~~01~~
Part A.

SECRET
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Begins: 4/11/82
Ends: 9/12/82

PO -CH /GH/0020
PART A

PO -CH /GH/0020
PART A

Chancellor's (Howe) Papers:

GROUP FIVE MINISTERS
MEETING KRONBERG 9 - 10
DECEMBER 1982

Disposal Directions 25 Years
[signature]
24/7/95

1

PS
PS/Mr. Hurd
PS/PUS
Mr. Evans
Mr. Hannay
Mr. Thomas
TREA

EMBASSY OF THE UNITED STATES OF AMERICA
LONDON

November 4, 1982

Copy by msg for
to Mr. [illegible]
UKMIS G
~~Helsinki~~
UKRep B

Dear Foreign Secretary:

I was asked to deliver the enclosed message to you from Secretary Shultz, which was received at the Embassy this morning.

and by bag to
Mr Brabb... Washin...
Mr Gars... Paris
Mr Barri... Bonn

Sincerely,

John J. Louis, Jr.
Ambassador

Enclosure

DESPATCHED.
5/11
DESPATCHED.

The Rt. Hon. Francis Pym, MCMP,
Secretary of State for Foreign and
Commonwealth Affairs,
Foreign and Commonwealth Office,
London, SW1.

(2)

Dear Francis:

The United Kingdom and the United States have a common interest in a strong and equitable multilateral trade system. In order to sustain and improve this system, particularly during the current period of serious trade tension, we also have a mutual stake in promoting effective international trade rules. The well-being of the institution we cooperatively developed to administer these rules, the GATT, is of major concern to both of us. These shared interests prompt me to request your personal assistance in assuring a productive outcome for the GATT Ministerial meeting in November.

I am encouraged that we are in general agreement on the importance of a successful Ministerial. However, with the meeting only a few weeks away, and with protectionist pressures in many countries intensifying, I am concerned that we must do more to assure a successful outcome. If the Ministerial does not achieve mutually beneficial results, which demonstrate that the GATT can address some of the trade system's pressing problems, it seems to me that the risk of a serious deterioration in world trade relations is very grave.

I am pleased at the progress we have made toward a work program on services. I know that we share a strong interest in an open international regime for services, and appreciate the support you have given to our initiative.

There are three other areas, however, in which I believe it is particularly important for the Ministerial to make progress. The first is safeguards. Without an understanding on the type of measures a country can legitimately take when one of its industries faces injury from imports, the concept of a standstill on protective measures will not find support. At the same time, it is imperative that we find a solution to the problem of selective safeguards, which developing countries perceive as a major threat to their market access. I am convinced that unless we conclude a safeguards agreement with selectivity provisions acceptable to the developing countries, we will lose the impact we need from the

political statement by the GATT Ministers. It seems to me that Secretary General Dunkel's proposal contains the elements of a solution to this problem, and I urge you to give it your support. Unilateral selectivity cannot be the basis of a viable safeguards agreement.

The second area which the Ministerial must address is agricultural trade, including in particular the use of agricultural export subsidies. The long-standing policy differences between the United States and the Community are well known to you. I appreciate that it will not be possible to resolve these differences before the Ministerial. However, it is vital that we agree on a method for discussing these issues within the GATT. In addition, we must agree to initiate GATT discussions which permit significant progress toward resolving these problems in the relatively near term. If we cannot take these steps I am concerned that the frustration of producer groups with the trading system will prove damaging to us all.

Finally, it is extremely important that we make progress toward integrating developing countries better into the trading system. One aspect of this effort is safeguards, another is the proposal which we have put forward for a round of trade negotiations with developing countries. We would like to have your active support in developing a more detailed negotiating program and in persuading developing countries with a large stake in trade that such negotiations would be strongly in their interest.

I recognize that these issues are complex and involve closely interwoven aspects of trade and foreign policy. Bill Brock, the U.S. Trade Representative has discussed these problems with Commission Representatives in Geneva and in Brussels. I have written President Thorn to express the same concerns which I am sharing with you. My purpose in writing is to suggest that we must concentrate on the political as well as the economic stakes involved in this meeting. We cannot afford the corrosive effects of a continuation of present trade tensions on our political relationships. The health of the Alliance and our relations with developing countries alike need the stability provided by a strong trade system. I hope that Great Britain's influence can be used to encourage others to make the effort necessary to assure that the Ministerial strengthens the trade system during this period of serious strain.

In this connection, I note that the Council of Ministers has as yet been unable to agree on a negotiating mandate on these and other questions. I hope that you will take a strong stand within the EC to assure a forthcoming EC position and that you will support the Commission's effort to assure pragmatic EC participation in the Ministerial.

Best regards.

Sincerely,

George

/S/ George Shultz

G5 DEPUTIES' MEETING, 10-11 NOVEMBER.

10/11/82
11/10/82

CONFIDENTIAL

Package on Increased IMF Resources

1. This note records the extent of agreement and the range of views found among The Five countries on the main elements of the package for increased IMF resources. It uses the United States paper dated November 9, 1982 as a reference document. This paper is at Annex A. The Paragraph references in the side-headings are to the U.S. document.

Paragraph 1

2. The range of view on the new size of the Fund was from 85 billion SDRs to 100 billion SDRs, or from a 39 percent increase to a 64 percent increase.

3. Within this range, the U.S. position was 85; the U.K. and Germany could accept any point within the range 85 to 100; France 90 to 100; Japan 100, but perhaps less if the distribution of quota shares were right.

4. For Japan, there was a link between the size of the Fund they could support and the results of the quota distribution.

Paragraph 2

5. Four out of five countries took the view that a special borrowing arrangement should be part of the package and should be built on the present General Arrangements to Borrow. Japan agreed that a special borrowing arrangement

should be part of the package but preferred a separate arrangement independent of the GAB, which should be preserved in its present structure.

6. As to the form of the amendment of the General Arrangements to Borrow, there was agreement among The Four that there should be a single new ceiling for the GAB in the range 15 to 20 billion SDRs, which should cover both the present cooperative function of the GAB and a new borrowing facility in favor of non-members of the GAB. The United States view of the ceiling was 18.3 billion SDRs, equivalent at present to $20 billion. It was common ground among The Four that the 15 to 20 billion SDRs would be available either for present GAB members in need, or for lending for other IMF member borrowers.

7. The United States, United Kingdom, and France were agreed on the following approach to the new GAB lending facility for the benefit of non-GAB members. To activate the new GAB lending the Managing Director would have to demonstrate:

(1) that there was a special situation in the international monetary and payments system which required additional resources because it represented a potential systemic threat;

(2) that the existing resources available to the Fund were likely to be exhausted, or that their lending was likely to be unacceptably inhibited in order to avoid exhaustion;

(3) that he faced valid applications from members for Fund assistance amounting to a substantial call on the Fund which could not be met without activation of the new facility.

8. If the Managing Director's application were approved by a suitable majority in the GAB, or by consensus, lending would be to the Fund at a market-related rate.

9. The response of the Group of Ten to an application from the Managing Director could be either a refusal; a deferment; a partial response; or a full response; in any event within the ceiling of the total GAB undertaking. In making a decision, the G-10 would obviously have to have regard to possible borrowing by its own members; and to whether any of its members were themselves in balance of payments difficulty and unable to contribute.

10. The procedure for activating the new facility would be; first, a proposal by the Managing Director; then a decision by the G-10; and then decisions by the IMF Board on the applications from particular member countries which gave rise to the Managing Director's proposal. The GAB funds

would be directed to borrowing from the IMF "enlarged access" though the GAB facility would not be the sole source of funds for "enlarged access."

11. Germany was able to join the general line of the approach agreed among The Three, but needed for the present to make a reservation about whether the new GAB lending should be related to a round sum application by the IMF or to a specific drawing for an individual case.

12. The Japanese view was that the present cooperative nature of the GAB should not be prejudiced by introducing into it a new facility on these lines. They preferred a separate facility outside the GAB of 10 to 15 billion SDRs which would be activated in relation to drawings from the IMF by particular countries. When added to the present GAB facility of 6.2 billion SDRs, the Japanese position produced a total of available borrowed resources for both purposes very close to the 15 to 20 billion SDRs agreed by The Four. Those who supported an amended GAB envisaged (as did Japan) that it would also be necessary to draw Saudi Arabia (and perhaps two or three other countries) into any agreement to provide new borrowed funds. It was therefore agreed that the difference between the Japanese position on a separate facility and the views of The Four was not all that great. Part of the difference was presentational and perhaps legislative.

13. It was generally agreed that it would be essential to associate Saudi Arabia with any new lending facility in support of the Fund; but that this should <u>not</u> be done by

bringing Saudi Arabia into G-10 or GAB membership. A Saudi Arabian contribution would go towards satisfying the range of 15 to 20 billion SDRs for the new facility. There would have to be a separate agreement between the Fund and Saudi Arabia and no doubt an appropriate degree of parallelism between the new GAB obligation and a Saudi Arabian obligation. It was also agreed that a new approach to Saudi Arabia should not be such as to prejudice the third tranche of Saudi Arabian lending (4 billion SDRs) under the existing three-year lending arrangement between the Fund and Saudi Arabia.

14. As part of any change in the GAB, existing GAB shares would need review. Germany, in particular, made clear that their present share would be unacceptable. The Japanese view was that their share would have to take account of the level of their new IMF quota. A table showing 1962 and 1982 GAB shares is at Annex B.

15. As in the present GAB, there would be a "take-out" from contribution to the new facility for GAB members in balance of payments difficulty. Such "take-outs" would reduce the effective ceiling of 15 to 20 billion SDRs and the maximum contribution from any member would be their quota share of the nominal ceiling. It would also be desirable that, as with present GAB drawings, amounts lent under the new facility should continue to count as part of the lender's reserves.

16. It was generally agreed that it remained the intention to phase out IMF borrowing as the international monetary and payments situation returned to greater normality. The new lending facility would accordingly be regarded as temporary and limited to the Eighth Quota Period. Any renewal would require a new demonstration of need.

Paragraph 3

17. On distribution of quota shares, there was agreement that there would be some reduction of U.S. quota share, but not such as to impair the U.S. blocking vote; and that there would be a reduction in the U.K. share and an increase in the Japanese and, to some extent, the German shares. It was also agreed that whatever the method chosen for determining new quota shares, that method should be applied uniformly across the IMF membership, without reservations for any particular block of members.

Paragraph 4(a)

18. It was agreed that normal access should continue to be 165 percent of quota after the quota increase as in Paragraph 4(a) of the U.S. paper.

Paragraph 4(b)

19. On "enlarged access" the United States, Germany and Japan were agreed in wishing to limit the cash value of

such access to the present absolute level. The Three envisaged that there might, however, be provision for higher access in exceptional cases. The United Kingdom preferred some cash increase in "enlarged access" following a quota increase, e.g., an increase of 20 percent. France wishes to carry through the 450 percent limit to the new quota level. It was agreed that "enlarged access" should continue to be temporary. One possibility which found support was to provide for a review of "enlarged access" mid-way through the Eighth Quota Period.

20. Paragraph 4(c) of the U.S. paper was regarded as covered under earlier headings.

Paragraph 5

21. This paragraph of the U.S. paper was generally agreed.

Paragraphs 6 & 7

22. There was agreement that it would be desirable to move the present 85 percent rate of remuneration towards the SDR interest rate. However, Germany, France, Japan, and the United Kingdom were not disposed to insist on the 100 percent rate, or indeed on any increase, if this proved a bar to general agreement on a package. Germany and France in particular

did not wish to deter early application to the Fund. On the target rate of growth for IMF reserves, views were in line with those on the rate of remuneration under Paragraph 6.

Paragraph 8

23. There was agreement that the U.S. proposal to require payment of 25 percent of increased quota subscriptions in SDRs or usable currencies should be tried. France suggested that this would raise the question of an SDR allocation. The U.K. view was that the proposal should not be pressed if it created significant pressure for an SDR allocation.

Paragraph 9

24. The U.S. proposal for acceleration of agreement and of implementation was generally agreed, but Japan and the United Kingdom thought that for public purposes the objective for implementation might be expressed as mid-1984 in order to accommodate legislative requirements and go carry greater conviction that the target was attainable.

CONFIDENTIAL

November 9, 1982

Elements of Package on Increased IMF Resources

1. Total IMF quotas would be increased to SDR 85 billion, an increase of SDR 23.9 billion or 39.2 percent.

2. Special borrowing arrangements totaling approximately \$20 billion equivalent, including the existing GAB of about \$7 billion equivalent, would be established in favor of the IMF, for use by the IMF in circumstances that pose a threat to the international monetary system. Questions to be addressed include:

(a) whether the existing GAB should be amended to permit its activation to finance IMF drawings by non-GAB participants; and

(b) whether the new borrowing lines to be established should be integrated into an amended GAB, should form a new separate "window" of the GAB, or should form a totally separate arrangement.

Interests of speed and simplicity would appear to argue for integrating the new borrowing lines into an amended GAB and maintaining essentially the G-10 plus Switzerland as the lending group. Consideration could be given to a limited expansion of the group or to establishment of a limited number of new "association" arrangements along the lines of the Swiss association.

3. The United States' quota share would be reduced to 19.8 percent, and the voting share to 19.0 percent, in the context of share changes for the IMF membership in general determined on the basis of uniformly applied criteria.

4. The guidelines on access to IMF resources would be modified along the following lines:

(a) Access to conditional IMF resources under normal circumstances would be limited to 165 percent of quota, the limit that applied to drawings in the credit tranches and EFF combined prior to the policy on "enlarged access."

(b) The "enlarged access" limits of 150 percent of quota per year or 450 percent over three years would be modified to maintain maximum access constant in absolute terms -- i.e., to about 108 percent and 325 percent respectively.

(c) The possibility of drawings on "enlarged access" -- i.e., beyond 165 percent and up to 325 percent of quota -- would be reserved for exceptional cases. It would be envisaged that the borrowing arrangements referred to in paragraph (3) above could be activated for such drawings, although activation might not be required in each instance of exceptional drawings.

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5. The limits on access to the Compensatory Financing Facility would be modified to maintain access constant in absolute terms -- i.e., to 90 percent of quota. Any drawings on the CFF would be contingent on IMF satisfaction that the borrower is cooperating with the IMF in an effort to find appropriate solutions for its balance of payments difficulties.

6. The rate of remuneration would be raised to 100 percent of the SDR interest rate.

7. Charges on drawings financed by ordinary resources would continue to be based on calculations designed to assure a target annual growth of IMF reserves. The target rate of growth for IMF reserves would be raised from 3 percent per year to a level related to market yields, for example, the SDR interest rate.

8. Countries would be given the option of paying the 25 percent portion of their quota subscriptions either in SDR or in the currencies of other members specified, with their concurrence, by the IMF. Such specifications would be designed to assure payment in currencies currently usable by the IMF in financing drawings at the time of payment.

9. The effort to strengthen IMF resources would be accelerated to aim for agreement on the quota increase and borrowing arrangement by January or early February 1983, and to aim for implementation of both by the end of 1983.

