement des problèmes de fond : déficit budgétaire et déficit commercial des Etats-Unis, faible croissance en Europe, propension structurelle à l'épargne excessive au Japon, menaces protectionnistes, responsabilités particulières des pays nouvellement industrialisés jouissant d'un fort surplus commercial, endettement du Tiers Monde.

./.

Pour restaurer la confiance des agents économiques, ramener le calme sur les marchés financiers, garder la maîtrise de l'évolution des taux de change, et écarter le danger d'une récession mondiale, il est important d'agir vite, fort et ensemble. L'interdépendance est aujourd'hui telle que chaque pays doit désormais définir sa politique en fonction de la recherche d'un optimum collectif.

Je vous prie, Monsieur le Chancelier de l'Echiquier, de bien vouloir agréer l'expression de ma très haute considération.

Jean-Claude Paye



4 novembre 1987

Note

La crise des marchés boursiers trouve pour l'essentiel son origine dans un changement assez soudain d'état d'esprit chez les opérateurs. La conviction s'est installée chez eux que les déséquilibres affectant l'économie internationale risquaient d'entraîner une forte hausse des taux d'intérêt et/ou une extension du protectionnisme et/ou une difficulté croissante pour les autorités monétaires à maîtriser l'évolution des marchés des changes. En d'autres mots, une récession à plus ou moins long terme. Les mêmes causes expliquent les pressions qui s'exercent depuis quelques jours sur le dollar.

Au-delà des difficultés de trésorerie qu'elle crée pour de nombreux intermédiaires financiers, la chute des cours boursiers réduit sensiblement les perspectives de croissance, notamment aux Etats-Unis, mais aussi, de manière directe et par contagion, dans les autres pays. Naturellement, l'ampleur de ces effets est difficile à prévoir ; par conséquent, les projections provisoires que le Secrétariat de l'OCDE prépare actuellement ne devront être considérées que comme un point de départ. Les principaux aspects de ces projections sont résumés dans les paragraphes qui suivent.

A supposer que les marchés financiers se stabilisent à partir de maintenant -- c'est-à-dire que les cours des actions ne subissent plus de fortes variations, que le repli récent des taux d'intérêt se confirme et que les taux de change se stabilisent à leur niveau de la fin octobre -- et à supposer également que la confiance des consommateurs ou des investisseurs ne soit pas fondamentalement ébranlée par ce qui vient de se passer, le Secrétariat estime que la situation générale serait la suivante :

- a. Les effets directs de la crise boursière et des développements qui l'ont accompagnée se font surtout sentir aux Etats-Unis, où le taux de croissance de la demande intérieure pourrait être inférieur de 1 à

1 1/2 pour cent en moyenne à ce qu'il aurait été autrement au cours des deux prochaines années. De ce fait, la croissance du PNB se ralentirait fortement dans ce pays, tombant à 1 1/4 pour cent environ au deuxième semestre de l'année prochaine avant de commencer à se redresser. Pour la plupart des autres pays, les effets directs de la crise boursière sont jugés beaucoup moins significatifs. Toutefois, le fléchissement de la croissance de la demande aux Etats-Unis et la forte réduction des importations américaines qui en résultera auront des effets secondaires importants sur les exportations des autres pays et, partant, sur leur croissance. En Europe, la demande intérieure pourrait croître d'environ 2 pour cent en moyenne au cours des deux prochaines années et le PNB d'environ 1/2 point de moins. Au Japon, la croissance de la demande intérieure pourrait se maintenir aux alentours de 3 1/2 pour cent, et le PNB progresser à un taux légèrement inférieur à ce chiffre.

- b. Par conséquent, pour l'ensemble de la zone OCDE, au lieu d'atteindre environ 2 1/2 pour cent par an, comme le Secrétariat l'avait prévu avant les turbulences actuelles, la croissance moyenne pourrait être quelque peu inférieure à 2 pour cent, avec un creux à 1 1/2 pour cent au deuxième semestre de l'année prochaine.

Par ailleurs :

- Le chômage recommencera en général à augmenter, y compris aux Etats-Unis, où il pourrait approcher 7 pour cent vers la fin de 1989.

- Les perspectives d'inflation sont généralement plus favorables, notamment aux Etats-Unis, où elles pourraient se stabiliser juste au-dessus de 3 pour cent au lieu de s'approcher de 5 pour cent.
 - Les déséquilibres de balance courante seront réduits de façon un peu plus sensible qu'on ne l'avait prévu précédemment, en particulier dans le cas des Etats-Unis ; cependant, le déficit américain ne tombera pas au-dessous de 100 milliards de dollars.
- c. Naturellement, les projections qui sont résumées ici sont entourées de grandes incertitudes, étant donné la difficulté d'apprécier dans quelle mesure la confiance a été affectée et continuera de l'être ; de plus, l'évolution de la situation dépendra du comportement d'autres variables. Les taux de change joueront un rôle particulièrement important à cet égard. Par exemple, si (au lieu de rester stable, comme on l'a supposé dans les projections) le dollar venait à se déprécier de 10 pour cent par rapport à son cours du 29 octobre contre les monnaies européennes et le yen, le taux de croissance des Etats-Unis serait majoré de plus de 1/2 point par an au cours des deux prochaines années (mais, par ailleurs, l'inflation atteindrait environ 4 1/2 pour cent en 1989) ; en Europe et au Japon, le taux de croissance serait réduit dans des proportions comparables. Exprimés en dollars, les déséquilibres de balance courante ne laisseraient pas apparaître d'amélioration supplémentaire l'an prochain, en raison des effets de courbe en J ; au deuxième semestre de 1989, en revanche, le déficit des Etats-Unis passerait au-dessous de la barre des 100 milliards de dollars et continuerait de se contracter ensuite.

Face à la situation présente et aux risques qu'elle comporte, l'action des autorités responsables doit viser deux objectifs :

- assurer le maintien d'une liquidité suffisante de l'économie ;
- porter remède plus vigoureusement aux causes profondes de l'instabilité.

I. Maintenir la liquidité de l'économie

C'est la nécessité immédiate, et les banques centrales y pourvoient déjà. Une telle action n'est pas simple à piloter :

. Elle doit se fonder sur une appréciation aussi exacte que possible du besoin effectif de liquidité. Celle-ci était abondante à la veille de la crise, du fait de l'expansion considérable des activités financières. Il s'agit maintenant de prévenir un enchaînement de banqueroutes d'intermédiaires financiers, et pour cela d'être prêt à faire face à toute éventualité. Mais il faut, dans le même temps, éviter de fournir l'aliment d'une reprise ultérieure de l'inflation.

. Une action étroitement concertée des autorités monétaires est nécessaire pour éviter des dérapages incontrôlés sur les marchés des changes. L'assouplissement de la politique monétaire aux Etats-Unis accroît la pression sur le dollar. Si l'on souhaite atténuer celle-ci, les actions menées par les autres pays doivent être ajustées en conséquence.

II. Remédier plus vigoureusement aux causes profondes de l'instabilité

Ces causes sont identifiées depuis longtemps. Il est clair que les efforts faits depuis plus de deux ans pour les corriger n'ont pas convaincu les opérateurs. Il faut donc redoubler d'efforts.

a. Déficit budgétaire des Etats-Unis

Même si l'on peut débattre, en termes théoriques, de l'effet qu'aurait une réduction supplémentaire de ce déficit, le fait est que, psychologiquement, il apparaît nécessaire d'aller plus loin dans l'effort entrepris pour éliminer en quelques années le déficit structurel du budget, même si cela signifie une augmentation des recettes. Les marchés sont persuadés qu'en réduisant plus fortement le déficit budgétaire on aidera les taux d'intérêt à baisser, et qu'en augmentant les recettes fiscales on aidera le peuple américain à prendre conscience qu'il doit cesser de "vivre au-dessus de ses moyens". A défaut d'un accord rapide et significatif entre le Congrès et l'Administration, il restera difficile, non seulement de rassurer les marchés, mais encore de convaincre les partenaires des Etats-Unis de s'engager dans des efforts supplémentaires.

b. Déficit commercial des Etats-Unis

Il serait dangereux de sous-estimer la puissance des pressions protectionnistes au Congrès et dans l'opinion américaine. Il ne suffit donc pas de rappeler aux législateurs américains les effets catastrophiques de la loi Smoot-Hawley, de leur faire remarquer que les exportations américaines croissent désormais très rapidement ou d'attirer leur attention sur les conséquences inflationnistes de mesures protectionnistes. Il serait utile que les partenaires des Etats-Unis - dans la zone OCDE comme à l'extérieur de celle-ci - considèrent comme étant de leur intérêt urgent

- de mettre tout en oeuvre, dans le respect de leurs engagements internationaux, pour contribuer à une amélioration sensible du commerce extérieur des Etats-Unis ;
- d'accélérer le cours de la négociation d'Uruguay au GATT.