Summary

1. Quotas	
Amount of Increase	SDR 23.9 billion
Percent Increase	39.2 percent
New Quota Level	SDR 85.0 billion
2. Borrowing Arrangement	SDR 18.3 billion, incl.GAB
3. U.S. Shares (percent)	Quota / Voting
Present	20.65 / 19.52
New	19.79 / 19.00
4. Access Limits (Percent quota)	
Present	
Traditional	165 percent
Enlarged Access	450 percent
New	
Normal	165 percent
Exceptional	325 percent
5. Access to CFF (Percent quota)	
Present	125 percent
New	90 percent, all conditional
6. Remuneration	
Present	85 percent SDR rate
New	100 percent SDR rate
7. Charges -- Ordinary Resources	
Present	Linked to 3 percent annual growth in IMF reserves
New	Linked to annual growth in IMF reserves at market rate (perhaps SDR rate)
8. Subscription Payment	25 percent in SDR or usable foreign currency at option of members
	75 percent in local currency
9. Timing	1-2/83 Agreement
	12/83 Implementation

11/9/82

GAB Share Variables
(Percent)

Participant	(1) GAB Shares 1962	(2) GAB Shares Nov. 2, 1982	(3) Current Quotas	(4) Calculated Quotas 1/	(5) Foreign Exchange 2/	(6) Foreign Trade 3/	(7) Non-Gold Reserves 4/ and GDP	(8) Non-Gold Reserves
United States	29.0	28.3	36.7	27.0	33.3	20.5	25.0	12.5
Germany	14.5	22.2	9.4	14.4	19.8	16.3	18.7	25.5
Japan5/	13.7	17.3	7.3	11.7	11.3	11.6	15.2	16.0
United Kingdom	14.5	8.5	12.8	9.0	6.0	9.7	7.9	8.1
France	8.0	5.3	8.4	9.8	6.6	10.8	9.1	9.6
Italy	8.0	3.3	5.4	6.4	8.1	7.6	7.9	9.6
Canada	2.9	2.5	5.9	5.0	1.5	5.6	2.8	1.5
Netherlands	2.9	3.7	4.1	5.3	3.8	6.5	3.8	5.2
Belgium	2.2	2.2	3.9	4.8	1.6	5.8	2.2	2.3
Sweden	1.4	1.0	2.0	2.5	1.5	2.8	1.9	2.0
Switzerland6/	2.9	5.6	4.1	4.1	6.6	2.8	5.5	7.7
Total Value (US $Millions)	6,891	7,054						

Columns 3-6 are variables proposed by Germans in 1978. Germans also presented shares for the SFF and OECD Support Fund.

1/ IMF calculation of June 18, 1982 using five formula method with 20 percent reduction in variability coefficient.

2/ IFS, as of August 31, 1982. US arbitrarily assigned one third share.

3/ IFS, exports and imports 1980.

4/ Average of shares of non-gold reserves (August 31, 1982) and GDP (1980).

5/ Japan unilaterally raised its GAB commitment by Y 250 billion ($900 million) in 1976.

6/ Switzerland, a non IMF member, is associated with the GAB with a total potential commitment of SF 865 million ($394 million) equivalent to 5.6 percent of the total commitments. Swiss quota assumed equal to SDR 1.4 billion, with share of calculated quotas set at the same level as in current quotas.

ANNEX B

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MXT 121/616/3

18 NOV 1982

OO WASHINGTON
OO UKMIS NEW YORK
GRS 1271
CONFIDENTIAL
FRAME EXTERNAL
FM FCO 121900Z NOVEMBER 82
TO IMMEDIATE WASHINGTON
TELEGRAM NUMBER 2012 OF 12 NOVEMBER
AND TO IMMEDIATE UKREP BRUSSELS, UKMIS GENEVA
INFO IMMEDIATE UKMIS NEW YORK (FOR MARSHALL)
INFO SAVING PARIS, BONN, ROME
GATT MINISTERIAL MEETING: MESSAGE FROM MR SHULTZ

MIPT. FOLLOWING IS TEXT OF MY REPLY TO MR SHULTZ.

1. DEAR GEORGE. THANK YOU FOR YOUR MESSAGE ABOUT THE GATT MINISTERIAL MEETING, WHICH WAS CONVEYED TO ME BY AMBASSADOR LOUIS ON 4 NOVEMBER. I ENTIRELY AGREE WITH YOUR ANALYSIS OF THE INTERESTS AND OBJECTIVES SHARED BY THE UNITED STATES AND THE UNITED KINGDOM. THIS WILL BE AN ENORMOUS HELP IN OUR JOINT EFFORTS TO SEEK SOLUTIONS TO THE PROBLEMS WHICH CONFRONT US IN THE TRADE FIELD (WHICH, AS YOU KNOW, INCLUDE AS FAR AS THE UK IS CONCERNED ASPECTS OF US TRADE POLICY, PRACTICES AND LEGISLATION WITH WHICH WE DISAGREE.) WE ALL HAVE AS STRONG A STAKE NOW IN THE PRESERVATION AND DEVELOPMENT OF THE OPEN TRADING SYSTEM AS WE DID IN ITS ORIGINAL CREATION WHEN OUR COUNTRIES WORKED SO EFFECTIVELY TOGETHER TO ESTABLISH THE GATT IN THE IMMEDIATE POST-WAR PERIOD.

2. IT IS VITALLY IMPORTANT THAT THE MINISTERIAL SHOULD HELP US CONTAIN AND REDUCE THE PROTECTIONIST PRESSURES CREATED AND EXACERBATED BY THE PRESENT WORLD RECESSION. A REALISTIC AND FLEXIBLE APPROACH TO THE PROBLEMS IS NECESSARY. THE UK HAS BEEN DOING ITS UTMOST TO PROMOTE THIS, IN PARTICULAR WITHIN THE EUROPEAN COMMUNITY. I AM GLAD TO SAY THAT THE COMMUNITY HAS NOW REACHED AGREEMENT ON A DETAILED SET OF GUIDELINES FOR THE COMMISSION WHO ARE THUS ABLE TO PLAY A FULL PART IN THE FINAL WEEKS OF THE PREPARATORY PROCESS. GASTON THORN CAN SPEAK AUTHORITATIVELY FOR THE COMMUNITY AS A WHOLE AND I AM SURE YOUR CONTACTS WITH HIM WILL PROVE HELPFUL.

3. YOU RAISE A NUMBER OF INDIVIDUAL ISSUES. THEY FALL GENERALLY TO THE COMMUNITY AS SUCH, AND IT IS FOR THE COMMISSION TO REPRESENT THE AGREED EC POSITION (TO WHICH OF COURSE THE UK HAS CONTRIBUTED). BUT WITH THIS RESERVATION I SHOULD LIKE TO OFFER A NUMBER OF COMMENTS SINCE I THINK IT IS ESSENTIAL THAT WE SHOULD UNDERSTAND EACH OTHER. GENERALLY SPEAKING OUR THINKING IS CLOSE TO THE US APPROACH YOU DESCRIBE. I PARTICULARLY WELCOME WHAT YOU SAY ABOUT THE POSSIBLE PROCEDURAL WAY FORWARD ON AGRICULTURE. THIS IS AN EXTREMELY SENSITIVE SUBJECT ON THE SUBSTANCE OF WHICH OPINIONS DIFFER SUBSTANTIALLY, AS YOU ACKNOWLEDGE, AND NOT JUST IN THE USA AND THE COMMUNITY. MULTILATERAL DISCUSSION IN THE GATT OFFERS THE PROSPECT OF CLEARING THE AIR AND ACHIEVING PROGRESS ON THE WHOLE COMPLEX OF ISSUES INVOLVED. IT IS EXTREMELY HELPFUL TO HAVE THE INDICATION YOU GIVE THAT THE UNITED STATES IS PREPARED TO JOIN OTHERS IN AGREEING TO PROCEED ON THIS BASIS.

4. ON SERVICES, OUR VIEWS COINCIDE. THE UNITED KINGDOM, LIKE THE UNITED STATES, HAS A PARTICULARLY STRONG INTEREST IN PROMOTING THE LIBERALISATION OF BARRIERS TO TRADE IN THIS SECTOR. WE HAVE PERSUADED THE COMMUNITY TO ACCEPT THE IDEA OF A GATT STUDY OF SERVICE TRADE ISSUES AND YOU WILL CERTAINLY CONTINUE TO HAVE OUR SUPPORT.

5. WE ARE ALSO IN COMPLETE AGREEMENT ABOUT THE NEED FOR DEVELOPING COUNTRIES WHICH ARE IN A POSITION TO DO SO TO UNDERTAKE AN INCREASING RANGE OF GATT OBLIGATIONS. BUT THERE IS A PROBLEM OVER PERSUADING THEM TO COME TO THE NEGOTIATING TABLE IN THE FIRST PLACE AND, ONCE THERE, WE NEED TO GET THEM TO APPRECIATE THAT IT REALLY IS IN THEIR INTEREST TO ENGAGE IN GENUINE NEGOTIATIONS. SURELY IT IS NOW URGENTLY NECESSARY TO GET AWAY IN GATT FROM APPROACHES WHICH DEVELOPING COUNTRIES SEE AS CONFRONTATIONAL. THE IDEA FLOATED BY THE COMMUNITY OF A 'FEASIBILITY STUDY' SEEMS TO US TO OFFER A NON-CONFRONTATIONAL AND THEREFORE POTENTIALLY PRODUCTIVE APPROACH. BUT WE ARE CLEAR THAT SUCH A STUDY MUST BE UNDERTAKEN AND COMPLETED WITH ALL DUE DESPATCH. WE NEED TO BE ABLE TO DEMONSTRATE EARLY PROGRESS IF PRESSURES FOR RETALIATORY ACTION AGAINST HIGH TRADE BARRIERS MAINTAINED BY OTHER COUNTRIES ARE TO BE DEFUSED.

6. ON ALL THESE POINTS THE UNITED STATES AND THE COMMUNITY SEEM TO BE ON A CONVERGING COURSE. ON DISPUTE SETTLEMENT TOO I THINK THERE IS A GENERAL WISH TO SEE SOME IMPROVEMENT IN THE WAY PROCEDURES ARE CURRENTLY OPERATING. WHAT HAS HAPPENED IN THE DISC CASE HAS DAMAGED THE REPUTATION OF DISPUTE SETTLEMENT IN THE GATT. CLEARLY WE ALL WANT TO AVOID A RECURRENCE. BUT I AM NOT SURE WE SHOULD ACTUALLY BE HELPED IN THIS BY THE ADOPTION OF US IDEAS WHICH, AS I UNDERSTAND IT, WOULD INVOLVE ENDOWING THE GATT WITH AN ELEMENT OF JUDICIAL POWER. UNFORTUNATELY, AS WE KNOW TO OUR COST IN THIS COUNTRY, IT IS ALL TOO EASY FOR THE EXECUTIVE OR LEGISLATURE OF A SOVEREIGN STATE TO REFUSE TO COMPLY WITH THE RULING OF AN INTERNATIONAL COURT ON THE GROUNDS THAT DOMESTIC POLITICAL DIFFICULTIES ARE OVERRIDING. THE TRADITIONAL GATT APPROACH OF CONCILIATION AND CONSENSUS HAS MUCH TO RECOMMEND IT. IT IS IMPORTANT THAT WE SHOULD ALL ADHERE FULLY TO WHATEVER IS EVENTUALLY DECIDED.

7. FROM WHAT YOU SAY ON SAFEGUARDS AND THE RELATED PROPOSAL FOR A 'STANDSTILL' OR 'CEASEFIRE' ON PROTECTIVE MEASURES IT IS CLEAR WHERE WE DIFFER IS IN OUR PERCEPTION OF THE NATURE OF THE UNDER-LYING PROBLEM. IT WOULD, I THINK, BE WRONG TO REGARD THE COMMUNITY AS IN ANY SENSE OPPOSED TO FURTHER WORK ON A COMPREHENSIVE SAFEGUARDS AGREEMENT, THOUGH THERE ARE GENUINE DOUBTS ABOUT THE PRACTICABILITY OF ACHIEVING IN THE NEXT TWO WEEKS A BREAKTHROUGH WHICH, DESPITE ENORMOUS EXPENDITURE OF EFFORT, HAS ELUDED US FOR YEARS. THE DIFFICULTY OF FINDING A UNIVERSALLY ACCEPTABLE FORMULA WHICH STRIKES THE RIGHT BALANCE BETWEEN SELECTIVITY AND DISCIPLINE REMAINS UNDIMINISHED. IF, HOWEVER, THERE IS A GENERAL WISH TO SEE SOME PROGRESS, TRANSPARENCY SEEMS TO US TO OFFER THE MOST PROMISING AVENUE TO EXPLORE AND IN THE SHORT TIME REMAINING THE COMMUNITY WOULD, WE THINK, CERTAINLY BE WILLING TO CONSIDER ANY IDEAS WHICH ARTHUR DUNKEL OR ANYONE ELSE MIGHT CHOOSE TO PUT FORWARD.

8. BUT OUR REAL CONCERNS RUN DEEPER THAN THE MECHANICS OF SAFE-GUARD ACTION. WHILE THE GATT SYSTEM IS UNDOUBTEDLY UNDER SEVERE STRAIN, IT WOULD SURELY BE WRONG TO ATTRIBUTE THE CAUSE TO TECHNICAL DEFICIENCIES IN GATT RULES. AT THE SAME TIME THERE IS

OF COURSE A GENERAL RECOGNITION THAT A RETREAT FROM OUR COMMITMENT TO THE GATT WOULD NOT ONLY FAIL TO IMPROVE THE SITUATION, BUT WOULD ACTUALLY MAKE IT FAR WORSE. WITH THIS CONSIDERATION IN MIND, THE COMMUNITY HAS PROPOSED A RATHER DIFFERENT APPROACH SETTING CURRENT DIFFICULTIES IN THE WIDER MACRO-ECONOMIC CONTEXT AND MAKING CLEAR THE NEED FOR A COLLECTIVE EFFORT WITH CONTRIBUTIONS - CONSISTENT WITH THE SPIRIT AS WELL AS THE LETTER OF THE GATT - FROM ALL COUNTRIES WHICH BENEFIT FROM THE OPEN TRADING SYSTEM. THIS NATURALLY INCLUDES THOSE WHICH HAVE DONE LEAST IN THE PAST. VISITS TO WASHINGTON THIS WEEK BY WILLI HAFERKAMP OF THE COMMISSION AND MY COLLEAGUE ARTHUR COCKFIELD, THE SECRETARY OF STATE FOR TRADE, ARE PROVIDING AN OPPORTUNITY FOR DETAILED DISCUSSION WITH THE US ADMINISTRATION, THOUGH PRIMARILY WITH BILL BROCK AND OTHERS CONCERNED WITH TRADE POLICY. YOU ARE HOWEVER QUITE RIGHT TO EMPHASISE THE FOREIGN POLICY ELEMENT IN ALL THIS. IT IS OF CAPITAL IMPORTANCE THAT THE FREE WORLD SHOULD CLEARLY DEMONSTRATE ITS WILL TO WORK TOGETHER FOR THE PRESERVATION OF ONE OF ITS ESSENTIAL INSTITUTIONS. BUT ITS STATEMENT OF COMMITMENT WILL ONLY CARRY CONVICTION IF EXPRESSED IN REALISTIC AND DEMONSTRABLY EQUITABLE TERMS. THE PRINCIPLES UNDERLYING THE COMMUNITY APPROACH ARE A CONSCIOUS ATTEMPT TO MEET THIS CRITERION. THEY HAVE MY PERSONAL SUPPORT AND I COMMEND THEM TO YOU FOR SERIOUS CONSIDERATION.

BEST WISHES
FRANCIS

PYM

NNNN
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ECD(E)
NAD

EMBASSY OF THE
UNITED STATES OF AMERICA

London

November 20, 1982

Resident Clerk
Foreign & Commonwealth Office
London, S. W. 1

Dear Resident Clerk:

I would appreciate your transmitting the enclosed message from Secretary of the Treasury Regan to Chancellor of the Exchequer Howe which was received at the Embassy this morning.

Sincerely,

Edward O. Follis (duty officer)

for John J. Louis, Jr.
Ambassador

Enclosure:
UNCLASSIFIED

Dear Sir Geoffrey:

While trade issues are not my primary concern, I request your personal assistance in assuring that the GATT Ministerial is successful. A trading system weakened by growing import restrictions and competitive subsidization will weaken the general fabric of international economic relations and destroy some of the progress we have made in strengthening international economic cooperation.

The United States believes that the GATT Ministerial must and can make meaningful progress towards addressing the major problems facing the international trading system. Without such progress, I am afraid that the protectionist pressures which are currently threatening the international trading system could undermine the international economic system as a whole.

The most important task for the Ministerial will be a strong declaration of intent by GATT members to avoid protectionist measures, and to work towards eventually scaling down existing trade distortive measures. This is a difficult step to take politically, but one which will benefit our economies in the long run.

It is unrealistic to expect a complete moratorium on protectionism; there are circumstances under which a country must act to safeguard domestic industries. Therefore, any anti-protectionism declaration should be accompanied by a commitment on new GATT rules governing the imposition of temporary import restraints -- "safeguards." The present use of such import restraints, in most cases outside of the GATT framework, is getting out of hand. New GATT rules should place greater discipline on the use of temporary import restraints, at the same time widening the application of the rules to all types of safeguard actions. We should try at the Ministerial to obtain agreement on a set of principles addressing key areas such as transparency, coverage, time limits, injury and degressivity.

Another threat to the stability of the international economic system is the spiraling use of subsidies, particularly in the agricultural area. Subsidy wars are expensive and achieve little. To forestall such an occurrence, the United States has suggested that countries at least agree to sit down and discuss ways of resolving the subsidy issue, with a set deadline for recommendations to their respective governments.

Dear Sir Geoffrey:

While trade issues are not my primary concern, I request your personal assistance in ensuring that the GATT Ministerial is successful. A trading system weakened by growing import restrictions and nonproductive subsidization will weaken the general fabric of international economic relations and destroy some of the progress we have made in strengthening international economic cooperation.

The United States believes that the GATT Ministerial must and can make meaningful progress towards addressing the major problems facing the international trading system. Without such progress, I am afraid that the protectionist pressures which are currently threatening the international trading system could endanger the international economic system as a whole.

The most important task for the Ministerial will be a strong declaration of intent by GATT members to avoid protectionist measures, and to work towards eventually scaling down existing trade distortive measures. This is a difficult step to take politically, but one which will benefit our economies in the long run.

It is unrealistic to expect a complete moratorium on protectionism; there are circumstances under which a country must act to safeguard domestic industries. Therefore, any anti-protectionism declaration should be accompanied by a commitment on new GATT rules governing the imposition of temporary import restraints -- "safeguards." The present use of such import restraints, in most cases outside of the GATT framework, is getting out of hand. New GATT rules should place greater discipline on the use of temporary import restraints, at the same time widening the application of the rules to all types of safeguard actions. We should try at the Ministerial to obtain agreement on a set of principles addressing key areas such as transparency, coverage, time limits, injury and degressivity.

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In addition to addressing the two immediate threats of safeguards and agricultural subsidies, the United States has proposed that GATT look at emerging trade issues which will probably have a significant effect on trade flows in the future. In particular, the United States hopes GATT members agree to begin work on the issues of trade in services, trade-related performance requirements and high technology trade.

I bring these issues to your attention because I know that you are as concerned as I am that current economic difficulties worldwide will encourage trade-distortive practices, perhaps initiating a vicious cycle of worsening economic conditions answered by adoption of additional protectionist measures. One cannot look at trade issues in a vacuum. We must maintain an international trade system that permits and encourages sound economic policies.

I look forward to meeting you in the near future to discuss these and other issues of mutual concern.

With best wishes.

Sincerely,

/s/ Donald T. Regan

Donald T. Regan

Reference ....

Copies to:

* DO Dept. of Trade

HM Treasury

* PS/Mr Rees

PS

PS/PUS

Mr Evans

ECD(E) ✓

Mr Bone + 3 } via Resident Clerk
Mr Hannay

CODE 18-78

FROM: G W MONGER
DATE: 29 November 1982

CHIEF SECRETARY

cc as below

I am doubtful about some aspects of this project:

a. the public expenditure calculations show, especially for the Northern Ireland option, substantial extra expenditure next year as compared with the alternative of closing down the gas industry (column 4 of annex to Mr Prior's letter). The project does not break even, on p.e. terms, compared with this alternative, until about the end of the decade. The big savings on p.e. occur after 1990. This profile of early costs covered by later savings is a familiar one and we well know that things do not always work out that way. I would not attach undue weight to the p.e. savings of £136m given in the last line of Mr Prior's table.

b. Mr Prior is proposing to spend £147m renovating the gas industry in Northern Ireland. The offsetting savings after 1990 depend on the assumption not only that Kinsale gas can be sold at a profit but also that all gas sales can be increased five-fold by 2003. This cannot be certain, especially since the price of the gas will be substantially above that in Great Britain and will be escalated in line with that of oil. (The contract will in any case need to be re-negotiated after 20 years.) This expansion is, however, said to be "necessary for a viable industry" (paragraph 5).

c. The paragraph on security considerations (paragraph 12) is very carefully worded. Mr Prior quotes the view of his security advisers that such considerations "would not be an insuperable obstacle", but that the pipeline would be a target for attack. I suspect that there may turn out to be major problems in this area.

2. There is also the political aspect of co-operation with the Irish Republic. This could be very controversial in Northern Ireland and perhaps at Westminster. But this is, of course, a matter of political judgment.

3. I would not claim that these points are conclusive. Mr Prior has already accepted that he can meet the extra costs within the total agreed for his 1982 PES, and this meets our main concern. The other provisos suggested in the submission will help. Avoidance of the closure of the gas industry in Northern Ireland will save 1000 jobs. The security problem is not directly for us, even though it might have expenditure implications.

4. I suggest that you might send a rather more sceptical reply to Mr Prior making these points but making it clear that you will not oppose his proposals, on the strict understanding that he is not asking for more money and that he agrees the provisos mentioned in Mr Pratt's submission. I attach an alternative draft accordingly.

G W MONGER

DRAFT LETTER TO:

SECRETARY OF STATE FOR NORTHERN IRELAND

Thank you for sending me a copy of your minute to the Prime Minister of 11 November. I have since seen her reply of 15 November, and Nigel Lawson's minute of 23 November.

2. I have some reservations about this proposal:

- first, I see that it will lead to a sizeable increase in expenditure next year, especially if the gas is to be supplied throughout Northern Ireland as you prefer. The conclusion that it will save public expenditure depends on the forecasts for the period after 1990, which are bound to be very uncertain.

- Secondly, the forecasts assume that supply of Kinsale gas will make possible a five-fold increase in sales of gas in Northern Ireland. Indeed, such an increase is stated to be "necessary for a viable industry". But we cannot be certain that it will take place given the poor prospects for growth of energy demand, and the escalation of the price of Kinsale gas with the price of oil.

- Thirdly, there is clearly cause for concern about the security considerations. You quote your security advisers as saying only that these considerations "would not be an insuperable obstacle" and that terrorist attacks are likely. The Prime Minister has referred to the possibility of intervention of supply.

- Fourthly, I have noted Nigel Lawson's reservations about the proposed terms of the deal with the Irish Republic.

3. Nevertheless, I accept that the project has important employment implications, and if colleagues generally are content, I would not want to oppose its going ahead, on these provisos:

- First, that any additional costs are borne within your PES allocation. I see that you have accepted this, and your acceptance helps substantially to deal with my worries.

- Secondly, I am concerned that there should be no question of Kinsale gas following the precedent of the Northern Ireland Electricity Service, whose price is of course subsidised at a level equivalent to the highest in Great Britain. I should be grateful to have your assurance now that the transitional subsidies provided for under the terms of your project, and due to be phased-out by 1987-88, will be the limit of Exchequer subsidy to the Northern Ireland gas industry.

- Thirdly, I should like to ask for your agreement that financial targets based on a percentage return on net assets, on the pattern of those we set for nationalised industries in Great Britain, should be set for the Northern Ireland gas industry. The industry as a whole is not projected to move into operating profit until

1988-89. But I should like to suggest that our officials should study, and report back to us on, the feasibility of setting annual deficit targets for the industry, which would plot a path to eventual profitability. I would envisage these targets being formally set for the industry, as is our practice for certain deficit industries in Great Britain such as British Rail.

4. I should be glad to have your agreement to these provisos.

5. I am sending copies of this minute to the Prime Minister and to other recipients of yours.

(SIGNED: CHIEF SECRETARY)

FINANCIAL SECRETARY TO THE TREASURY

> Chancellor

. . . I was there! But I wish I wasn't. It was, I thought, very poor.

O dear

RH

25/11/'82

Mr Harris

IEA

R.H

I've retained the text to read

U may like to answer

The Institute of Economic Affairs

Registered No. 755502 England Charity No. CC/235 351 Limited by Guarantee

Registered Office
2 LORD NORTH STREET WESTMINSTER SW1P 3LB
Telephone: 01-799 3745

Press Release for 00.01 hours, Monday 29 November 1982

The IEA is an independent research and educational trust founded in 1957

CHALLENGE TO BUSINESS FROM NOBEL PRIZE WINNING CHICAGO ECONOMIST

The pleasures of regulation and the pains of competition

"I believe that the automobile industry, or the chemical industry, or the computer industry, has done more for American civilisation than the US Congress, with the Presidency and the courts thrown in for good measure. Together with other industries not yet born, they are capable of doing as much in the future." (p.14)

In his Wincott lecture "The Pleasures and Pains of Modern Capitalism"*, given shortly before he was awarded the 1982 Nobel Prize for Economic Science, Professor Stigler, of Chicago University, described "the regulating sector" of the American economy as "the biggest of all growth industries".

Growth of regulation

"There is no more notorious fact than the modern proliferation of governmental policies designed to control and direct economic activity... For the United States - where the praises of Adam Smith are sung more often and more loudly than in Glasgow - the Directory [of Federal Regulatory Agencies] reports 88,000 employees of 57 federal agencies busily directing our economy, triple the number so engaged 10 years earlier." (excluding the Internal Revenue Service) (pp.7/8)

Who benefits?

Professor Stigler observes that although all consumers - from rich to poor, but especially poor - benefit from an efficient economy

"...most economic regulations do not benefit even an important sub-class of consumers. Consumers do not gain from the regulation of public utilities,

* To be published by the IEA on behalf of the Wincott Foundation on Monday, November 29th as
The Pleasures and Pains of Modern Capitalism
by George J. Stigler
Occasional Paper 64; Price £1.00

financial institutions, labour markets, imports and exports - and literally thousands of other regulatory policies of almost inconceivable variety. There is in the United States a compensation scheme for the owners of bees whose death may have been hastened by pollutants. The introduction of this policy a few years ago, one Department of Agriculture employee has observed, has led to the complete disappearance of bees who die a natural death." (p.9)

As Professor Stigler stresses,

"The consumers of honey did not get this programme adopted. Nor did consumers support state licensing laws requiring a barber to have more hours of training (as many as 1,200) than an airline pilot." (p.9)

Since "the business community is the beneficiary of more governmental favours than it ever received in the past" and consumers do not benefit, it looks as if

"the major part of the regulations to which businessmen are subjected must be of their own contriving and accepted by them. It is they who persuaded the federal and state governments to initiate the controls over financial institutions, transport and communication systems, extractive industries and so on." (p.11)

Pains of capitalism

Having considered some of the pains of modern capitalism, such as the losers from regulation, the tax burden of welfare programmes, and the self-defeating outcomes of widespread access to the political system of many industries and occupations, Professor Stigler faces an "embarrassing problem".

Embarrassing problem

"And so we face an embarrassing problem if we wish to return to a freer, more traditionally liberal society: the business community does not wish to be released from the public interventions to which it is subject...Each industry will agree on the desirability of making other industries freer and more competitive, but will assert that its own industry would become disorganised and perhaps even non-viable if the state withdrew." (p.22)

Professor Stigler concludes that

"Unless and until the business community is persuaded that on balance it will gain from a freer regime, it is unreasonable to expect the rest of society to join the movement towards deregulation." (p.22)

New hope

But

"The quantitative study of the effects of public policy on the efficiency of the economy, and the identification of the beneficiaries and victims of particular policies, has grown prodigiously"... and is "substantially changing the attitude of economists towards public policy. For a long, long time a criticism of business was alone sufficient to warrant a new piece of state intervention in the economy. The resulting mixture of costly inefficiencies and perverse income redistributions is changing that response. Economists are developing the knowledge which will eventually permit the limits of the competence of the state to be defined in a way that can usefully be applied. If we pursue this programme with sufficient skill and zeal, the long-run prospects of capitalism will surely improve." (p.23)

PERSONAL AND CONFIDENTIAL

PWP

SIR KENNETH COUZENS o/r

FROM: J O KERR
DATE: 29 November 1982

cc Mr Littler
Mr Lavelle

THE IMF EXERCISE : NEXT STEPS

We spoke on 23 November about the case for preparing an early contingency plan on what steps the Chancellor should take if:-

(a) He is this week elected to replace MacEachan as Chairman of the Interim Committee; and

(b) G5 on 9 December goes well.

I had particularly in mind the need to clear spaces in the Chancellor's diary, and consult embassies abroad, should any travel before 28 January be required. You thought that talks with the Saudis might be desirable, and that it might also be necessary to visit Washington.

2. The Chancellor is anxious for early advice, and tried to speak to you over the weekend. He would be grateful for your advice, and a contingency plan, as soon as possible.