De son côté, le Congrès des Etats-Unis serait bien inspiré de mettre de côté ses projets de législation protectionniste, qui ne sont pas pour rien dans la nervosité actuelle des marchés.

c. Croissance en Europe et au Japon

Même si l'effet à en attendre sur l'amélioration de la balance commerciale américaine est relativement modeste et lent à se manifester, l'augmentation de la demande interne au Japon et plus encore en Europe se recommande, à la fois comme contribution à la réduction du chômage, qui reste très élevé dans de nombreux pays, et comme moyen de restaurer la confiance des agents économiques.

En Europe, une responsabilité particulière incombe à l'Allemagne, du fait de son poids économique et parce que la croissance y est actuellement et risque d'y demeurer plus faible que dans la plupart des autres pays. L'ampleur du surplus de la balance commerciale, ainsi que le niveau très faible de l'inflation et le taux élevé de chômage offrent aux autorités allemandes, sans remettre en cause la crédibilité à moyen et long termes de leurs politiques monétaire et budgétaire, une certaine liberté d'action, qui devrait être exploitée sans tarder et devrait s'appuyer sur un programme significatif de réformes structurelles. Cela permettrait aux autres pays européens de disposer à leur tour d'une marge de manoeuvre un peu plus large pour soutenir leur croissance.

Au Japon, où un substantiel accroissement de dépenses budgétaires est en cours de réalisation, il importe que soient accélérées les réformes structurelles qui contribueront à réduire l'excédent du compte courant japonais. Quant à la politique monétaire, son assouplissement tout récent pourrait se prolonger si les pressions à la hausse du yen et les conséquences récessionnistes de la crise boursière internationale réduisaient durablement le risque de réapparition de l'inflation, qu'avait fait naître une rapide croissance de la masse monétaire.

d. Pays en développement

- . Il serait utile d'obtenir des pays nouvellement industrialisés d'Asie, qui jouissent de surplus commerciaux considérables, des preuves tangibles de leur coopération à

la réduction des déséquilibres actuels. Leur participation pourrait se manifester par une politique d'appréciation de leurs monnaies, par une politique systématique d'augmentation des importations, par une contribution accrue au développement du Tiers Monde.

- . Le problème de l'endettement continue de faire peser une menace d'incertitude et d'instabilité dans la période actuelle. Des progrès visibles dans la solution de ce problème doivent donc être recherchés. Une responsabilité particulière incombe, à cet égard également, aux pays jouissant de surplus importants de leur balance des opérations courantes.

CONFIDENTIAL

107350
MDADAN 3579

CONFIDENTIAL
FM UKDEL OECD PARIS
TO DESKBY 051200Z FCO
TELNO 55
OF 050845Z NOVEMBER 87

ADVANCE COPY

PERSONAL FOR BRAITHWAITE

PERSONAL FOR PS/CHANCELLOR, SIR G LITTLER AND EVANS - TSY

PERSONAL FOR PS/GOVERNOR AND LOEHNIS - BANK OF ENGLAND

MY 2 IPTS:

MESSAGE FROM OECD SECRETARY-GENERAL TO GROUP OF TEN

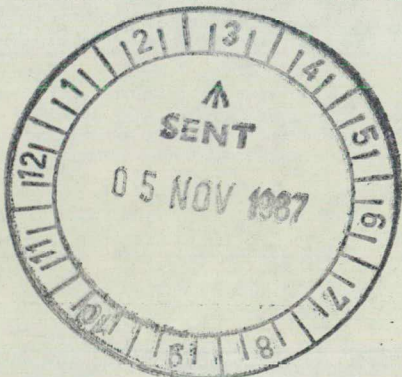
FOLLOWING IS THE TEXT OF THE PAPER ANNEXED TO PAYE'S LETTER TO THE CHANCELLOR/GOVERNOR GIVEN IN MY IPT.

1. THE PRIME CAUSE OF THE STOCKMARKET CRISIS WAS A RATHER ABRUPT CHANGE IN MARKET SENTIMENT. THE CONVICTION TOOK HOLD THAT THE IMBALANCES AFFLICTING THE WORLD ECONOMY COULD WELL PUSH UP INTEREST RATES STEEPLY, AND/OR LEAD TO INCREASED PROTECTIONISM, AND/OR MAKE IT INCREASINGLY DIFFICULT FOR MONETARY AUTHORITIES TO CONTROL THE EVOLUTION OF FOREIGN EXCHANGE MARKETS - IN OTHER WORDS, LEAD SOONER OR LATER TO RECESSION. THESE SAME FACTORS ACCOUNT FOR THE PRESSURE ON THE DOLLAR OVER THE PAST FEW DAYS.

2. QUITE APART FROM THE ENSUING LIQUIDITY PROBLEMS FOR MANY FINANCIAL INTERMEDIARIES, THE PLUNGE IN STOCKMARKET PRICES IS CONSIDERABLY LIMITING PROSPECTS FOR GROWTH, PARTICULARLY IN THE UNITED STATES, THOUGH IT WILL ALSO HAVE DIRECT AND KNOCK-ON EFFECTS IN OTHER COUNTRIES. THE SIZE OF THESE EFFECTS IS OF COURSE UNCERTAIN: AND SO THE PROVISIONAL PROJECTIONS THAT THE OECD SECRETARIAT IS NOW PREPARING NEED TO BE SEEN AS NO MORE THAN A POINT OF DEPARTURE. THE PRINCIPAL FEATURES OF THESE PROJECTIONS ARE SUMMARISED IN THE FOLLOWING PARAGRAPHS.

3. ASSUMING THAT FINANCIAL MARKETS NOW STABILIZE - WITH NO FURTHER LARGE SHOCKS TO EQUITY PRICES, A CONFIRMATION OF THE RECENT DECLINE IN INTEREST RATES, AND A STABILIZATION OF EXCHANGE RATES AT THE LEVELS OBSERVED AT END OCTOBER - AND ASSUMING FURTHER THAT CONFIDENCE OF CONSUMERS AND INVESTORS IS NOT FUNDAMENTALLY SHAKEN BY RECENT DEVELOPMENTS, THE SECRETARIAT'S ANALYSIS WOULD

PAGE 1
CONFIDENTIAL



POINT TO THE FOLLOWING BROAD PICTURE:

A) THE PRINCIPAL DIRECT IMPACT OF THE STOCK MARKET FALL, AND RELATED DEVELOPMENTS, IS FELT IN THE UNITED STATES, WHERE THE RATE OF GROWTH OF DOMESTIC DEMAND MAY AVERAGE 1-1 1/2 PERCENTAGE POINTS LOWER THAN OTHERWISE DURING THE COURSE OF THE NEXT TWO YEARS. GNP GROWTH IN THE UNITED STATES WOULD AS A RESULT DECELERATE MARKEDLY TO A RATE OF ABOUT 1 1/4 PER CENT BY THE SECOND HALF OF NEXT YEAR BEFORE BEGINNING TO RECOVER. FOR MOST OTHER COUNTRIES, DIRECT IMPACTS ARE JUDGED TO BE VERY MUCH LESS SIGNIFICANT. WEAKER US DEMAND GROWTH, HOWEVER, AND THE RESULTING MARKED REDUCTION IN US IMPORTS, WILL HAVE IMPORTANT SECONDARY EFFECTS ON OTHER COUNTRIES' EXPORTS AND, THROUGH THIS, ON GROWTH. GROWTH OF DOMESTIC DEMAND IN EUROPE OVER THE NEXT TWO YEARS MAY AVERAGE 2 PER CENT, WITH GNP GROWTH ABOUT 1/2 PERCENTAGE POINT BELOW THAT. JAPAN MAY MAINTAIN ITS GROWTH OF DOMESTIC DEMAND AROUND 3 1/2 PER CENT, WITH GNP GROWING SLIGHTLY LESS.