3. I have spoken today to the FCO about the weekend press reports of a rift in our relations with the Arab world over the Prime Minister's refusal to receive an Arab league delegation including a PLO representative. I am told that relations are indeed dicey: King Hassan of Morocco, who was to lead the delegation, is apparently incensed; and - more relevantly - King Fahd of Saudi Arabia has, more in sorrow than in anger, sent a message of complaint to the Prime Minister. The FCO would not advise any

bilateral Ministerial visits to Saudi Arabia for the next few weeks. I have however explained that the Chancellor would, if he went, be going in an international capacity, as Interim Committee Chairman-Elect, and possibly accompanied by the IMF Managing Director. The FCO thought that this would probably be feasible, though there might still be a slight frost in the air. Dates to avoid would be those of the OPEC meeting in Vienna on 18/19 December. Lord Cockfield plans a visit to Saudi Arabia in early January, and Mr Pym one ~~only~~ in mid-January.

J O KERR

SECRET

Jill

Pl. spk

1. Gov.

2. Geography / cars

3. History

4. (G [?] not PS)

D

Jill

MR KERR

FROM: MISS J RUTTER
DATE: 29 November 1982

ARRANGEMENTS FOR THE G5

I attach as requested draft telex for the Chancellor to send to Hans Tietmeyer. You might consider it more appropriate for Sir Kenneth Couzens or yourself to reply in which case the draft can be suitably amended. As it stands it contains all the relevant details.

2. Mr Beamish in the Embassy informs me that while the Germans will meet the cost of hotel rooms for 3 members of the delegation, any additional member will be expected to pay for his or her own accommodation. The Schloszhotel Kronberg is already booked out for the G5 so that would mean accommodation in a neighbouring hotel - not necessarily a bad thing as accommodation in the Kronberg apparently costs some DM200 to DM300 a night. Moreover no food will be provided for the poor companion - you may therefore like to consider whether anyone should be taken. I have drafted the telex in the sense that there will be an accompanying Private Sectetary. Obviously it can be easily amended.

3. As I think I mentioned to you earlier the flying times to Frankfurt are hardly ideal . I have booked the Chancellor onto an outward flight BA726 at 11.25 arriving Frankfurt at 1350. Stoltenberg's contention that it is a half hour drive from Frankfurt to the Kronberg that suggests that the Chancellor will possibly (British Airways permitting) be kicking his heels from 2.45 to 4.00. This may not matter too much. Worse are the flights on Friday morning. I learned from Mr Beamish that Stoltenberg will have to leave at 9.30 so the working breakfast will take place

between 8.00 and 9.30. With the half hour drive into town that means that the Chancellor will have an hour and 40 minutes with very little to do other than see the Goethe Haus to complete his immersion in German culture. You may like to consider the case I made to you earlier for hiring a plane. Obviously again if that were the decision part of the telex dealing with the flight times would obviously have to be redrafted.

?

4. The final point is one raised by Mr Beamish. As it stands we will be accepting the Germans offer of transfer facilities, so there will be no role for the British representative in Frankfurt. Mr Beamish raised the question of whether the Consul General could appear on the tarmac for the ritual handshaking. I would have thought that this was totally inappropriate in a case of what is supposed to be a secret meeting. I have told Mr Beamish that I do not think the Consul General will be called upon to put in an appearance. But I said that this was obiously ad referendum to you. Grateful for confirmation that I have taken the right line.

JKR

JILL RUTTER

DRAFT TELEX TO

HANS TIETMEYER
STAATSSEKRETAER
IM
BUNDESMINISTERIUM DER FINANZEN

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

Your telex of 25 November refers.

2. We would be grateful for transfer facilities from the Airport to Kronberg (and in the ~~any~~ other direction on 10 December). We will be arriving on BA726 on 9 December at 1350 and departing on 10 December on BA725 at 1140.

3. We will require one additional room for my Private Secretary. The party will be the Governor of the Bank of England, Sir Kenneth Couzens, Mr Kerr and myself.

4. With best wishes.

GEOFFREY HOWE

SECRET

FROM: JILL RUTTER
30 November 1982

MR. KERR

ARRANGEMENTS FOR THE G5 9/10 December.

I have discussed the arrangements for the G5 with the British Embassy in Bonn, Sir Kenneth Couzens' office, and with the Governor's office.

2. I have booked the Chancellor on to BA726, departing Heathrow at 11.25 and arriving at Frankfurt at 1350. Dr. Stoltenberg estimated that it was a 30 minutes drive from the airport to the Schloszhotel Kronberg im Taunus so the Chancellor will arrive in good time (British Airways permitting) for the meeting. As you know, the items on the Cabinet agenda of Treasury interest - contracting out and Civil Service manpower targets after 1984 - have been postponed until 16 December because of the Chancellor's absence. On this timing the Chancellor will be able to attend Cabinet which starts at 9.45 on present plans for three-quarters of an hour. [The E discussion on trade policy has been postponed.]

3. The flights after the working breakfast are less good. Dr. Stoltenberg will have to leave at 9.30. The first flight back to London is the 11.40 BA725 arriving at Heathrow at 1210. In the light of this I investigated the possibility of chartering a private plane. In fact there would be few advantages as a small plane - a 5-seater - would take 2 hours 15 minutes to 2 hours 30 minutes compared with the scheduled flying time of 1 hour 15 mins. So there would be little time gained for an additional cost of £250 or so.

4. I have discussed the arrangements with Mr. Beamish. He tells me that the Germans will meet the cost of hotel rooms for three members of the delegation, but any additional member would be accepted to pay for his own accommodation. The hotel itself is

/already

already booked out, so that would mean accommodation in a neighbouring hotel. Moreover the dinner will be restricted to the three principals - I doubt therefore whether it would be worth sending a Private Secretary to Frankfurt.

I think RB is probably right. Not in meetings, not in meals, not even in the hotel — I doubt if Jill or I would earn our fare. But it's for you to say. GL.

subject to G10 on Friday.

5. As you indicated, if the Chancellor decides against sending a Private Secretary this will suggest an enhanced role for the Consul General. Mr. Beamish is sounding out our man in Frankfurt. He sees no difficulties in theory with the scheme proposed.

6. I have spoken to both the Governor's office and Sir Kenneth Couzens' office. Mr. Little will be attending the WP3 in Paris so Sir Kenneth Couzens will accompany the Chancellor on both legs of the trip. On present plans, so will the Governor.

JkR

JILL RUTTER

CHANCELLOR OF THE EXCHEQUER

1/12/82

C.

Mr Nott is contemplating changing the rules. But not before 1 Jan. And no new rules have yet been devised. So the bill next week, they say, would still be £10,000. Which means, I fear, going commercial.

JHe.

Jill: so can I now see your draft telex to Hept T.

? JHe

cc Mr. Bottrill
Mr. Atkinson 6/3/1

FLAG A

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+ EEE BMF FSNR 59 021282 1230=

DR. GERHARD STOLTENBERG
BUNDESMINISTER DER FINANZEN

BONN, DECEMBER 1, 1982

EXCHEQUER
- 2 DEC 1982
ACTION SIR K COUZENS
COPIES TO SIR D WASS, MR LIT
MR CAREY, MR L

SIR GEOFFREY HOWE
CHANCELLOR OF THE EJCHEPUER
OF THE UNITED KINGDOM

LONDON

DEAR COLLEAGUE,

AS PROMISED IN MY INVITATION TO KRONBERG, I WOULD NOW LIKE TO PROPOSE THE ANNOTATED AGENDA FOR OUR MEETING. MR. SPRINKEL WILL INTRODUCE THE FIRST AGENDA ITEM (IMF MATTERS), M. CAMDESSUS AND POSSIBLY CHAIRMAN VOLCKER WILL INTRODUCE THE SECOND ITEM (COUNTRY QUESTIONS), AND SIR KENNETH COUZENS WILL INTRODUCE THE THIRD ITEM (PROCEDURAL QUESTIONS RELATED TO OUR MULTILATERAL SURVEILLANCE). WE SHOULD BASE THE DISCUSSION OF ITEM ONE ON THE PAPER AGREED BY OUR DEPUTIES ON NOVEMBER 10.

FOLLOWING IS THE PROPOSED ANNOTATED AGENDA. THE PARAGRAPH NUMBERS RELATING TO ITEM ONE FOLLOW THE DEPUTIES' PAPER.

ITEM 1: IMF MATTERS

PARAGRAPH 1 SIZE OF THE FUND

CAN WE NOW AGREE ON A COMMON POSITION REGARDING THE QUOTA TOTAL? FLAG B

PARAGRAPH 2 SPECIAL BORROWING ARRANGEMENT FLAG C

I SUGGEST THAT WE BREAK DOWN THE ISSUE INTO THE FOLLOWING QUESTIONS:

A) DO WE ENDORSE THE IDEA OF A SPECIAL BORROWING ARRANGEMENT AS PART OF THE PACKAGE?

B) SIZE OF THE ARRANGEMENT.

C) USE OF BORROWED FUNDS AND CONDITIONS FOR ACTIVATION. (THIS ITEM IS LINKED WITH PARAGRAPH 4 B.)

D) PROCEDURE FOR ACTIVATION.

E) PARTICIPATION IN THE BORROWING ARRANGEMENT AND SHARES OF PARTICIPANTS.

F) INCLUSION IN GAB OR SEPARATE ARRANGEMENT.

G) INTEREST RATE, OPTING OUT, MOBILISATION OF CLAIMS, DURATION AND REVIEW OF THE ARRANGEMENT.

C

FROM: J.G.LITTLER
DATE: 3 DECEMBER, 1982

CHANCELLOR OF THE EXCHEQUER

cc Sir Kenneth Couzens
Mr. Carey
Mr. Lavelle
Mr. Hawtin
Mr. Denison

YUGOSLAVIA

You are aware that Yugoslavia has a severe and urgent debt problem and that the IMF and United States have been approaching a limited number of other countries with ideas of new support arrangements.

2. The subject will be on the agenda at Kronberg, and I will send you a fuller brief, after further meetings among officials at the beginning of next week. Meanwhile, the Foreign Secretary is meeting Mr. Shultz on Tuesday and may, when he sees you privately on Monday morning, mention Yugoslavia. In agreement with me his officials are advising him that he will have to content himself with a general expression of political sympathy and no more until the financial position and implications have been further examined. He may find it helpful if you could agree, as I think you can, that he could tell Mr. Shultz that you are likely to be engaged in the problem and discussing it with colleagues including Mr. Regan shortly.

3. I attended yesterday in Paris a meeting promoted by the United States, with Finance and Foreign Ministry representatives from the US, France, UK, Germany and Italy. It became rather clearer than previously (although we are all still anxious to await further enlightenment from the IMF Mission which is at present in Belgrade, just starting a fresh review) that there is a considerable problem of domestic economic adjustment in Yugoslavia, fraught with political difficulties, which contributes to an unsatisfactory current balance of payments position and prospect; but that the adverse numbers which are really hitting Yugoslavia's liquidity at present are the uncertain movements of remittances of emigrant workers, etc., and the attempts by many banks to close outstanding loans as they fall due, and refrain from offering new credit.

4. The US approach struck many of us as amateurish. All other countries present thought that they are underestimating (optimistically) the immediate scale and duration of the problem; they spoke of encouraging commercial banks to maintain the flows of credit,

FROM: C.D.POWELL
DATE: [illegible]

cc Sir [illegible]
Mr. [illegible]
Mr. [illegible]
Mr. [illegible]
Mr. [illegible]

[illegible]

YUGOSLAVIA

You are aware that Yugoslavia has [illegible] on its foreign debt, and that the [illegible] and United States have been approaching a limited number of [illegible] of new support arrangements.

2. The subject will be on the agenda at [illegible], and I will send you a fuller brief after further meetings among officials at the beginning of next week. Meanwhile, the Foreign Secretary is meeting Mr. [illegible] and may need to see you privately on Monday [illegible] Yugoslavia. [illegible] with [illegible] him that he will have to content himself with a general expression of political sympathy and no more until the financial position and implications have been further considered. [illegible] if you could agree, as I think you can, that he could tell [illegible] that you are likely to be engaged in the problem and discussing it with colleagues including Mr. [illegible].

3. [illegible] in terms [illegible] by the United States [illegible] representatives from the US, France, UK, Germany and Italy. It seems rather clearer than previously (although [illegible]) [illegible] that there is a [illegible] Yugoslavia, [illegible] prospects [illegible] that the [illegible] Yugoslavia's [illegible].

4. [illegible]

but seemed to have given little thought to what they would do about US banks. They want to mobilise a $1.5 billion (or perhaps only $1 billion) support arrangement. They suggested the burden should be shared in proportion to outstanding credits. They offered with apparent generosity to subscribe $300 million, but under questioning revealed that they had in mind provision on credit of surplus cereals

5. All present in Paris agreed on the political importance of trying to help Yugoslavia. But all European Finance Ministry representatives, including myself, drew attention to the unsatisfactory state of internal economic policies, and to the impossibility of mounting a successful rescue operation unless commercial banks stay fully in the market, and even add to their exposure. We suspect a tendency for US banks to be pulling out at least as fast as others. Several of us hinted that an orderly and well stage-managed rescheduling might well be a necessary part of any package, and that it might even suffice without special Government support.

6. There was a curious diversion towards the end of the meeting when the French alleged that there had been an understanding at the Venice Summit (June 1980) which they described in elaborate terms (undertakings by the Summit countries to seek to mobilise three tranches of $900 million each, through their commercial banks or otherwise, of which the first tranche had been achieved, but beyond that only a part of the second tranche - including full subscription by France!) The US representative welcomed this "reminder"; the Italian quickly tried to maintain that Italy too had fulfilled its obligations under both first and second tranches. The Germans and I said that we were not aware of any commitment of this kind. (I spoke privately with my German colleague afterwards and found him very angry at the French attempt to bounce us all into something whose existence he firmly denied.) A search of papers here and in the Foreign Office today reveals no such commitment or understanding as the French described, and we have found records of discussions later in 1980 which could not have been written in the terms in which we find them if any such prior understanding had existed.

7. The theme of my brief for you for Kronberg will be:

- willingness to recognise the political importance of helping Yugoslavia, but it must be on sensible terms;

but seemed to have given little thought to what they would do about [illegible]. They want to stabilise at [illegible] billion (or perhaps only [illegible] billion) [illegible] support arrangements. [illegible] suggested the [illegible] should be shared in proportion to net exporting capacities. They offered with apparent generosity to contribute [illegible] billion, but under questioning revealed that they meant [illegible] gift [illegible] of surplus cereals.

5. [illegible] will present in Paris [illegible] on the [illegible] importance of [illegible] to help themselves, not all purposes [illegible]. [illegible] representative [illegible], [illegible] drew attention to the [illegible] state of [illegible] and to the [illegible] of [illegible] unless commercial [illegible] [illegible] fully [illegible] the market, and [illegible] to their [illegible] [illegible] for the [illegible] as [illegible] feel as others. [illegible] that [illegible] [illegible] should be a necessary part of any package, and that it might [illegible] without specific [illegible] support.