B) THUS, FOR THE OECD AS A WHOLE, INSTEAD OF GROWTH AT AROUND 2 1/2 PER CENT PER YEAR AS HAD BEEN PROJECTED BY THE SECRETARIAT BEFORE THE TURMOIL, IT MAY AVERAGE A BIT BELOW 2 PER CENT - WITH A TROUGH AT 1 1/2 PER CENT IN THE SECOND HALF OF NEXT YEAR.

OTHER KEY FEATURES:

- UNEMPLOYMENT WILL IN GENERAL BEGIN TO RISE AGAIN, INCLUDING IN THE UNITED STATES, WHERE IT MAY APPROACH 7 PER CENT BY END-1989.
- THE INFLATION OUTLOOK IS GENERALLY BETTER, ESPECIALLY IN THE UNITED STATES, WHERE IT MAY STABILIZE AT JUST ABOVE 3 PER CENT INSTEAD OF RISING TOWARDS 5 PER CENT.
- CURRENT-ACCOUNT IMBALANCES WILL BE REDUCED SOMEWHAT MORE THAN ENVISAGED EARLIER, ESPECIALLY IN THE UNITED STATES: BUT EVEN SO THE US DEFICIT WILL NOT FALL BELOW DOLLARS 100 BILLION.

C) PROJECTIONS SUCH AS THE ONES SUMMARISED HERE ARE OF COURSE PARTICULARLY UNCERTAIN IN VIEW OF THE DIFFICULTY OF ASSESSING HOW CONFIDENCE HAS BEEN AFFECTED, AND WILL BE AFFECTED: AND OUTTURNS WILL DEPEND ON HOW OTHER VARIABLES BEHAVE. IN THIS REGARD, EXCHANGE RATES ARE PARTICULARLY RELEVANT. FOR ILLUSTRATION, IF (INSTEAD OF REMAINING STABLE AS ASSUMED IN THESE

PROJECTIONS) THE DOLLAR WERE TO DECLINE BY 10 PER CENT FROM OCTOBER 29TH LEVELS AGAINST THE EUROPEAN CURRENCIES AND THE YEN, THIS WOULD RAISE THE US GROWTH RATE BY OVER 1/2 PERCENTAGE POINT, IN EACH OF THE NEXT TWO YEARS (BUT ALSO BOOST INFLATION TO AROUND 4 1/2 PERCENT BY 1989): IT WOULD LOWER GROWTH IN EUROPE AND JAPAN BY COMPARABLE AMOUNTS. CURRENT ACCOUNT IMBALANCES IN DOLLAR TERMS WOULD NOT SHOW FURTHER IMPROVEMENT OVER THE NEXT YEAR BECAUSE OF J-CURVE EFFECTS: BUT BY THE SECOND HALF OF 1989, THE US DEFICIT WOULD BE BELOW DOLLARS 100 BILLION AND STILL FALLING.

4. GIVEN THE PRESENT SITUATION AND ITS ATTENDANT RISKS, THE RESPONSIBLE AUTHORITIES MUST FOCUS THEIR ACTION ON TWO OBJECTIVES:

- ENSURING THE MAINTENANCE OF ADEQUATE LIQUIDITY:
- TAKING MORE VIGOROUS STEPS TO TACKLE THE ROOT CAUSES OF INSTABILITY.

I. MAINTAINING LIQUIDITY

5. THE IMMEDIATE NEED IS TO MAINTAIN LIQUIDITY AND THE CENTRAL BANKS ARE ALREADY DOING SO. BUT ACTION OF THIS KIND IS NOT EASY TO DIRECT:

ACTION MUST BE BASED ON AS ACCURATE AN EVALUATION AS POSSIBLE OF LIQUIDITY REQUIREMENTS. JUST BEFORE THE CRISIS BROKE LIQUIDITY WAS ABUNDANT DUE TO THE CONSIDERABLE EXPANSION OF FINANCIAL ACTIVITY. IT IS IMPORTANT NOW TO PREVENT A CHAIN REACTION OF BANKRUPTCIES AMONG FINANCIAL INTERMEDIARIES AND BE READY TO DEAL WITH ANY CONTINGENCY. IN SO DOING, HOWEVER, CARE MUST BE TAKEN TO AVOID ANY SUBSEQUENT REKINDLING OF INFLATION.

CLOSELY CONCERTED ACTION BY MONETARY AUTHORITIES IS NECESSARY TO PREVENT TURMOIL ON FOREIGN EXCHANGE MARKETS. THE EASING OF US MONETARY POLICY INCREASES PRESSURE ON THE DOLLAR. IF THIS IS TO BE MODERATED, OTHER COUNTRIES' ACTIONS WILL HAVE TO BE ADJUSTED ACCORDINGLY.

II. TACKLING THE ROOT CAUSES OF INSTABILITY MORE VIGOROUSLY

6. THESE CAUSES HAVE LONG BEEN IDENTIFIED. PATENTLY, CORRECTIVE EFFORTS OVER THE PAST TWO YEARS HAVE NOT BEEN SUFFICIENT TO CONVINCE MARKET PARTICIPANTS. MUCH MORE MUST THEREFORE BE DONE.

A. THE US BUDGET DEFICIT

THERE MAY BE ROOM FOR THEORETICAL DEBATE ABOUT THE EFFECT OF A FURTHER REDUCTION IN THE US BUDGET DEFICIT BUT, THE FACT IS THAT, PSYCHOLOGICALLY, IT IS NECESSARY TO GO FURTHER IN THE EFFORT TO ELIMINATE THE STRUCTURAL BUDGET DEFICIT OVER A FEW YEARS - EVEN IF THIS IMPLIES INCREASING REVENUES. MARKETS ARE CONVINCED THAT REDUCING THE DEFICIT MORE SHARPLY WILL HELP BRING DOWN INTEREST RATES AND THAT INCREASING TAX REVENUE WILL HELP THE AMERICAN PEOPLE TO REALIZE THAT THEY CANNOT GO ON 'LIVING BEYOND THEIR MEANS'. FAILING SIGNIFICANT AGREEMENT SOON BETWEEN CONGRESS AND THE ADMINISTRATION, IT WILL REMAIN DIFFICULT NOT ONLY TO REASSURE MARKETS BUT ALSO TO CONVINCE THE TRADING PARTNERS OF THE UNITED STATES TO MAKE FURTHER EFFORTS.

B. THE US TRADE DEFICIT

IT WOULD BE UNWISE TO UNDERESTIMATE THE STRENGTH OF PROTECTIONIST PRESSURES IN CONGRESS AND AMERICAN PUBLIC OPINION. IT IS THEREFORE NOT ENOUGH TO REMIND AMERICAN LEGISLATORS OF THE CATASTROPHIC EFFECTS OF THE SMOOT-HAWLEY ACT, OR TO POINT OUT TO THEM THAT AMERICAN EXPORTS ARE NOW GROWING VERY RAPIDLY, OR TO DRAW THEIR ATTENTION TO THE INFLATIONARY CONSEQUENCES OF PROTECTIONIST MEASURES. IT WOULD BE HELPFUL IF THE UNITED STATES' TRADING PARTNERS - BOTH INSIDE AND OUTSIDE THE OECD AREA - RECOGNISED THAT IT WAS IN THEIR OWN IMMEDIATE INTEREST TO:

- DO THEIR UTMOST, CONSISTENT WITH THEIR INTERNATIONAL COMMITMENTS, TO CONTRIBUTE TO A SUBSTANTIAL IMPROVEMENT IN US FOREIGN TRADE:
- SPEED UP THE PACE OF THE URUGUAY ROUND NEGOTIATIONS IN THE GATT.

THE US CONGRESS, FOR ITS PART, WOULD DO WELL TO SHELVE ITS PLANS FOR PROTECTIONIST LEGISLATION WHICH HAVE CONTRIBUTED NOT A LITTLE TO CURRENT MARKET JITTERS.

C. GROWTH IN EUROPE AND JAPAN

EVEN IF THE EXPECTED FAVOURABLE IMPACT ON THE US TRADE BALANCE IS FAIRLY SMALL AND SLOW TO MATERIALISE, HIGHER DOMESTIC DEMAND IN JAPAN AND EVEN MORE SO IN EUROPE WOULD HELP BOTH TO REDUCE UNEMPLOYMENT IN THOSE MANY COUNTRIES WHERE IT REMAINS VERY HIGH AND TO RESTORE MARKET CONFIDENCE.

IN EUROPE, SPECIAL RESPONSIBILITY FALLS ON GERMANY BECAUSE OF ITS ECONOMIC IMPORTANCE AND BECAUSE, AT THE PRESENT TIME, ITS GROWTH IS CURRENTLY WEAKER THAN MOST OTHER COUNTRIES, AND IS LIKELY TO REMAIN SO. THE SIZE OF ITS TRADE SURPLUS AS WELL AS ITS VERY LOW INFLATION AND HIGH UNEMPLOYMENT AFFORD THE GERMAN AUTHORITIES - WITHOUT JEOPARDISING THE MEDIUM AND LONG TERM CREDIBILITY OF THEIR MONETARY AND FISCAL POLICIES - A DEGREE OF FREEDOM OF ACTION WHICH SHOULD BE EXPLOITED WITHOUT DELAY AND BACKED BY A SIGNIFICANT PROGRAMME OF STRUCTURAL REFORM. THIS WOULD IN TURN PROVIDE THE OTHER EUROPEAN COUNTRIES WITH SLIGHTLY MORE SCOPE FOR SUPPORTING GROWTH.

IN JAPAN, WHICH IS IN THE PROCESS OF SUBSTANTIALLY INCREASING BUDGET EXPENDITURE, IT IS IMPORTANT TO SPEED UP THE STRUCTURAL REFORMS THAT WILL HELP TO REDUCE ITS CURRENT ACCOUNT SURPLUS. THE VERY RECENT EASING OF MONETARY POLICY COULD BE EXTENDED IF UPWARD PRESSURE ON THE YEN AND THE RECESSIONARY REPERCUSSIONS OF THE WORLD STOCKMARKET CRISIS DURABLY REDUCED THE RISK OF A RESURGENCE OF INFLATION, WHICH HAD BEEN ENGENDERED BY THE RAPID GROWTH OF MONEY SUPPLY.

D. THE DEVELOPING COUNTRIES

IT WOULD BE USEFUL IF THE NEWLY INDUSTRIALISING ASIAN COUNTRIES, WHICH HAVE CONSIDERABLE TRADE SURPLUSES, COULD PROVIDE TANGIBLE PROOF OF THEIR COOPERATION IN REDUCING PRESENT IMBALANCES. THEIR INVOLVEMENT COULD TAKE THE FORM OF ALLOWING THEIR CURRENCIES TO APPRECIATE, SYSTEMATICALLY EXPANDING THEIR IMPORTS, AND MAKING AN INCREASED CONTRIBUTION TO THE DEVELOPMENT OF THE THIRD WORLD.

THE DEBT PROBLEM CONTINUES TO ADD TO UNCERTAINTY AND INSTABILITY AT THE PRESENT TIME. VISIBLE PROGRESS TOWARDS A SOLUTION MUST BE SOUGHT. SPECIAL RESPONSIBILITY FALLS, IN THIS RESPECT TOO, ON COUNTRIES THAT HAVE SUBSTANTIAL CURRENT ACCOUNT SURPLUSES.

BAYNE

ADVANCE 3

MR BRAITHWAITE
TSY

BANK OF ENGLAND

NNNN

CONFIDENTIAL

107266
MDHIAN 4311

CONFIDENTIAL
FM UKDEL OECD PARIS
TO DESKBY 051200Z FCO
TELNO 54
OF 041715Z NOVEMBER 87

PERSONAL FOR BRAITHWAITE

PERSONAL FOR PS/CHANCELLOR, SIR G LITTLER AND EVANS - TSY

PERSONAL FOR PS/GOVERNOR AND LOEHNIS - BANK OF ENGLAND

MIPT:

MESSAGE FROM OECD SECRETARY-GENERAL TO GROUP OF TEN

1. TEXT OF PAYE'S LETTER TO CHANCELLOR /GOVERNOR IS AS
FOLLOWS:

DEAR CHANCELLOR/GOVERNOR

THE CRISIS WHICH HAS AFFECTED THE STOCK MARKETS, OVER THE
PAST TWO WEEKS, AND MORE RECENTLY THE EXCHANGE MARKETS, COULD,
GIVEN ITS TURBULENCE AND WORLDWIDE CHARACTER, HAVE SERIOUS
ECONOMIC REPERCUSSIONS. IT DEMANDS A CONCERTED RESPONSE BY THE
MAJOR WESTERN ECONOMIC POWERS.

IT SEEMS TO ME THAT IT IS VERY MUCH PART OF THE OECD
SECRETARIAT'S ROLE TO MAKE A CONTRIBUTION TO CONSIDERATION OF
THESE ISSUES.

I AM THEREFORE TAKING THE LIBERTY OF SENDING YOU THE ENCLOSED
SHORT PAPER. IT IS ALSO BEING SENT UNDER THE SAME SEAL OF
CONFIDENTIALITY TO THE OTHER MINISTERS AND CENTRAL BANK GOVERNORS
OF THE GROUP OF TEN.

UNDERLYING THIS NOTE IS THE CONVICTION THAT THE TURMOIL ON
MARKETS IS ESSENTIALLY ATTRIBUTABLE TO THREE FEARS: THE FEAR OF
A CONTINUING RISE IN INTEREST RATES: THE FEAR OF A SURGE IN
PROTECTIONISM: AND THE FEAR OF AN UNCONTROLLED DOLLAR FALL.
THESE FEARS ARE GENERATED BY THE PERSISTENCE OF SERIOUS IMBALANCES
IN THE WORLD ECONOMY. IF THESE IMBALANCES ARE REDUCED TOO
SLOWLY, THE CALM THAT COULD BE RESTORED TO THE MARKETS WILL
REMAIN DECEPTIVE. IT WOULD NOT REMOVE THE NEED, QUITE THE

PAGE 1
CONFIDENTIAL

CONTRARY, TO TACKLE THESE IMBALANCES EVEN MORE ENERGETICALLY.

THE SUGGESTIONS PUT FORWARD IN THIS PAPER ARE BASED ON THE IDEA THAT, OVER AND ABOVE IMMEDIATE MEASURES TO MAINTAIN LIQUIDITY, IT IS CRUCIAL TO ACCELERATE EFFORTS TO TACKLE CONVINCINGLY THE ROOT CAUSES - THE UNITED STATES' BUDGET AND TRADE DEFICITS, SLOW GROWTH IN EUROPE, STRUCTURAL PROPENSITY TO EXCESS SAVING IN JAPAN, THREATS OF PROTECTIONISM, THE LARGE TRADE SURPLUSES OF NEWLY INDUSTRIALISING COUNTRIES AND THE RESPONSIBILITIES THAT THESE IMPLY, AND THIRD WORLD DEBT.

IN ORDER TO RESTORE CONFIDENCE, SET FINANCIAL MARKETS ON A CALMER COURSE, KEEP CONTROL OF THE EVOLUTION OF EXCHANGE RATES AND AVOID THE DANGER OF WORLD RECESSION, IT IS IMPERATIVE TO ACT SPEEDILY, EFFECTIVELY AND IN CONCERT. INTERDEPENDENCE TODAY IS SUCH THAT EACH COUNTRY MUST NOW DEVISE ITS POLICIES IN ORDER TO ACHIEVE THE OPTIMUM OUTCOME FOR ALL.