6. There was a curious [illegible] towards the end of the meeting when the French alleged that there had been an understanding at the Venice Summit (June 1980) which they described in elaborate terms (undertakings by the [illegible] countries to [illegible] their [illegible] [illegible] through [illegible] commercial terms or otherwise) [illegible] first [illegible] and [illegible] achieved, [illegible] only a part of the [illegible] - [illegible] full substitution by [illegible]). [illegible] representative [illegible] this "revelation"; [illegible] [illegible] to [illegible] that [illegible] two [illegible] its [illegible] [illegible] first and [illegible]. The Germans and I said that we were not aware of any commitment of this kind. [illegible] [illegible] to [illegible] and [illegible] [illegible] [illegible], [illegible] [illegible] [illegible] of paper [illegible] the [illegible].

7. [illegible]

[illegible]

[illegible]

- need to wait for the clearer picture which the IMF Mission alone can give in 3 or 4 weeks' time;

- the almost certain need at some stage for rescheduling, if only to hold some banks in, who would otherwise escape through any help given from other sources;

- resistance to any precipitate and half-baked scheme of the kind which the US are at present advocating.

I would expect your German colleague to approach discussion in a similar spirit, and quite probably the French also, with the Japanese wanting to have as little to do with the problem as possible.

(J. G. LITTLER)

FLAG H

G5 MINISTERS' MEETING - KRONBERG ON 9/10 DECEMBER
POST-VERSAILLES MULTILATERAL SURVEILLANCE

As part of the statement on international monetary undertakings issued with the Versailles communique the Summit partners and especially the five SDR countries agreed to co-operate with the IMF on its work on surveillance. This commitment has taken shape in the form of private meetings between the Finance Ministers of the five SDR countries and the Fund's Managing Director.

2. The first of these took place in the margins of the IMF/World Bank meetings in Toronto. No public report was made but the Managing Director later gave a brief summary of the discussion to the Fund's Executive Directors. He reported that the Fund had played a useful role in these discussions and that the purpose of the meetings in promoting greater awareness and understanding had been fully realised.

3. You will remember that de Larosiere prepared a short personal paper for the G5 meeting in Toronto which we found disappointing but which the Americans found quite acceptable. The paper noted the progress already made in reducing inflation but urged the G5 countries to aim for a further reduction to around 3-5 per cent. At the time he singled out France and the UK as examples where further efforts were required. He warned G5 countries against any policy relaxation, mentioned the need for a cautious US monetary policy and for firm action to be taken except perhaps by Japan to reduce deficits.

4. It was a disappointment in that it did not take up the question of how the G5 countries should co-ordinate their policies. Nor did it point out where the main onus of adjustment should lie. It should have indicated the appropriate policy stance and the main policy adjustments that individual countries needed to secure the health of the world economy and to minimise the disruptive efforts of monetary and exchange rate instability. As it did not address these issues satisfactorily it might be worth raising the possibility of Larosiere producing another better paper.

5. Inflation has been brought down everywhere and Larosiere's 3-5 per cent target, contrary to impressions in September, now may be almost within reach for all SDR countries except France.

6. Perhaps one of the major factors likely to provoke exchange rate realignments in the immediate future is the prospective current account imbalance among the major economies. The growing US deficit together with the large surplus forecast for Japan and Germany will, other things being equal, lead to downward pressure on the dollar and upward pressure on the yen and the DM. Any further falls in US interest rates not matched by falls in Japan and Germany could tend to accentuate these developments. A rising DM could put EMS pressures on the French franc.

7. No date has been set for the next meeting with Larosiere, although it has in principle been understood that the group should meet at least once a year and perhaps every six months. The next Interim Committee meeting, possibly around the middle of February, will be heavily preoccupied with the IMF quota review. This might suggest that a G5 Ministers' meeting in the spring would provide a more suitable opportunity for a discussion with Larosiere prior to reporting back to the Williamsburg Summit.

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JURGENSEN GROUP: STATE OF PLAY

After the approval in Toronto of its work programme and the proposed outline of its Report, the Group has been making its way through a substantial quantity of individual country studies, case studies and empiric (academic) studies.

2. This process is now largely complete. The Group has next to try to consider what general conclusions can fairly be drawn from this material and agree how it might be expressed. Work has begun on the drafting of the Group's Report and there has already been some discussion of the relatively uncontroversial initial sections eg on objectives of intervention. The next meeting of the Group is planned for 16-17 December and two final meetings are scheduled for January 1983.

3. Although the quality of the studies has generally been high and the Group has kept doggedly at its task, it seems unlikely at this stage that the conclusions it reaches will be either unexpected or enormously profound. Nor does it seem likely that it would move the Americans to adopt a significantly more liberal view of the merits of intervention. On the other hand on present form the balance of the analysis seems likely to be well in line with the stance of UK policy in this area. The Report seems likely, for example, to endorse a smoothing role for intervention but to be a good deal more sceptical about any more substantial role in the determination of the level of exchange rates over time.

4. The Group has not yet seriously addressed the question of how best to distil the outcome of its work in a convenient form for Ministers or such questions as public presentation. On the latter point there may well be a disposition in due course to seek agreement to publication of at least some of the underlying studies. Deputies will no doubt wish to consider some of these points. The position is complicated by the likely acceleration of the Interim Committee timetable. Some special arrangements may need to be made for Ministerial consideration of this work before the Williamsburg Summit.

GPS 275 CONFIDENTIAL ~~PS/~~CHANCELLOR, TREASURY

CONFIDENTIAL

DESKBY 070900Z

FROM UKDEL IMF/IBRD WASHINGTON 062235Z DEC 82.

TO IMMEDIATE F C O

TELEGRAM NUMBER 277 OF 6 DECEMBER

INFO BELGRADE.

JK

YUGOSLAVIA: ECONOMIC CRISIS.

1. WHITTOME (EUROPEAN DEPARTMENT) ASKED ABOUT PROGRESS AT THE PARIS MEETING ON 2 DECEMBER. HAVING CHECKED WITH LITTLER, I GAVE HIM A RESUME OF THE MAIN POINTS IN YOUR TELNO 183.

2. WHITTOME THANKED ME FOR THIS INFORMATION. HE WAS CONCERNED THAT THE US WERE GIVING THE YUGOSLAVS AN UNDULY STRONG IMPRESSION THAT THE US WAS PREPARED TO HELP TIDE OVER THE LIQUIDITY CRISIS. A YUGOSLAV DELEGATION IN WASHINGTON LAST WEEK HAD BEEN ''TREATED ROYALLY''. THIS WAS NOT MAKING IT ANY EASIER TO GET AGREEMENT ON A NEW FUND PROGRAMME. HE TOOK NOTE THAT OTHERS AT THE PARIS MEETING HAD ADVISED AT LEAST AN ELEMENT OF RESCHEDULING AND COMMENTED THAT RESCHEDULING WOULD FURTHER STRENGTHEN THE NEED FOR ADJUSTMENT BECAUSE OF THE NEED TO FINANCE DOWNPAYMENTS, WHEREAS A PACKAGE ENTIRELY CONSISTING OF NEW MONEY WOULD PRESENT A SOMEWHAT EASIER OPTION FOR THE YUGOSLAVS.

3. WHITTOME INTENDS TO JOIN THE FUND TEAM IN BELGRADE AT THE END OF THIS WEEK, LEAVING WASHINGTON AT NOON ON 10 DECEMBER. HE SPECULATED THAT G5 MINISTERS MIGHT DISCUSS YUGOSLAVIA AT THEIR MEETING ON 9 DECEMBER AND HOPED THAT HE WOULD SOMEHOW HEAR THE OUTCOME OF THAT DISCUSSION, IF NECESSARY THROUGH THE US EMBASSY IN BELGRADE.

4. FCO PLEASE ADVANCE TO LITTLER AND LAVELLE (HMT), P J BULL (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

ADVANCED AS REQUESTED

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MR EVANS
MR GOODISON
MR THOMAS
MR HANNAY
MR HAYES

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FROM: A R H BOTTRILL
DATE: 6 DECEMBER 1982

1. SIR K COUZENS

2. CHANCELLOR

cc Sir D Wass
Mr Littler
Mr Lavelle
Mr Carey
Mrs Hedley-Miller
Mr Odling-Smee
Mr Atkinson
Mr Graham

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

G5 MINISTERS' MEETING, KRONBERG, 9-10 DECEMBER, 1982

The German Finance Minister, Dr Stoltenberg, has circulated an annotated agenda for this meeting. This steering brief and the individual briefs, therefore, follow the order in that. A copy of the agenda is attached at Flag A, together with a record of the G5 Deputies' meeting in Washington on 10 November which provides the main relevant reference document.

IMF matters

2. There are two key points to the meeting. The first is to establish whether broad G5 agreement can be reached on the main issues surrounding the Quota Review. The second is to consider whether any agreed package can command sufficient support among other Fund members to justify an early meeting of the Interim Committee in January/February.

3. The main issues are:

(i) The size of the quota increase (Flag B): The US still wants to limit the increase to SDR 85 billion, but the other G5 members would be prepared if necessary to raise quotas as high as SDR 100 billion. It depends partly on the size of any extra borrowing arrangement. On tactics, we may need to find out whether the US might be prepared at a later stage to accept a larger quota increase if that would make it easier for the LDCs to accept a reduced quota share or lower access limits. It may be useful for G5 to keep in reserve some bargaining counters like this.

... (ii) Special borrowing arrangement (Flag C): We have been strong advocates of a review of the GAB and can welcome inclusion in the package of a new borrowing arrangement with 'windows' for both existing participants and for the Fund on behalf of other borrowers. A figure of SDR 20 billion would seem appropriate if both needs are to be met, as long as the UK share is not too great. Our share has fallen over the years to about 8 per cent. Illustrative US calculations based on GDP and reserves suggest this is about right but figures based on quotas would be higher.

... (iii) Distribution of quota shares (Flag D): We have favoured publicly the Australian approach (method 3) which would allocate the increase in quotas in line with calculated quota shares. It is fair and straightforward. Others have advocated an equi-proportional element. This causes us no difficulty but we have not supported it so far in the interests of keeping aboard the Japanese who fear it dilutes further the adjustment of quota shares (in their favour).

... (iv) Access to IMF resources (Flag E): We believe that access limits should be reviewed in the light of the results of the quota exercise with a view to phasing out enlarged access gradually as the need for it declines. This should be possible perhaps by the time of the Ninth Quota Review, and suggests the need possibly for a review mid-way through the Eight Quota period. As a first step, access limits may need to be scaled down from the present 450 per cent multiple of quota but we recognise the need to safeguard access in cash terms for all members. At G5 Deputies, we suggested that a minimum/increase of 20 per cent in access for all members might be needed to secure LDC agreement. The Executive Board, however, has not addressed this question and attempts at G5 agreement are probably premature. The best arrangement would be to try to shelve discussion of this until after the Interim Committee agrees the main package, but this may not be possible if LDCs insist.

(v) Other items - remuneration, charges subscriptions and timetable (Flag F): Questions of remuneration, charges and subscription payments are probably best left to the Executive Board rather than tacked onto the main package. On timetable, we believe that a date of mid-1984 rather than end-1983 is more realistic.

I don't think there should be a "G5 package". KEC 7/12

4. It will be important to bear in mind throughout the G5 discussions that any package will need to be acceptable to other Fund members, particularly among the developing countries. The Chancellor, as likely chairman of the next Interim Committee meeting, will have a strong interest in ensuring that the G5 package can command a broad measure of support. The LDC reaction to the putative G5 proposals has so far been muted but it is not difficult to see some potential sticking points. The main ones are likely to be resistance to reduction in quota share or in access limits by those countries such as India which stand to lose either votes or find their future access to finance curtailed.

5. G5 Ministers will need to consider in consultation with the Managing Director, how the package might best be presented to other Fund Members. One possibility would be to table the G5 proposals at the Executive Board to seek reactions. Another would be to ask Larosiere to take informal soundings. A Board discussion might be the most open way. Reliance on Larosiere might tend to cast him in the role as potential broker between G5 and the LDCs, although his good offices would be useful. In either event, the Chancellor may need to avoid being too closely identified with the G5 package if he is also to be chairman.

6. The timing of any early Interim Committee meeting will depend on obtaining sufficient support from both industrial and non-industrial countries for the package. There is a balance to be struck between maintaining momentum and securing consensus. The Executive Board is already scheduled to discuss the distribution of quotas again in early January. It also seems unlikely that LDC and OPEC reactions to any G5 proposals will be clear before then. An Interim Committee in February then would be perhaps the best that could be hoped for. Snags over distribution or access could even jeopardise this. On the other hand, pressures in the real world could reinforce the case for an early move to boost confidence.

(v) Other items - remuneration, charges, subscriptions and timetable (para 2 j): Questions of remuneration, charges and subscriptions/payments are probably best left to the Executive Board rather than tacked onto the main package. On timetable, we believe that a date of mid-1984 rather than end-1983 is more realistic.

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Country questions

7. Dr Stoltenberg has suggested that Ministers discuss Yugoslavia, Mexico, Argentina and Brazil. You have seen Mr Littler's note of 3 December recording last week's discussions about Yugoslavia in Paris and he promised you a separate fuller note. Mexico has signed a letter of intent with the IMF in connection with its application for a SDR 3½ billion loan over three years. The terms, however, are too imprecise to be wholly satisfactory and have been poorly received by commercial banks. We shall be seeking clarification from the Fund. On Brazil, you will be aware that an approach has been made to the Fund for a CFF drawing of SDR 500 million and a three-year EFF loan of SDR 4½ billion. The Brazilians are also seeking more immediate help from industrial countries to meet an alleged short-term need for liquidity. We shall be seeking to ensure that negotiation of a Brazilian programme with the Fund is not as fraught as the Mexican case. Argentina is seeking SDR 1¼ billion from the Fund and has also signed a letter of intent. We have not seen details yet. Background notes on these and other problem countries are at Flag G .

Multilateral surveillance

9. The Toronto meeting with Larosiere to discuss the policies of G5 countries was not wholly satisfactory, and we should perhaps seek a better paper from him next time. This should try to suggest how the balance of policies might be improved both for the group as a whole and for individual countries. The Jurgensen study of intervention in the foreign exchange markets is scheduled to have its final meetings in January. Ministers will want to discuss both topics probably at a future meeting. An early Interim Committee might be too preoccupied with the quota package. This suggests perhaps a spring meeting ahead of the Williamsburg Summit. Briefs on both surveillance and Jurgensen are at Flag H .

Yes, Ktc

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Economic prospects and policies

10. Dr Stoltenberg has relegated this to an optional item 'if time permits', but it seems unlikely that Ministers will not want to spend some time on the present economic situation, particularly in view of the sharp downward revision to forecasts for 1983 since the Toronto meeting. We have argued the case for the need to assess the impact of policies carefully in this situation and to pursue both monetary and fiscal policies flexibly within the broad framework of the strategy to reduce inflation. The new weakness of the dollar and old fact of the growing US budget deficit are two themes which may attract attention. A

... brief is at Flag J.

GATT

... 11. Mr Regan may raise this. A defensive brief is at Flag K.