YOURS SINCERELY

(JEAN-CLAUDE PAYE)

BAYNE

YYYY

DISTRIBUTION 7

MAIN 2

NO DISTRIBUTION

MR BRAITHWAITE

ADDITIONAL 5

PS/CHANCELLOR TSY
SIR G LITTLER TSY
MR EVANS TSY

PS/GOVERNOR BANK OF ENGLAND
MR LOEHNIS BANK OF ENGLAND

NNNN

CONFIDENTIAL

Handwritten notes in red ink:
* * *
We must discuss them - see Gp X -
What the future holds. Finance / CAP
Must be done
(Must be done)
Can't be done
Don't give PM
Don't give a good
one BT
(Pm here)

107247
MDHIAN 4305

CONFIDENTIAL
FM UKDEL OECD PARIS
TO DESKBY 051200Z FCO
TELNO 53
OF 041445Z NOVEMBER 87

PERSONAL FOR BRAITHWAITE

PERSONAL FOR PS/CHANCELLOR, SIR G LITTLER AND EVANS - TSY

PERSONAL FOR PS/GOVERNOR AND LOEHNIS, BANK OF ENGLAND

MESSAGE FROM OECD SECRETARY-GENERAL TO GROUP OF TEN

1. PAYE, THE OECD SECRETARY-GENERAL, HAS DECIDED TO SEND IDENTICAL LETTERS TO THE FINANCE MINISTERS AND CENTRAL BANK GOVERNORS OF THE GROUP OF TEN, GIVING HIS VIEWS ON HOW OECD MEMBERS COULD BEST RESPOND TO THE AFTERMATH OF THE STOCK MARKET (AND EXCHANGE MARKET) TURBULENCE.
2. MY IFT CONTAINS THE TEXT OF THE LETTERS ADDRESSED TO THE CHANCELLOR OF THE EXCHEQUER AND THE GOVERNOR OF THE BANK OF ENGLAND. THE LETTERS TRANSMIT A SHORT PAPER, THE TEXT OF WHICH IS IN MY SECOND IFT. SIGNED COPIES FOLLOW BY BAG.
3. PAYE HAS ASKED NATIONAL DELEGATIONS TO TRANSMIT THESE BY TELEGRAM IN THE INTERESTS OF SPEED. HE HAS PARTICULARLY ASKED THAT THEY BE HANDLED WITH GREAT DISCRETION AND I AM THEREFORE GIVING THESE TELEGRAMS VERY RESTRICTED DISTRIBUTION. PART OF HIS CONCERN IS TO AVOID CRITICISM FOR HAVING ADDRESSED ONLY CERTAIN OECD MEMBERS, NOT ALL.
4. COMMENT FOLLOWS.

BAYNE

YYYY

CONFIDENTIAL

107247
MDHIAN 4305

DISTRIBUTION

9

MAIN 2

NO DISTRIBUTION

MR BRAITHWAITE

ADDITIONAL 7

PS
CHANCELLOR TSY
~~SIR G LITTLER TSY~~
MR EVANS TSY

PS/GOVERNOR BANK
MR LOEHNIS BANK OF ENGLAND
[HENRY]

NNNN

CONFIDENTIAL

112357
MDADAN 3766

CONFIDENTIAL
FM UKDEL OECD PARIS
TO DESKBY 061230Z FCO
TELNO 56
OF 061050Z NOVEMBER 87
INFO ROUTINE WASHINGTON, BONN, PARIS, ROME, TOKYO, OTTAWA
INFO ROUTINE UKREP BRUSSELS

ADVANCE COPY

MY TELS NOS 53, 54 AND 55 (NOT TO ALL):
PAYE'S MESSAGE TO THE GROUP OF TEN

SUMMARY

1. THE OECD SECRETARY-GENERAL HAS SENT MESSAGES TO THE G10, GIVING UPDATED OECD FORECASTS AND RENEWING POLICY RECOMMENDATIONS WHICH ARE MADE MORE RELEVANT BY THE STOCKMARKET COLLAPSE. HIS AIM IS TO REMIND G7 MINISTERS DISCREETLY THAT OECD COULD HELP THEM. HE WILL NOT STRIKE ATTITUDES IN PUBLIC.

DETAIL

2. PAYE TOLD A VERY RESTRICTED MEETING OF HEADS OF DELEGATION ON 5 NOVEMBER THAT HE HAD SENT MESSAGES (A LETTER AND SUPPORTING NOTE: TEXTS IN MY TELS NOS 54 AND 55) TO THE FINANCE MINISTERS AND CENTRAL BANK GOVERNORS OF THE G10 COUNTRIES. HE WISHED TO REMIND THE LEADING MEMBER COUNTRIES OF THE NEED FOR COOPERATION IN DEALING WITH THE PROBLEMS PROVOKED BY THE STOCKMARKET COLLAPSE. HE HAD CHOSEN A LETTER RATHER THAN A PUBLIC STATEMENT, WHICH COULD BE DANGEROUS, OR A CALL FOR A SPECIAL MEETING, WHICH COULD BE UNPRODUCTIVE. HE HAD LIMITED HIS APPEAL TO THE G10 COUNTRIES, AS BEING THE MAJOR ACTORS AND BECAUSE THE OECD WAS FORMALLY LINKED TO THE G10: HE ALSO WANTED TO ACT AS CONFIDENTIALLY AS POSSIBLE.

3. PAYE'S NOTE OFFERED INITIAL FORECASTS OF THE ECONOMIC IMPCT OF THE STOCKMARKET FALL TO DATE. THIS WOULD TAKE ABOUT 9.5 PER CENT OFF GNP GROWTH IN OECD FOR 1988 AND AGAIN FOR 1989. THE GREATEST EFFECT WOULD BE IN THE US, WHERE THE TROUGH WOULD COME IN LATE 1988. UNEMPLOYMENT WOULD START RISING AGAIN, ESPECIALLY IN THE US. THE US CURRENT ACCOUNT DEFICIT WOULD FALL, BUT STILL BE ABOVE DOLLARS 100 BILLION TWO YEARS FROM NOW (THE PRE-CRISIS FORECAST IS FOR DOLLARS 125 BILLION). A 10 PER CENT DECLINE IN THE DOLLAR WOULD ENABLE THE US TO CLAW BACK SOME GROWTH, AT THE COST OF HIGHER INFLATION LOCALLY AND SLOWER GROWTH ELSEWHERE, AND WOULD BRING THE US EXTERNAL DEFICIT BELOW

DOLLARS 100 BILLION. PAYE STRESSED THESE FIGURES WERE ILLUSTRATIVE. HE WAS NOT FORECASTING OR RECOMMENDING SUCH A DECLINE.

4. THE POLICY RECOMMENDATIONS IN THE NOTE ARE NOT NEW, AS PAYE STRESSED. THE INTENTION WAS TO REMIND MINISTERS OF CONCLUSIONS ALREADY REACHED ABOUT ACTION REQUIRED TO CORRECT IMBALANCES. IT WAS ALL THE MORE ESSENTIAL TO CORRECT THE US BUDGET DEFICIT AND TO RESIST PROTECTIONISM. GERMANY COULD IMPROVE ITS PERFORMANCE AND IN DOING SO HELP GROWTH ELSEWHERE IN EUROPE. JAPAN SHOULD PURSUE STRUCTURAL REFORMS. PAYE'S NOTE ALSO STRESSED THE IMPORTANCE OF PARALLEL ACTION BY THE ASIAN NICs.

5. HEADS OF DELEGATION WELCOMED PAYE'S ACTION. SEVERAL COUNTRIES - ITALY, SWITZERLAND AND SOME NORDICS - URGED HIM TO GO FURTHER IN TAKING THE INITIATIVE. PAYE REJECTED THIS FIRMLY. HE HAD NO ILLUSIONS ABOUT OECD'S INFLUENCE. IT WOULD BE ABSURD FOR HIM TO ASSUME A 'MESSIANIC MISSION', TO MAKE PUBLIC RECOMMENDATIONS TO MEMBER GOVERNMENTS WITHOUT A MANDATE TO DO SO.

6. I DREW ON THE CHANCELLOR'S MANSION HOUSE SPEECH TO MAKE THREE POINTS:

A. ONE MUST NOT FORGET THE FINANCIAL REASONS FOR THE FALL OF THE STOCKMARKETS, WHICH HAD BEEN RISING VERY STRONGLY FOR A LONG TIME. OTHERS SUPPORTED THIS.

B. THERE WERE GREAT DANGERS IN AN UNCONTROLLED FALL IN THE DOLLAR. THE LOUVRE AGREEMENT MUST BE PRESERVED.

C. IT WAS ESSENTIAL TO MAINTAIN LONG-TERM RESISTANCE TO PROTECTIONISM. OECD COULD HELP IN THIS.

COMMENT

7. PAYE'S REVISION OF GNP FORECASTS LOOK PLAUSIBLE AND IN LINE WITH OUR OWN. (THE COMMISSION, HOWEVER, CLAIM THAT FRENCH AND ITALIAN FORECASTERS SAW NO NEED TO CHANGE THEIR FIGURES.) THEY WILL BE UNWELCOME TO THE US, BECAUSE THE TROUGH COINCIDES WITH NEXT YEAR'S ELECTIONS. THE CONSEQUENCES OF A 10 PER CENT DOLLAR DEPRECIATION WERE ALREADY CONSIDERED BY WP3 IN JUNE (SEE CPE/WP3(87)4. BUT PAYE'S PAPER MAKES IT LOOK A BETTER OPTION FOR THE AMERICANS, WITHOUT BRINGING OUT THE DANGERS.

8. THE POLICY RECOMMENDATIONS CONTAIN NOTHING NEW. THE PRIORITY GIVEN TO CORRECTING THE US BUDGET DEFICIT, EVEN IN CONDITIONS OF SLOWER GROWTH, IS WELCOME.

9. IN ADDRESSING A MESSAGE TO G10 MINISTERS AT THIS MOMENT, I BELIEVE PAYE'S MAIN INTENTION WAS TO BRING OECD'S WORK BEFORE MINISTERS OF THE GROUP OF SEVEN, IN CASE THEY SHOULD MEET AGAIN SHORTLY. PAYE WANTS TO REMIND G7 MINISTERS OF THE QUALITY OF OECD'S WORK, IN THE HOPE THAT THEY MIGHT THINK OECD COULD BE USEFUL IN POLICY COORDINATION. BUT HE WANTS OECD'S WORK TO BE JUDGED ON ITS MERITS. HE DOES NOT INTEND TO 'MUSCLE IN' OR STRIKE ATTITUDES IN PUBLIC.

10. AS WAS NOTED AT HIS MEETING, THE OECD'S ECONOMIC POLICY COMMITTEE, ON 16-17 NOVEMBER, WILL BE THE FIRST MAJOR INTER-GOVERNMENTAL MEETING SINCE THE STOCKMARKET FALL (ASSUMING THE G7 DO NOT MEET). THERE MAY BE FURTHER PRESSURES THERE FOR INITIATIVES, WHETHER BY OECD ITSELF OR OTHERS.

BAYNE

YYYY

DISTRIBUTION

12

ADVANCE 12

MR BRAITHWAITE
MR MAUD
MR RICHARDSON
MR BROADBENT *ECO ADV*
PS/CHANCELLOR, HM TRSY
MR MIDDLETON, HM TRSY

MR BURNS, HM TRSY
MR LITTLER, HM TRSY
MR H EVANS, HM TRSY
MR MATTHEWS, HM TRSY
PS/GOVERNOR, BANK OF ENGLAND
MR LOEHNIS, BANK OF ENGLAND

NNNN

FROM: MRS R LOMAX
DATE: 6 November 1987

PRINCIPAL PRIVATE SECRETARY

G10 GOVERNORS: CONVERGENCE

The G10 Governors are meeting in Basle on Monday. They will be discussing a paper on convergence, agreed by the Cooke Committee and are expected to approve the proposals, and agree to the publication of a similar paper by the end of the year. Herr Poehl, as Chairman of the G10 Governors, will make a fairly anodyne press statement reporting on the state of play.

2. The Bank Press Office report a fair amount of interest both in the Basle meeting, and in the convergence issue. But we have no reason to expect any dramatic new development. In particular, we are not aware of any change in the German position, and even if there were one, I would be most surprised if the German Ministry of Finance were to allow Herr Poehl to commit them at a central bankers' meeting. I think it is fairly clear that Poehl will be speaking as Chairman of the G10 Governors only.

RL

RACHEL LOMAX



UNITED KINGDOM DELEGATION TO THE
 ORGANISATION FOR ECONOMIC CO-OPERATION
 AND DEVELOPMENT
 19 RUE DE FRANQUEVILLE, PARIS 16E
 TELEPHONE 524.98.28

090/6

6 November 1987

A C S Allan, Esq.,
 Principal Private Secretary to the
 Chancellor of the Exchequer,
 HM Treasury

CH/EXCHEQUER	
REC.	6 NOV 1987
ACTION	SIR G. LITTLER
COMES TO	MR BYATT
	MR A.J.C. EDWARDS
	MR H.P. EVANS

Dear Allan,

MESSAGE FROM THE OECD SECRETARY GENERAL TO FINANCE MINISTERS
 OF CENTRAL BANK GOVERNORS OF THE GROUP OF TEN

I enclose the signed version of Jean-Claude Paye's message
 to the Chancellor, in both English and French versions. The
 text has already been sent by telegram, in UKDe1 OECD tels Nos 54-55.

Yours sincerely
Nicholas Bayne

N P Bayne



FROM: J M G TAYLOR
DATE: 6 November 1987

67 2/11
B

15/11

17/11

Pmp

Sir Abel says we need to
APB
2/11/11

SIR G LITTLER

cc Mr Byatt
Mr A J C Edwards
Mr H P Evans

MESSAGE FROM OECD SECRETARY-GENERAL TO GROUP OF TEN

The Chancellor has seen UKDEL OECD's Telnos.53, 54 and 55, enclosing a paper from Paye.

2. He has read the paper with interest. He has commented that we must try and weave its themes into the EC future financing/CAP reform debate. (He has in mind particularly, here, the statement that it would be helpful if the US's trading partners recognised that it was in their own interest to do their utmost to contribute to a substantial improvement in US foreign trade, and to speed up the pace of the Uruguay round negotiations.) He has further commented that it might be worth minuting the Prime Minister if we can quickly devise a good line to use with our EC partners.

3. I should be grateful for advice.

JMGT

J M G TAYLOR

purp 11.11.87

11/11/87

FROM: A D LOEHNIS

THE GOVERNORS

- Copies to
- | | |
|-------------|--------------------|
| Mr George | Mr Arrowsmith |
| Mr Walker | Mr Crawford |
| Mr Galpin | Mr Elston |
| Mr Flemming | Mr D W Green |
| Mr Cooke | Mr Latter |
| Mr Coleby | Mr P N Mayes |
| Mr Barnes | Mr Miles |
| Mr Gill | Mr Iles |
| Mr Quinn | Mr Lewis |
| Mr Kent | Mr Reid |
| Mr Kirby | Mr Webster |
| Mr Price | Group Leader, Gp 2 |
| Mr Beverly | (International) |
| Mr Clews | |
| Mr Farrant | |

[Handwritten red scribbles]

*Oh
262 thought
you might like to see this.*

*JF
12/11*

*(Cooke attee discussion
especially)*

*pull
u - r - GP
Crawford's
responsibility
~~approach~~
approach*

Sir Geoffrey Littler (HMT)
Mr Lankester (UKDEL, Washington)

REPORT OF THE MEETING OF THE G10 GOVERNORS, BASLE,
MONDAY 9 NOVEMBER 1987

1 There were two items on the agenda of this meeting, which lasted for an unusual three and a half hours:

(a) an exchange of views on recent developments in the foreign exchange, money and capital markets;

(b) an exchange of views on the report of the Cooke Committee on convergence of capital measurement and capital standards for international banks.

I TOUR D'HORIZON

2 A disproportionate amount of time was spent agreeing a press statement which could be issued in the name of the Chairman of the G10 Governors, on the basis of the draft prepared by Lamfalussy. An unprecedented number of journalists were besieging the BIS building, and it was agreed that it was not practical for emerging

Governors to say nothing. A statement would therefore be handed out by the BIS press office, and if Governors could not avoid speaking to journalists, they should confine themselves to the main heads of the agreed statement. Since the Governors were not in a position to agree on a new course of policy or action until the outcome of the budget discussions in Washington was known, the statement could only be cotton wool, which was probably the reason why it took so long to agree. The final version is attached.

3 Greenspan then gave his assessment of the effect of the stock market decline on monetary policy. The first reaction had been one of fear and apprehension, leading to a shift towards liquidity and quality. If the demand for liquidity had not been met, there would have been a large run-up in interest rates. The Fed had therefore felt that their task was to reduce the fear by standing ready to resolve issues, such as a run on the banks, by providing liquidity. This had been largely successful, and damage to financial institutions had in fact been well contained.