A. Bottrill

A BOTTRILL

ENC

CONFIDENTIAL

Chancellor

FROM: A R H BOTTRILL
DATE: 7 DECEMBER 1982

SIR K COUZENS

cc Mr Lavelle

AMENDED US PROPOSALS FOR GAB

Dini has circulated the attached note from Sprinkel, spelling out US ideas on what the Fund package should contain and full details of the US proposals for a revised GAB. Although the note is addressed to G10 Deputies it is likely to colour discussions among G5 Ministers.

2. The note is very much as predicted. Much of it we agree with or can go along with. Points of interest or difficulty for us are:

a. The US want agreement (at least within G10) on all elements of the package before the Interim Committee meeting. But some of these (remuneration, payment of quota subscription) cannot really be dealt with even in principle without a Fund paper. And it is tactically wiser to leave as much of the discussion on access limits until after the package has been discussed at the Interim Committee.

b. Para 2. We do not rule out participation in the G10/GAB being extended to Australia, and possibly Spain.

c. Para 4. To maintain better control over access by non-participants, we are suggesting that activation for a series of countries should be for a year at a time, and not open-ended.

d. Para 6. The US are irritatingly talking now of SDR 15-19 billion, ie no higher than US $ 20 billion.

e. Para 7. The US illustrative examples give us a much lower share than we feared (8 per cent for GDP/non-gold reserves key; 9 per cent for calculated quotas key). The Japanese and Germans will probably argue that our share should be higher.

A Bottrill

A BOTTRILL

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CONFIDENTIAL

MESSAGE FOR LAMBERTO DINI AND G10 DEPUTIES
FROM UNDER SECRETARY SPRINKEL AND GOVERNOR WALLICH

Dear Lamberto:

Pursuant to our discussion at the G10 Deputies meeting on November 29 1982 we enclose a proposed outline of the main elements of a revised and expanded general arrangements to borrow.

This outline attempts to reflect the principal points made at the meeting and the general sense of direction that appeared to emerge from the discussion. The outline assumes that modifications of the GAB would be kept to the minimum necessary to achieve desired changes, but does not suggest specific drafting changes that would need to be made in the existing GAB agreement. To help facilitate our discussions, we have asked the IMF staff to prepare and provide to us prior to our next meeting draft amendments to the GAB decision and associated letter that would give effect to the outline we have proposed.

The United States would be prepared to support a modification of the GAB along the lines set forth in the enclosed outline. But as we indicated during the discussion November 29, our support would be contingent upon reaching agreement on an overall package of measures. We believe that --- in addition to an expanded GAB --- there needs to be a clear understanding within the Group on the following elements of a comprehensive package:

(1) the size and distribution of the quota increase;
(2) changes in enlarged access policy;
(3) changes in access under, and the conditionality of, the compensatory financing facility;
(4) adjustments to the rate of remuneration and IMF charges on ordinary resources; and
(5) the payment of the quota subscription.

We recognise that you and others are concerned that Ministers not be burdened with unnecessary detail at the Interim Committee. We do not believe it is necessary that all of these elements be

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(5) the payment of the quota subscription.

We recognize that you and others are concerned that Ministers not be burdened with unnecessary detail at the Interim Committee. We do not believe it is necessary that all of these elements be discussed in detail at the Interim Committee, but we do feel that agreement on these other elements at the same time is essential in order to move ahead on the quota increase and GAB expansion. The details of some of these matters can, of course - as you indicated - be sorted out in the executive board, but agreement among us in principle on all elements should in our view be reached by the time of the Interim Committee meeting.

We would appreciate it if you would circulate this note and outline to the Deputies (we are providing it to the G10 Executive Directors here in Washington). We hope that this will help provide a basis for our next discussion on these issues.

Sincerely, BERYL W. SPRINKEL, HENRY C. WALLICH

cc: Managing Director De Larosiere

Text of enclosure follows:

Proposed outline of main elements of a revised and expanded general arrangements to borrow.

1. CONCEPT. IMF quotas would remain the principal source of IMF resources to meet the ordinary balance of payments financing requirements of its members. The broad purpose of the GAB would remain to supplement the IMF's resources if needed, to forestall or cope with an impairment of the international monetary system. The arrangements would provide standby lines of credit in favour of the IMF which could be activated to finance or help finance IMF drawings by any IMF member country, under prescribed circumstances,to deal with extraordinary situations that could pose a threat to the stability of the international monetary system. Conditions and procedures for activation by participants would be unchanged: e.g. the GAB could be activated to finance reserve tranchedrawings by participants. In order to insure the liquidity of reserve claims on the IMF arising in part from extensions of credit by participants to the IMF under the arrangements. The arrangements could be activated to finance IMF drawings by

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non-participants only in conjunction with upper credit tranche or extended Fund facility programs. Activation would not be effective in advance of IMF Executive Board approval of such programs.

2. PARTICIPATION. Participation would remain unchanged at present. However, it would be envisaged that a number of countries not participants in the GAB but willing to make a commitment could establish parallel arrangements for lending to the IMF that could be called upon under the same circumstances that apply to the GAB. The minimum for new adherents should probably be raised significantly.

3. CRITERIA FOR ACTIVATION FOR NON-PARTICIPANTS.
(A) Unlike the present GAB, whose use is limited to financing IMF drawings by countries that participate in the GAB, the revised GAB could be activated to finance IMF drawings by other IMF member countries if the following criteria were met:-

(1) that a potential systemic threat requiring additional IMF resources existed (this might involve a potential IMF request by a single country or a series of countries with balance of payments problems a character or size that could pose a threat to the stability of the international monetary system;
(II) the possible financing

(III) theresources would be used in conjunction with upper credit tranche or extended fund facility programs.

(B) DECISIONS ON ACTIVATION OF THE ARRANGEMENT WOULD PAY DUE REGARD TO THE POTENTIAL FOR CALLS ON THE ARRANGEMENT TO FINANCE IMF DRAWINGS BY PARTICIPANTS IN THE ARRANGEMENT.

4. Procedures for activation for non-participants. Procedures for calls, voting and activation could be as set out in paragraphs 6 and 7 of the existing Executive Board decision on the GAB and the supporting letter from Minister Baumgartner of December 15 1961, except that agreed criteria for activation would be reflected in these paragraphs; procedures for early consultations between the Managing Director and participants on the possibility of activating the

arrangements would need to be assured; the need for consultative meetings and reviews as described in paragraph (F) of the Baumgartner letter might be modified.

5. TERMS AND CONDITIONS. Obligations under the arrangement would be denominated in SDR. Advances to the IMF under the arrangement would earn interest at the average of interest rates on five-year Government securities in the countries whose currencies comprise the SDR, and the ½ per cent charge now levied would be eliminated. All other provisions relating to evidence of indebtedness, interest and charges, use of borrowed currency, repayment by the Fund, rates of exchange, transferability and notices, would be as set forth in paragraphs 8-14 of the existing GAB decision.

6. SIZE. The size of the arrangement would be of the order of SDR 15-19 billion, taking into account existing GAB commitments, the size of the quota increase and the desire to provide a credible back-up arrangement for the IMF.

7. SHARES. The financing obligations of individual participants should be broadly reflective of their size and roles in the international economy and of their ability to provide financing to the IMF. Numerous "keys" have been suggested and discussed in the past. One key that suggests itself in particular, as indicative of these considerations, would be based on an average of shares of GDP and foreign reserves excluding gold. Others have suggested that calculated IMF quotas, or IMF quotas effective after the current increase, might serve as an appropriate key. No such keys are necessarily a determinant of precise participation. However, they can serve as the basis for discussion, which would presumably take into account participation in other lending arrangements vis-a-vis the IMF such as the supplementary financing facility. Illustrative tables of participation for present GAB participants and Switzerland, based on SDR 15 billion and SDR 18.7 billion arrangements and keys based on shares of GDP/non-gold reserves and calculated quotas, are attached. The agreement of other countries to provide financing to the IMF in parallel with the

arrangements would need to be assured; the need for consultative meetings and reviews as described in paragraph (F) of the Baumgartner letter might be modified.

5. TERMS AND CONDITIONS. Obligations under the arrangement would be denominated in SDR. Advances to the IMF under the arrangement would earn interest at the average of interest rates on five-year Government securities in the countries whose currencies comprise the SDR, and the ½ per cent charge now levied would be eliminated. All other provisions relating to evidence of indebtedness, interest and charges, use of borrowed currency, repayment by the Fund, rates of exchange, transferability and notices, would be as set forth in paragraphs 8-14 of the existing GAB decision.

6. SIZE. The size of the arrangement would be of the order of SDR 15-19 billion, taking into account existing GAB commitments, the size of the quota increase and the desire to provide a credible back-up arrangement for the IMF.

7. SHARES. The financing obligations of individual participants should be broadly reflective of their size and roles in the international economy and of their ability to provide financing to the IMF. Numerous "Keys" have been suggested and discussed in the past. One key that suggests itself in particular, as indicative of these considerations, would be based on an average of shares of GDP and foreign reserves excluding gold. Others have suggested that calculated IMF quotas, or IMF quotas effective after the current increase, might serve as an appropriate key. No such keys are necessarily a determinant of precise participation. However, they can serve as the basis for discussion, which would presumably take into account participation in other lending arrangements vis-a-vis the IMF such as the supplementary financing facility. Illustrative tables of participation for present GAB participants and Switzerland, based on SDR 15 billion and SDR 18.7 billion arrangements and keys based on shares of GDP/non-gold reserves and calculated quotas, are attached. The agreement of other countries to provide financing to the IMF in parallel with the

GAB could augment the amounts available or affect the commitments suggested in these tables.

8. ENTRY INTO FORCE. The expansion of the GAB would take effect when it had been adhered to by at least seven countries with credit lines amounting to not less than 80 per cent of the agreed total.

TABLE 1. Illustrative participation in expanded general arrangements to borrow (SDR millions)

(AA)
ASSUMPTIONS: SIZE -- SDR 18.7 billion (20 billion equivalent)
KEY -- average of shares of GDP and non-gold reserves (BB)

COUNTRY	PRESENT GAB COMMITMENT	NEW GAB COMMITMENT	INCREASE IN GAB COMMITTMENT
BELGIUM	142.5	410.3	267.8
CANADA	162.2	522.2	360.0
FRANCE	394.7	1,715.9	1,321.2
GERMANY	1,527.7	3,506.4	1,978.7
ITALY	234.9	1,492.1	1,257.2
JAPAN	1,227.1	2,853.6	1,626.5
NETHERLANDS	244.2	708.7	464.5
SWEDEN	78.5	354.4	275.9
SWITZERLAND	372.1	876.6	504.5
UNITED KINGDOM	573.7	1,492.1	918.4
UNITED STATES	1,865.1	4,718.7	2,85
TOTAL	6,822.7	18,650.6	11,828.3

TABLE 2: ILLUSTRATIVE PARTICIPATION IN EXPANDED GENERAL ARRANGEMENTS TO BORROW (SDR MILLIONS) (AA)
ASSUMPTIONS: SIZE -- SDR 15 BILLION= KEY -- AVERAGE OF SHARES OF GDP AND NON-GOLD RESERVES (BB)

COUNTRY	PRESENT GAB COMMITMENT	NEW GAB COMMITMENT	INCREASE IN GAB COMMITMENT
BELGIUM	142.5	330.0	187.5
CANADA	162.2	420.0	257.8
FRANCE	394.7	1,380.0	985.3
GERMANY	1,527.7	2,820.0	1,292.3
ITALY	234.9	1,200.0	965.1
JAPAN	1,227.1	2,295.0	1,067.9
NETHERLANDS	244.2	570.0	325.8
SWEDEN	78.5	285.0	206.5
SWITZERLAND	372.1	705.0	332.9
UNITED KINGDOM	573.7	1,200.0	626.3
UNITED STATES	1,865.1	3,795.0	1,929.9
TOTAL	6,822.7	15,000.0	8,177.3

TABLE 3: ILLUSTRATIVE PARTICIPATION IN EXPANDED GENERAL ARRANGEMENTS TO BORROW (SDR MILLIONS) (AA)
ASSUMPTIONS: SIZE -- SDR 18.7 BILLION (20 BILLION EQUIVALENT)= KEY -- CALCULATED QUOTAS (BB)

BELGIUM	142.5	876.6	734.1
CANADA	162.2	895.2	733.0
FRANCE	394.7	1,809.1	1,414.4
GERMANY	1,527.7	2,667.1	1,139.4
ITALY	234.9	1,193.7	958.8
JAPAN	1,227.1	2,163.5	936.4
NETHERLANDS	244.2	988.5	744.3
SWEDEN	78.5	447.6	369.1
SWITZERLAND	372.1	932.5	560.4
UNITED KINGDOM	573.7	1,678.6	1,104.9
UNITED STATES	1,865.1	4,998	3,133.3
TOTAL	6,822.7	18,650.8	11,828.1

TABLE 4: ILLUSTRATIVE PARTICIPATION IN EXPANDED GENERAL ARRANGEMENTS TO BORROW (SDR MILLIONS) (AA)

ASSUMPTIONS: SIZE -- SDR 15 BILLION= KEY -- CALCULATED QUOTAS (BB)

CUNTRY	PRESENT GAB COMMITMENT	NEW GAB COMMITMENT	INCREASE IN GAB COMMITMENT
BELGIUM	142.5	705.0	562.5
CANADA	162.2	720.0	557.8
FRANCE	394.7	1,455.0	1,060.3
GERMANY	1,527.7	2,145.0	617.3
ITALY	234.9	960.0	725.1
JAPAN	1,227.1	1,740.0	512.9
NETHERLANDS	244.2	795.0	550.8
SWEDEN	78.5	360.0	281.5
SWITZERLAND	372.1	750.0	377.9
UNITED KINGDOM	573.7	1,350.0	776.3
UNITED STATES	1,865.1	4,020.0	2,54.9
TOTAL	6,822.7	15,000.0.	8,177.3

FOOTNOTES FOR TABLE 1: (AA) ALL FIGURES AT EXCHANGE RATES OF SEPTEMBER 30, 1982= (BB) 1980 +0= AUGUST 1982 RESERVES.

FOOTNOTES FOR TABLE 2: KAA)ALLLL FIGURES AT EXCHANGE RATES OF SEPTEMBER 30, 1982= (BB) 1980 GDP= AUGUST 1982 RESERVES.

FOOTNOTES FOR TABLE 3: (AA)-ALL FIGURES AT EXCHANGE RATES OF SEPTEMBER 30, 1982: (BB) 1AASSUMED SWISS SHARE OF 5 PERCENT.

FOOTNOTES FOR TABLE 4: KAA) ALL FIGURES AT EXCHANGE RATES OF SEPTEMBER 30, 1982= (BB)AASSUMED SWISS SHARE OF 5 PERCENT.

7/12/82.

C Advice is virtually ready, & guided.

EXCHEQUER
-7 DEC1982
ACTION
COPIES TO
Mr Carey.
Sir K. Couzens
Mr Lovelle
Mr Hawtin
Mr Denison
Mr Littler.

FCS/82/204

CHANCELLOR OF THE EXCHEQUER

Yugoslavia: Economic Crisis

1. At our meeting yesterday we touched on the outcome of the meeting in Paris on 2 December of officials of Yugoslavia's five main Western creditors at which the Americans put forward their proposal for a special assistance package to help Yugoslavia overcome its acute liquidity problem in the first half of 1983. I enclose for ease of reference a copy of the reporting telegram. The problem is on the agenda for discussion at the traditional Berlin meeting of the French, Germans, Americans and ourselves before the NATO Ministerial Meeting on 9 December. I expect to come under heavy pressure from George Shultz to take part in this operation. I also understand that Yugoslavia is on the agenda of a meeting you will be attending on 9 December with the Finance Ministers of some of our closest allies.

2. As you know, the next meeting of officials of the five countries will be in Paris on 14 December. I consider it important that at that meeting we should be able to play a positive part in any conclusions that might be reached about how to assist Yugoslavia.

3. I do not underestimate the difficulties involved. But in my view there are three reasons why we should be prepared to provide some extra assistance for Yugoslavia:

a. the Yugoslavs have publicly set their faces against rescheduling. They will take time to be brought round to the view that this should comprise an element, even a major one, of any package that might be offered them;

b. if while we are discussing the matter among ourselves, or with the Yugoslavs, the Commercial banks call in their

/short

short term deposits (currently about $1.6 billion) the problem, both financially and politically will become a great deal more difficult to manage;

c. if, on 14 December, we are the only country not prepared to do anything over and above debt relief for Yugoslavia, I would expect this to get back to the Yugoslavs very quickly with serious short term and long term economic and political effects on our interests.

4. The sort of package I have in mind would contain, as an essential pre-requisite, a tight IMF programme together with an element of debt relief and some special assistance, in whatever form. I hope that our officials can work urgently on a position on these lines in preparation for the 14 December meeting. My officials will have some specific ideas to put forward on the question of the form our special assistance contribution might take.

5. I am sending copies of this minute to the Prime Minister, the Secretary of State for Trade, the Governor of the Bank of England and Sir Robert Armstrong.

(FRANCIS PYM)

Foreign and Commonwealth Office
7 December 1982

OO BELGRADE
PP ROME
GRS 1002
CONFIDENTIAL

FM FCO 031300Z DEC 82
TO IMMEDIATE BELGRADE
TELEGRAM NUMBER 183 OF 3 DECEMBER
INFO IMMEDIATE COPENHAGEN (FOR EVANS AND BULLARD), UKDEL IMF/IBRD WASHINGTON
INFO PRIORITY WASHINGTON, BONN, PARIS, ROME
INFO ROUTINE UKDEL NATO
INFO SAVING UKDEL OECD, MOSCOW
YUGOSLAVIA : ECONOMIC CRISIS

SUMMARY

1. A MEETING IN PARIS ON 2 DECEMBER UNDER FRENCH CHAIRMANSHIP, ATTENDED BY REPRESENTATIVES FROM THE UK, FRG, US AND ITALY DISCUSSED YUGOSLAVIA'S ACUTE FINANCIAL PROBLEM. THE UNITED STATES PROPOSED THAT,TOGETHER WITH OTHER WESTERN CREDITORS,DOLLARS 1 BILLION OF GOVERNMENT-BACKED FINANCIAL ASSISTANCE SHOULD BE MADE AVAILABLE. THE US WAS PREPARED TO COMMIT ITSELF IN PRINCIPLE TO CONTRIBUTING. NO OTHER DELEGATION MADE A SIMILAR COMMITMENT AND OTHER OPTIONS FOR ASSISTING YUGOSLAVIA WERE ALSO CONSIDERED, INCLUDING RESCHEDULING IN SOME FORM. THE GROUP AGREED TO MEET AGAIN ON 14 DECEMBER TO SEE IF THERE WAS COMMON AGREEMENT TO ASSIST YUGOSLAVIA AND IF SO IN WHAT WAY.

2. DISCUSSION COVERED THE POLITICAL, ECONOMIC AND FINANCIAL ASPECTS OF THE PROBLEM.

POLITICAL

3. WITH THE US TAKING THE LEAD, THERE WAS AGREEMENT ON THE STRATEGIC AND POLITICAL IMPORTANCE OF MAINTAINING YUGOSLAVIA'S NON-ALIGNED STATUS. PAYE (FRANCE, CHAIRMAN) EMPHASISED THE POLITICAL AND STRUCTURAL FRAGILITY OF YUGOSLAVIA POST-TITO, THE ADDITIONAL STRAINS BROUGHT ABOUT BY ECONOMIC

AUSTERITY MEASURES NOW BEING PURSUED, THE VULNERABILITY OF THE COUNTRY TO EASTERN PRESSURES AND THE POLITICAL SENSITIVITY OF THE GOVERNMENT TO CERTAIN FORMS OF FINANCIAL ASSISTANCE.

ECONOMIC

4. ALL WERE AGREED THAT THERE WERE BASIC STRUCTURAL ECONOMIC WEAKNESSES (FEDERAL STRUCTURE OF THE COUNTRY, SELF-MANAGEMENT SYSTEMS, ETC). THESE REQUIRED MEDIUM/ LONG TERM TREATMENT AND APPROPRIATE IMF PROGRAMME. BUT THERE WAS AN IMMEDIATE FINANCIAL CRISIS REQUIRING URGENT ATTENTION.

FINANCIAL

5. MEISSNER (US) SAID THE IMMEDIATE PROBLEM WAS THE FINANCING GAP. THE MAIN ELEMENT WAS BANKING CONFIDENCE. MORE THAN A QUICK-FIX WAS NEEDED. ANY SOLUTION SHOULD LEAD INTO A LONGER TERM RESTRUCTURING AND CHANGES IN THE YUGOSLAV ECONOMY. RESCHEDULING WAS NOT THE RIGHT APPROACH. IT WOULD INCREASE LACK OF CONFIDENCE AND PRECIPITATE THE PROBLEM WE WISHED TO AVOID.

6. DISCUSSION TURNED TO THE FIGURES CIRCULATED BY THE AMERICANS (COPIES BY BAG). MOST DELEGATIONS QUESTIONED THE US ASSUMPTION ABOUT THE FINANCING GAP. MEISSNER EVENTUALLY ACCEPTED THAT IT WOULD BE AT LEAST DOLLARS 1.5 BILLION. SMITH (BANK OF ENGLAND) SAID THE IMF TEAM NOW IN BELGRADE MIGHT FIND THAT IT WAS WORSE.

7. MEISSNER SPELT OUT THE US PROPOSAL:

A. YUGOSLAVIA SHOULD HAVE DOLLARS 1 BILLION FOR THE FIRST SIX MONTHS OF 1983.

B. A PUBLIC STATEMENT OF INTENT SHOULD BE MADE BY LATE DECEMBER OR EARLY JANUARY.

C. THE FINANCIAL ASSISTANCE WOULD BE PART OF A PACKAGE INCLUDING AN IMF PROGRAMME, YUGOSLAV UNDERTAKINGS TO MAKE STRUCTURAL ADJUSTMENTS,AND INFORMAL UNDERSTANDINGS WITH THE COMMERCIAL BANKS.

D. ALL HARD CURRENCY CREDITORS WOULD BE INVITED TO CONTRIBUTE, WITH BURDEN SHARING BASED ON THE APPROXIMATE RATIO OF PRESENT CREDIT EXPOSURE.

8. FRENCH COMMENTS REVEALED A SLIGHT DIFFERENCE OF EMPHASIS BETWEEN QUAI AND TRESOR. CAMDESSUS (TRESOR) SUGGESTED DEFERRING A DECISION TO GIVE TIME FOR A 'PEDAGOGIC EXCHANGE' WITH THE YUGOSLAVS IN WHICH THEY MIGHT BE BROUGHT TO APPRECIATE THE ADVANTAGES OF RESCHEDULING. PAYE (QUAI) STRESSED, HOWEVER, THAT SOMETHING ALSO NEEDED TO BE DONE TO DEAL WITH THE IMMEDIATE PROBLEM OF CONFIDENCE.

9. SARCINELLI (ITALIAN TREASURY) SAID THAT IF THE CREDITORS COULD CONVINCE THE MAJOR BANKS TO PROVIDE NEW LOANS THE PROBLEM WOULD BE RESOLVED. BUT ALL BANKS MAJOR AND MINOR WOULD NEED SIMILAR TREATMENT. HE MENTIONED SOME DEGREE OF RESCHEDULING AS A WAY OF LOCKING IN THE BANKS.

10. LOECK (FRG) THOUGHT THAT RESCHEDULING AND NEW LOANS WERE NOT ALTERNATIVES. IT WAS DIFFICULT, IF NOT IMPOSSIBLE, TO FIND THE MEANS TO COVER THE FINANCING GAP QUICKLY. RESCHEDULING HAD THE ADVANTAGE OF REDUCING THE AMOUNT OF FINANCE REQUIRED. BUT IT WAS QUITE CLEAR THAT NECESSARY BUILDING OF CONFIDENCE COULD NOT BE SOLVED BY RESCHEDULING ALONE: SOME NEW MONEY WAS ALSO NEEDED.

11. LITTLER (UK) RECOGNISED THE POLITICAL IMPORTANCE OF HELPING YUGOSLAVIA. BUT WE SHOULD NOT RULE OUT RESCHEDULING. THE TERM COVERED A WHOLE VARIETY OF OPTIONS. IT COULD BE PRESENTED AND PACKAGED IN MANY WAYS. IT WOULD BE A PITY IF THE IMF GAVE THE YUGOSLAVS THE IMPRESSION THAT RESCHEDULING, IN WHATEVER FORM, WAS RULED OUT. IN ANY OVERALL PACKAGE

12. PAYE INITIATED A DIFFUSE DISCUSSION OF THE 'VENICE DECLARATION' (JUNE 1980 ECONOMIC SUMMIT). HE CLAIMED THAT IF COMMITMENTS WERE HONOURED YUGOSLAVIA WOULD OBTAIN THE NECESSARY FUNDS. IT WAS CLEAR THAT PAYE CONSIDERED FRANCE HAD PLAYED A FULL PART AND SAW THIS AS A WAY OF REDUCING A FRENCH CONTRIBUTION TO ANY FUTURE PACKAGE. THE ITALIANS DID NOT RESPOND NEGATIVELY. LOECK RESISTED THE SUGGESTION STRONGLY. IF IT WAS PURSUED THE GERMANS WOULD WISH THE TOTALITY OF PAST CONTRIBUTIONS TO BE TAKEN INTO CONSIDERATION. WE SUPPORTED THEM. MEISSNER OPPOSED THE SUGGESTION ON THE

GROUNDS THAT IT WOULD OPEN UP A TIME WASTING DISCUSSION OVER BURDEN SHARING.

13. AFTER CONSIDERABLE FURTHER DISCUSSION AND ONE OR TWO ATTEMPTS TO SUM UP, PAYE CONCLUDED THAT:

A. THE IMF MISSION MIGHT PROVIDE BETTER CURRENT INFORMATION ABOUT THE YUGOSLAV ECONOMY, GOVERNMENTS SHOULD HOWEVER PROCEED IN PARALLEL:

B. DELEGATIONS PRESENT WOULD REFER TO THEIR GOVERNMENTS TO SEE WHETHER THEY WERE PREPARED TO STATE THEIR INTEREST IN HELPING YUGOSLAVIA:

C. IF THEY WERE THEY SHOULD DEFINE WHAT TYPE OF HELP EG PERSUADE THE COMMERCIAL BANKS TO EXTEND NEW CREDITS: NEW GOVERNMENT MONEY SEMI-COLON OR GOVERNMENT GUARANTEED LOANS

D. WHAT CONDITIONALITY SHOULD APPLY

E. HOW TO PRESENT A PACKAGE:

F. HOW TO BRING IN OTHER COUNTRIES (MEISSNER CLAIMED TO OTHER WESTERN COUNTRIES WERE WILLING TO CONTRIBUTE):

G. THOSE PRESENT WOULD RECONVENE ON 14 DECEMBER.

PYM

LIMITED
EESD
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CSCE UNIT
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WED
ESID
TRED
PLANNING STAFF
ERD
PUSD

NEWS D
INFORMATION D
PS
PS/MR RIFKIND
PS/PUS
SIR J BULLARD
MR EVANS
MR GOODISON
MR THOMAS
MR HANNAY
MR HAYES

ADDITIONAL DISTRIBUTION
EASTERN EUROPEAN ECONOMIC

20/3/12

7/12/82.

SIZE OF THE QUOTA INCREASE

Points to make

1. We recognise that SDR 85 bn, in conjunction with the rest of the package (particularly acceleration of the next quota review to January 1989 - on which we set great store) might meet the financing needs of the fund as currently foreseen.

2. BUT (a) we doubt that SDR 85 bn would give the right confidence-building signals to the markets;

(b) SDR 85 bn gives very little room for selective increases for individual members;

(c) most unlikely that we could quickly sell SDR 85 bn to other industrial and developing countries, so there is the risk that entire package would be delayed.

3. Thus we prefer an increase to SDR 90-100 bn. Final position within this range should reflect decision on size of GAB increase. If GAB increased to only SDR 15 bn, then quota increase of SDR 100 bn looks appropriate. With higher GAB figures, the quota increase could be smaller.

Background

4. At G5 Deputies, US advocated SDR 85 bn; UK and Germany could accept any point within the range SDR 85-100 bn (but in our case below SDR 90 bn only if the package was likely to attract wider support); France SDR 90-100 bn; Japan SDR 100 bn (perhaps less if the distribution of quota shares was right).

5. Since G5 Deputies met, the Executive Board has again considered the question. Apart from UK Germany, and US, all Directors could support an increase in Fund size to SDR 100-125 bn; their support for this range did not ostensibly assume any increase in the GAB or acceleration of implementation of both this and the next review. If the increase in the GAB (from SDR 6½ bn to SDR 15-20 bn) is added to the sort of figures for a quota increase being canvased in G5) the divergence between G5 and the rest is greatly narrowed. This is particularly so in respect of the useable addition to Fund resources: only half a quota increase would be in useable currencies, but most if a GAB increase.

6. Our estimate of demands upon Fund resources in the middle-late 1980's has somewhat altered qualitatively, though we emerge with the same range of SDR 90-100 bn as before. The probably pattern is for LDC deficits to be rather lower than we expected (reflecting more rapid adjustment by Latin American economies) but for the Fund to finance a rather larger share of them (reflecting lower growth of commercial bank lending). We had assumed that the Ninth Quota Increase would come into effect in 1990, and foresaw the balance of available Fund resources falling as net lending gradually increased. The prospect of the Ninth Quota increase being

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implemented two years earlier reduces the likelihood of the Fund running short of resources at the end of the period, and could legitimately be grounds for a slightly lower increase in quotas now.