4 The market contraction had wiped out the speculative gains of the last one and a half years, affecting particularly leverage situations. In such cases there would be a need to retrench, but elsewhere there should be no such need. It was too early as yet to tell what was happening, but there was little sign of any generalised major contraction. In certain specific areas sales were down, and there was heresay evidence of real estate projects being stopped, not backed up by any facts. Damage to date was less than had been expected, and provided the worst of the stock market falls were over, was tolerable. Greenspan thought the odds were in favour of slower economic growth, but no recession, a moderation of inflation and a generally better balance in the economic situation. He regretted, however, the deficiency of the forecasting available in such a situation. They would be watching that situation very carefully, in particular for any evidence of a cut-back in capital investment plans which would alter the situation.

5 In the subsequent discussion, de Larosiere asked two questions: there had been a tendency for interest rates to fall over the past few weeks - did this represent simply a shift from

equities to bonds or a change in monetary policy? How far was the fall likely to go, and how beneficial would lower interest rates be to the economy? He also wanted to know what effect the fall in their market capitalisation would have on investment projects of US corporations. Greenspan said that interest rates were lower because there had been a reversal of inflationary expectations. There had been some flow from equities to bonds, expunging capital values. How long this, or the fall in interest rates, continued would depend on fiscal and monetary policy. Clearly liquidity should not be added to the system if there was no demand for it. He did not find it easy to explain the change in inflationary expectations, but then he had not found it easy to explain why such expectations, reflected in rising long term interest rates, had existed prior to Black Monday. One indicator of the change in expectations was the lowering of commodity and gold prices. He agreed that since the stock market reflected estimates of current value of stocks and investment, any lowering of stock market prices should imply some cutback in investment plans. There was, however, no evidence that this had happened so far.

6 The Governor asked Greenspan what he thought would be a appropriate exchange rate level for the dollar, and also whether the US authorities contemplated any borrowing in foreign currencies. To the latter question, Greenspan replied there was no current intention to borrow in foreign currencies, because to do so would presuppose that they were willing and prepared to intervene. As to the appropriate level for the dollar, if the outcome of the budget talks was judged satisfactory it might be possible to maintain approximately current levels. If the outcome were judged bad, then the nature of the failure would influence how far it would fall. Duisenberg then referred to the recent confidential communication made by the Secretary General of the OECD to Governors and others, giving their forecast of the effect on growth of the stock market falls. This had already leaked to the press, and such a pessimistic forecast could be dangerous. Greenspan said that he was not too gloomy. Prior to the stock market fall their forecast had been one of accelerating growth, which might have led to a necessary and strong reaction by the end of 1988. He was on the whole happier that this had

been avoided. He had no evidence to support the OECD outlook for a significant slowdown in the US economy as a result of the stock market falls. Corrigan added that he thought the OECD forecast was mechanistic rather than subtle.

7 Poehl suggested that it was too early to make forecasts. The key question was whether the dollar was going lower. Recent falls must have improved US companies' competitiveness, and US assets should be looking attractive. He would expect capital to flow back into the dollar so that either equities would rise or interest rates fall. Greenspan said that the physical volume of exports was indeed rising, and the shift from imports to domestic sources continued. As a result industrial production was rising, and the necessary adjustment to the current account balance taking place. Languetin expressed fears that protectionism might appear in the guise of an undershooting in the exchange rate. Greenspan said that one of the silver linings of the present situation was that the chances of a protectionist trade bill succeeding in the Congress were reduced. He thought congressional attitudes had definitely changed for the better. The significant thing was the speed at which the dollar exchange rate changed. He did not think a slow decline would be catastrophic, because production processes could adapt. The more stability there was for the rate, the better it was for growth. At all costs, the decline in the dollar must not turn into a rout. [The picture that emerges from all this of Greenspan's views about the dollar is as follows: provided the budget discussions produce something that sounds reasonably plausible to the markets, the additional competitiveness gains to US industry from recent falls in the dollar should mean that it is approaching a level the markets will deem plausible. Such levels should then be defended in the interests of stability. If the outcome of the budget debate is unconvincing, the dollar will have further to fall, such a fall should be gently resisted in order to prevent it turning into a rout. The role of interest rates in all this is ambivalent. He implied that they could well go lower in the event either of additional problems in the financial sector or at any sign of cutbacks in capital investment.]

8 Sumita then gave an upbeat assessment of Japanese economic prospects in the wake of the fall in the Tokyo stock market,

suggesting that its deflationary effect, and that of the rise in the yen, would be relatively modest. Personal holdings of equities in Japan were small. Corporations and persons had showed that they could cope with a rise in yen since the Plaza agreement. The Japanese economy was in a phase of 'autonomous expansion', which was showing itself in stock building and investment in the manufacturing sector. The economy would receive a further boost from the budgetary measures, on top of the expansion fuelled by domestic demand.

9 The Governor said that the Autumn Statement forecast of UK growth slowing to 2 1/2% next year from 4% this year probably included about a 1/2% fall due to the stock market effect, which was bound to have some influence on company investment. The fiscal position remained sound, and the PSBR forecast for this year had now been lowered to just £1 bn - a 1/4% of GDP. There had been strong upward pressure on sterling in recent weeks, which had been met by a substantial amount of intervention to maintain the stability of sterling against deutschmark. Stock market losses had represented a tightening of monetary conditions, which had justified the lowering of interest rates by 1% in two stages. There was some puzzlement why the London stock market should have suffered relatively so much worse than New York or Tokyo when the economy was basically so sound. It could have had something to do with the new trading system on the Stock Exchange, and for the first two weeks the BP share offer may have had a dampening effect. The Bank's day by day monitoring of the position of financial institutions, however, suggested there should be no special preoccupations on that score.

10 De Larosiere said that the French Stock Exchange was very small relative to GDP. It was too early to suggest what the reaction of small shareholders, encouraged by the Loi Monory and recent privatisations, would do. There might be some inhibition on company investment as a result of the fall in capital values and a narrowing of outlets, but this could to some extent be offset by lower long-term interest rates and the capacity of french firms to finance themselves from their own resources. There might even be some incentive for real investment as a alternative to diminished prospects of financial profits. His

main concern was not the direct effects in France of falls on the Bourse, but of the indirect effect from overseas.

11 Poehl said that the German economy had been on a healthy upward trend since the spring, with domestic demand rising at an annual rate of 3-4%. This could be affected by the fall in equity prices. The autumn forecast of the German economic institutes suggested that imports would grow by 5% next year and exports by only 3 1/2%, which suggested that the adjustment to the current account was well in train. The 1988 tax cuts could boost private consumption. His own view was that the stock market itself would not have much effect on consumption and investment, but that the higher deutschmark could effect investment decisions. In this connection, however, the stability of European exchange rates was more important than a rise against the dollar. The German terms of trade would also have improved. Against this, Poehl thought that the mood of German business community "had changed dramatically for the worse". This made him personally favour further action on the fiscal front, but he had to say frankly he thought it unlikely to happen. Without any further action, such as accelerating the 1990 tax cuts, the budget deficit was already rising, and he did not think that the Government would take any positive action to increase it further. Poehl went on to defend the Bundesbank's monetary policy against the charge of excessive restriction. Despite strong monetary expansion over the past two years, and over-shooting of the CBM target, the recent increase in interest rates had been reversed. With their discount rate at 3% and their repo rate at 3 1/2% there was very limited room for manoeuvre. "I am not saying that there is no room to go any lower, but prefer to reserve that last resort for any emergency situation, which I hope we can avoid". Duisenberg asked whether there was likely to be a repetition of last year's end of year rise in German interest rates, which have caused so much trouble. Poehl said that there was a seasonal end-year problem, in anticipation of which they had recently lowered the Lombard rate, which put a ceiling on money market rates - "maybe we should have lowered it more". Under further questioning from Dennis, Poehl said that what he meant by "real emergency" was a situation where there was a coordinated international package of fiscal and monetary measures to restore confidence and stabilise the dollar.

II CONVERGENCE OF BANKING CAPITAL

12 Cooke introduced his Committee's report on the convergence of capital measurement and capital standards (BS/87/68E) together with its cover note. He hoped that Governors would agree that the exercise should be progressed as suggested in that cover note, namely that the Governors should endorse the Committee's recommendations on the proposed system of capital measurement, the setting of a minimum target standard, the transitional arrangements and the procedures for the implementation of the agreed framework. The report reflected a sensitive and hard to achieve balance of conflicting priorities between different national systems. It would be difficult to change any parts of it without unravelling the whole. There were a number of technical factors still to be resolved for the version of the report which would be published, and which he hoped would be available for Governor's approval at the December meeting. He hoped Governors would continue their previous support and encourage their representatives on his Committee to reach agreement on the technical matters so that the end-year target could be met.

13 Cooke drew attention to the particular issue of country transfer risk, where the majority of the Committee had opted for a "club" approach, distinguishing a group of countries presumed to be of higher credit standing than the rest of the world. The Committee recognised the significant political difficulties posed by this, and sought the Governor's guidance as to whether those difficulties could be accepted in the interests of preparing a framework which is more credible from a prudential point of view. He also mentioned the desirability of issuing some sort of press notice, given the number of journalists in Basle, and the interest which they have shown in the exercise following its regrettable leaking into the press some weeks earlier.

14 It was apparently this leak to the press that provoked an astonishingly vituperative outburst against the whole exercise by de Larosiere. He began by saying that the analysis of the report in detail in the Wall Street Journal had been very regrettable, had placed the French monetary authorities in a very difficult

situation vis-a-vis the French banks, and had, he implied, been engineered in order to put pressure on Governors. The scars created by this episode would be "difficult to remove". He objected to the hasty procedure of being asked to give agreement and make announcements to the press before there had been any opportunity to discuss with fellow Governors certain important points of principle, such as the target ratio of 8%, the "club" issue, the handling of provisioning etc. On no account was he prepared to endorse or approve the report that day.

15 This was the cue for Poehl to let fly. He too said that the leaks to the press were totally unsatisfactory and counter-productive, and said that there was no case for making any press statements that day. On the substance, he agreed on the desirability of the harmonisation of banking capital rules, but it had to be accepted that national systems were really different. The report's definition of capital represented a weakening of German rules, and he could not recommend it to the German government or parliament who legislate in this matter, particularly at a time when definitions of banking capital needed strengthening. He could not accept the "club" approach to monetary transfer risk. He was unhappy about the proposed consultation process. He would need three or four months to resume discussions with the German banks and the Finance Minister before he was prepared to endorse the proposals. He suggested that the Cooke Committee should have further meetings to discuss the details already referred to, as well as to look again at the definition of capital and the "club" approach.

16 Corrigan leapt to the defence of the Cooke proposals. Recent events had only served to underline the urgency of getting the agreement launched. All that Cooke had suggested was a framework within which national consultation could take place - there was no commitment to anything before the end of the six month consultation period. All that Governors were being asked for was to agree that the framework was appropriate. As regards classifications of country risk, he was content that the paper should contain alternatives rather than recommendations. In other respects, the framework met the Fed's requirements.

17 The Governor also defended Cooke's proposals. Dissatisfaction with the press leak or with the request for decisions soon should not be used to justify losing the momentum of the initiative. Since the matter was now in the press, it was better to give them some report on the progress, rather than let them speculate about disagreement. He doubted the wisdom of asking the Cooke Committee to go over work they had already done to try to find a different compromise. He suggested that the proposals be accepted. He was supported in this by Dennis, who said that on the question of country transfer risk, he did not like the "club" solution, and could contemplate no club that did not include his Nordic neighbours. If there must be a club, let it be the OECD.

18 This all produced a counter-attack from de Larosiere and Poehl. De Larosiere claimed that there had only been one meeting of the Cooke Committee since the Governors had had their initial consideration of the report in July, despite French requests that there should be a further meeting. The French preoccupations about the 8% ratio, the treatment of provisions, and the particular definition of capital had been brushed aside. Poehl objected to the fact that German reservations were highlighted in an annex. He thought that the report should reflect differences of opinion and alternative approaches in the text itself. He could not accept that German legislation might have to be changed in the sense of the report as it stood.

19 Duisenberg said he was surprised at the way the discussion was going. He had been told that, subject to the special official German reservation, the report had been agreed. The mandate to produce harmonisation proposals in this area was long standing, and the Governors had encouraged the Cooke Committee to find compromises. It might be useful if the report could list different approaches to the country transfer risk problem. He was convinced that the Governors must reach a decision on this in December. Languetin also expressed reservations about the "club" approach. He would go along with the OECD club provided there was a mechanism which enabled one to include non-OECD members who were deemed "equivalent". Sumita reiterated Japanese concern about the club approach and about the treatment of undisclosed

capital gains, but said that this did not detract from their support from the paper as it stood.

20 By now the time was approaching 6.30, and the discussion rather petered out. Poehl said that there were two main open questions that the "club" approach and the definition of capital. He could not see why only one definition of capital should be thought to be valid. The Governor suggested that if you did not have a common principle to this, the whole exercise was otiose. Corrigan pointed out that the German capital standard was in fact included in the first tier of capital envisaged in the paper.

21 Exercising a right of reply, Cooke pointed out that the German reservation had been contained as a separate appendix at the express request of the German representatives on the Committee. He also pointed out that even though there may have only been one full Committee meeting since July, all members of the Committee have been working almost continually on the paper ever since. The present text of the report had the full endorsement of ten out of twelve of the members of the Committee. He had understood that the French reservations to the text had been withdrawn after he had made certain drafting changes. He hoped that in future it could be ensured that representatives on the Committee did not give their agreement to a report unless they were certain that such agreement had the support of their superiors.

22 It was not clear where matters were left, except that there should be another meeting of the Cooke Committee with a view to producing a revised text for the December meeting. Apart from the technical clarifications already referred to by Mr Cooke, revisions would involve a setting out of the alternative approaches to country transfer risk. It looks as though the French reservations, and the question of how the German reservation should be handled, would best be dealt with outside the Committee procedure.

Bank of England INCOMING MESSAGE 194

RECEIVED AT 17:36 ON 9-NOV-

87

194

87

TI NIM001

PRINTED AT 08:10 ON 10-NOV-

Gov's

ZCZC NIM001 100810 100745

TELEX

.TELEX FROM BIS BASLE

NO TEST VERIFICATION PERFORMED

962816 BIZ CH

DATE : 9.11.1987

TO : BANK OF ENGLAND
LONDON

FROM : BANK FOR INTERNATIONAL SETTLEMENTS - BASEL

OUR REFERENCE : BIZ 12391

PRESS STATEMENT

BY THE

CHAIRMAN OF THE GOVERNORS OF THE GROUP OF TEN

THE CENTRAL BANK GOVERNORS OF THE GROUP OF TEN COUNTRIES HAVE THIS AFTERNOON HELD THEIR USUAL MONTHLY MEETING. THEY HAVE EXCHANGED VIEWS ON RECENT DEVELOPMENTS IN THE MONEY, CAPITAL AND EXCHANGE MARKETS AND ARE IN AGREEMENT BOTH ON THEIR ANALYSIS OF THE PRESENT SITUATION AND ON THE POLICIES THAT ARE NEEDED TO DEAL WITH IT. IN PARTICULAR:

- THEY EXPRESSED THEIR SATISFACTION AT RECENT MEASURES TAKEN TO MAINTAIN THE SMOOTH FUNCTIONING OF THE FINANCIAL SYSTEM AND REAFFIRMED THEIR COMMITMENT TO THAT END;

- THEY STRESSED THE IMPORTANCE OF MOVES BY GOVERNMENTS OF MAJOR INDUSTRIAL COUNTRIES TO ADOPT FISCAL POLICIES WITH THE OBJECTIVES OF REDUCING EXISTING PAYMENTS IMBALANCES, PROMOTING EXCHANGE RATE STABILITY AND SUSTAINING NON-INFLATIONARY GROWTH;

- THEY ARE READY TO SUPPORT THESE OBJECTIVES WITH APPROPRIATE MONETARY POLICIES;

- THEY WELCOME THE RECENT MEASURES TAKEN BY EUROPEAN CENTRAL BANKS, WHICH REFLECT THEIR STRENGTHENED MONETARY CO-OPERATION.

INTERBANK

** END OF 1 **

AOL 10/11 41