7. The trade-off between the size of the GAB increase and the size of the quota increase is only one of the factors which will affect the final size of the Fund. Probably more important is the willingness of the US to accept a quota increase beyond SDR 90 bn. A further factor is the effect on quota shares and ranking. If the quota increases are all distributed pro rata with calculated quotas (method 3 or "Australian" method), the Japanese would overtake the French at just under SDR 95 bn and the Germans would overtake the UK at just over SDR 95 bn.

FLAG C

SPECIAL BORROWING ARRANGEMENTS

POINTS TO MAKE

(Following comments follow the order of questions in Stoltenberg's cable).

(a) Agree that special borrowing arrangement should be part of the package. It is a key selling point for a quota increase below LDC expectations. It is also a wider confidence-boosting element.

(b) We favour figures at the top end of the range, and provision for its size to be reviewed at each quota review. Even an increase to SDR20 billion would hardly restore the GAB to its original level in real terms, let alone allow it to embrace new functions. If the facility is limited to SDR15 billion, then a quota increase to SDR100 billion would be appropriate.

(c) Access to GAB by G10 participants should remain basically unchanged (ie no question of having to demonstrate a crisis first, GAB can be mobilised to finance G10 drawings of their reserve positions). Activation of the new window for non-participants should be confined to high-conditionality lending in times of major strain in the international system when the Fund's quota-based resources are insufficient. The Enlarged Access arrangements agreed in 1980 are a good model.

(d) Procedures for activation should follow the sequence of a proposal by the Managing Director, acceptance by the G10, but decisions on individual countries' programmes should remain with Executive Board. On the German reservation. There must be some flexibility for Executive Board to decide the precise amounts of GAB each recipient gets, perhaps even the precise list of recipients. But there needs to be some constraint - in particular to ensure that once the emrgency goes away, access to GAB credit is wound down. This could be achieved by activating a round sum credit line, but the credit line lapses after say a year, unless the Managing Director makes a fresh proposal.

(e) We agree the need for parallel arrangements for Saudi Arabia. We expect the Swiss to be offered full G10 membership if and when they join the Fund. If Australia, and perhaps Spain, also want G10 membership, it might help spread the burden more widely. We do not have to arrive at a decision on GAB shares yet. We sympathise with the German and Japanese view that their present share of the GAB is too high. UK should not, however, be expected to shoulder the same share as in 1962. GAB shares need fundamental review. Quota shares are not a particularly good indicator of ability to tend: reserves and GDP should be given rather greater weight. Following the review GAB contributions should be SDR-denominated to prevent fortuitous shifts in shares as a result of exchange rate changes between reviews.

(f) We prefer separate window within GAB for non-participants. Total integration is ruled out because of different conditions of access for participants and non-participants. Completely separate facilities does not allow the flexibility of moving GAB resources from the existing to the second window or vice versa depending on the circumstances at the time.

(g) Interest rate may depend upon whether foreign exchange or national currencies are provided. If foreign exchange, then market rates are appropriate: Saudis will undoubtedly expect market rates for their parallel contribution, and provision of foreign exchange at less than market rates would cause legislative difficulties for us. If national currencies (as provided now to existing GAB), then we still prefer a market rate, since we would need to borrow the money domestically at market rates.

- Opting out arrangements should be available as at present.

- We agree that loan claims under the GAB should be liquid and easy to mobilise, so as to ensure their reserve asset character.
- We agree that the arrangement should be reviewed at the time of the Ninth Quota Review. It is ,however, assumed widely that the arrangement will be permanent (as distinct from existing bilateral arrangements with Saudi Arabia etc).

Background

1. The US proposals have not yet been widely circulated. Apart from the G5 Deputies' discussion, there has been a generally satisfactory response from G10 Deputies and the EC Finance Council dinner in November. On 2 December the US circulated documentation to an informal meeting of G10 Executive Directors at the Fund, and Dini is circulating it to G10 Deputies for their discussion on 10 December. A copy is attached at Flag ...

2. Discussion has so far stressed the benefits of grafting the US ideas onto the existing GAB, partly because legislatures (especially US Congress) may thereby look at it with less scepticism, and partly because it removes some of the snags associated with Mr Sprinkel's original ideas. Debate now seems to be mainly concentrated on the criteria for activation, the question of participation in the new-style GAB and the question of comparative access for participants and non-participants.

3. We ourselves have been strong advocates in the Fund of reviewing the size of the existing GAB, which has remained essentially at its original level of SDR 6½ billion since it was set up in 1962. Then, the GAB was equivalent to 60 per cent of G10 quotas, now only 20 per cent (and less still after the Eight Quota Review). Similarly, the GAB has fallen from 15 per cent of G10 reserves to 4 per cent.

4. Our earlier thinking was that an increase in quotas to SDR 90-100 billion should provide adequate resources for the needs of non-oil developing countries in the late 1980s, but a sufficiently large GAB (in our view SDR 15-25 billion) was still needed to meet G10 contingencies. An enlargement of the GAB to SDR 15-20 billion, even if its scope is extended to provide finance for LDCs in a crisis, goes some way towards this. We prefer SDR 20 billion (if we can get it without committing ourselves to an unduly large share), and would like to see it further augmented by parallel lending by Saudi Arabia.

Giving it a dual role of providing resources for on-lending to LDCs is not too troublesome. Widespread LDC deficits should not as a general rule coincide with widespread deficits among G10 members; and even if they did, the G10 would be free to ensure that their own needs should be fully catered for before allowing GAB resources to be lent out to non-participants. The Americans no longer seem to envisage two independent pools of money for GAB participants and non-participants but rather two windows into the same facility. We can welcome this as a more flexible structure.

6. This fundamental revamping of the GAB provides a suitable opportunity for correcting other anomalies. Interest rates on GAB lending are far too low - the only outstanding loan (in support of a US reserve tranche drawing) earns the Germans and Japanese a fixed rate of only 4 per cent. Our aim was to see the interest rate on national currencies provided through the GAB lifted to at least the rate of remuneration earned on national currencies provided under quota subscriptions (currently 7.57 per cent) and to see it float with subsequent quarterly changes in the rate of remuneration. (One point needs clarifying here - do the US envisage the G10 providing national currencies to each other but foreign exchange for lending to non-participants? Or are all loans to be national currencies, or all in foreign exchange? This has some importance because the case for a market rate of interest on loans of foreign exchange is a strong one, particularly because the Saudis would expect no less for their own parallel lending).

7. A second anomaly concerns the denomination of GAB obligations, (as distinct from the denomination of the vehicle currencies). Obligations are still expressed in national currencies, although exchange rate changes since 1962 have significantly affected their present values in SDR terms. There is a widespread view that future obligations should be expressed in SDR terms. This would bring them into line with the SDR denomination of both quota subscriptions and bilateral lending to finance Enlarged Access.

8. The distortions of existing GAB shares will also have to be corrected. Thanks to exchange rate changes since 1962, the Germans and Japanese are carrying too much of the burden, and we ... are shouldering too little. I attach a table prepared by the Bank which examines what the GAB shares might be on various assumptions. We might be in line for about 10-12 per cent, instead of the present 8 per cent. In the past GAB participation has been seen as unattractive, and there have been frequent wrangles over who should provide how much. Increasing the interest rate to a market level, SDR-denomination, and clear provisions for opting out should cut out much of the financial penalty and risk of lending through the GAB.

9. On the issues under active discussion:

(a) <u>Criteria for activation</u>. We see slightly different criteria for activating the two windows. There seems little reason to change the criteria for activating the existing window for GAB participants (ie a stated requirement from a specific member for a reserve tranche drawing or a credit drawing under any facility, where the Managing Director, after consultation, considers that the drawing "is necessary in order to forestall or cope with an impairment of the international monetary system and that the Fund's resources need to be supplemented for this purpose").

But at the second window for non-GAB participants, there might need to be three changes. First, the wording on "impairment of the international monetary system" could be tightened to reflect more the view that the second window is available only in a more serious emergency. Secondly, drawings should only be available to finance upper credit tranche drawings involving high conditionality and payments imbalances which are serious in relation to quota.

Thirdly, because it is undesirable that the Managing Director should keep on coming back to the G10 for a large number of fairly small drawings, there should be provision for lines of credit to be made available in round sum for periods of say a year at a time which the Executive Board may assign to individual programmes which fulfil the criteria. We envisage that the second window could be activated at an early stage to finance drawings under the Fund's existing policy of Enlarged Access.

(b) New participants in the GAB. Switzerland is a natural member when she joins the Fund, and should remain an associate member if possible until then. Her participation might be over and above the SDR 20 billion available from G10 members. Australia has long been upset not to have been invited to participate in G10 when it was set up: they would be a useful addition to G10 counsels. They have a reasonable case to be considered since their quota exceeds Sweden's by more than 50 per cent. Another potential candidate might be Spain, whose quota also exceeds Sweden's (by about 20 per cent).

(c) Saudi Arabia and the GAB. Larosiere believes it worth considering whether they should be brought into closer relationship with the GAB, even if they themselves might well not want to join the G10. One possibility is that they should have associate membership, rather like Switzerland now. We have an open mind. We can go along with a general G10 view that Saudi Arabia should not be offered formal associate status, but we feel strongly that the question of the precise relationship between the G10 and the Saudis needs to be discussed frankly with the Saudis at an early stage, and certainly before the Interim Committee. Larosiere believes a visit by the Chancellor to Saudi Arabia would be helpful.

3

FLAG D

DISTRIBUTION OF QUOTA INCREASE

If this is a "plain man's guide", I don't know what I am!

Points to Make

1. We agree the general understandings reached at G5 Deputies (i.e. some reduction in US and UK shares; and increase in the Japanese, and to some extent the German shares). We emphasise need for uniform treatment of all members, irrespective of country bloc.

2. We are hesitant about leaving the modalities, which will determine the extent of the shift, to the Executive Board. Views there remain diverse and wide apart. Lack of progress on this issue could delay agreement on the package or unravel it later.

3. To improve prospects of early agreement, we feel that the distribution techniques need to be kept simple and transparently fair. The shift towards relative economic positions will only be a partial one at best, but less major industrial countries coordinate their views, the shift may be further diluted by LDC demands for a large equiproportional increase.

4. We oursleves favour the quota increase being distributed pro rata with calculated quotas (method 3). Some compromise may be necessary, but we would prefer concessions to be made on access to fund resources rather than at the expense of uniformity in distributing the quota increase.

Background

5. Four basic distributions methods, with numerous variants, have been considered. Method 1 allocates selective increases to those countries (128) whose calculated quotas exceed their actual quotas. Method 2 is similar, but is limited to 106 members. Method 3, the Australian approach, distributes the quota increase to all members pro rata with CALCULATED quota increase. Method 4 restricts selective quota increases to the 35 or 50 members whose actual quota share is below their calculated quota share.

6. The following table sets out for G5 countries and main country blocs their present quota share, and their share if all the quota increase is distributed in relation to calculated quotas, (Method 3), or only half, or if every member is guaranteed at least a 25% increase in quota.

	Present share	SDR 90 bn all method 3	SDR 100 bn all method 3	SDR 100bn 50% method 3 50% pro rata with existing quotas	SDR 100 bn all method 3 but minimum increase of 25%
US	20.7	19.4	19.1	19.9	19.1
UK	7.2	6.7	6.6	6.9	6.6
GERMANY	5.3	6.5	6.7	6.0	6.7
FRANCE	4.7	5.2	5.2	5.0	5.2
JAPAN	4.1	5.1	5.3	4.7	5.3
Total Industrial	61.3	63.0	63.4	62.3	63.2
Oil Exporters	10.9	12.0	12.2	11.6	12.2
NOLDCs	27.8	25.0	24.4	26.1	24.6
(India)	(2.8)	(2.2)	(2.1)	(2.5)	(2.2)

6. We have taken as our objectives in the discussions so far the securing of a high quota ranking for the UK (it looks as if we may well retain second place, but in any event will not drop below third); an increase in the share of industrial countries as a whole; a and distribution method which is uniform, transparent and simple, but at the same time allows the grievances of those most out of line to be addressed if not fully satisfied.

7. Recent Executive Board discussion has shown a wide diversity of view. Japan and some OPEC members want selective increases to be focused more or less exclusively on those most underendowed with quota. Those NOLDCs most overendowed with quota (eg India) naturally enough want most of the increase distributed equiproportionately to prevent their present share being eroded, or alternatively an entrenched position for LDCs. Remaining Directors could largely accept Method 3 as the basis for distributing the increases although many including the US and France were prepared to dilute it with a significant (50%) equiproportional element. The Germans and Canadians were prepared to go along with a small equiproportional sweetener. One idea which met with some industrialised country support was for a minimum increase of at least 25% for all members; this would to some extent protect the share of the Indians and most African members from falling too far. As the table above shows it is a much less costly concession than a large equiproportional element.

8. Other concessions have been suggested in the past. An increase in Basic Votes (each member has 250 Basic Votes, the quota-equivalent of which is SDR 25 mn) would involve a change in the Articles and can be ruled out. Most would be prepared to go along with maintaining the present number of LDC

<u>Directors</u> in the Board, even if their v ting power is eroded: there may, however, have to be some ie shuffling of LDC constituencies.

9. We ourselves are more inclined to make concessions on access (q.v.) than on quota shares and voting power. But if concessions have to be made it is desirable, first, that they do not complicate the quota distribution in a way which entrenches existing anomalies or creates new ones; and secondly that G5 have a better coordinated view amongst themselves of what should be offered. Larosiere has indicated that there will need to be further Executive Board discussions before a framework can be put to the Interim Committee.

10. Japan's position needs sensitive handling. They are likely to tie their position on the size of the Fund and the GAB to a significant improvement in their present quote share, and probably will not be satisfied with a quota less than the French. Although they do not seriously threaten our own position, the methodology they use to justify exceptional treatment for themselves would if uniformly applied - significantly reduce our quota share. It may be that they will eventually go along with Method 3. There are few concessions consistent with uniformity that we can offer them. There could perhaps be an understanding that the next quota review too would have a selective element. But it is probably premature to suggest this.

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10. Japan's position needs sensitive handling. They are likely to tie their position on the size of the Fund and the GAB to a significant improvement in their present quota share, and probably will not be satisfied with a quota less than the French. Although they do not seriously threaten our own position, the methodology they use to justify exceptional treatment for themselves would if uniformly applied - significantly reduce our quota share. It may be that they will eventually go along with Method 5. There are few concessions consistent with uniformity that we can offer them. There could perhaps be an understanding that the next quota review too would have a selective element. But it is probably premature to suggest this.

JB

4

FLAG E

ACCESS TO FUND RESOURCES

POINTS TO MAKE

1. We agree that access to the Fund's ordinary resources cannot normally exceed 165% of quota.

2. Enlarged Access, involving Borrowed Resources, was established to meet the repercussions of the second oil shock. The repercussions have persisted longer than expected, but Enlarged Access should be progressively wound down as the global imbalances subside. Helpful to react a common understanding that by the time the Ninth Quota Review is implemented (1989) we can dispense with Enlarged Access altogether. A review mid-way through the Eighth Quota period would facilitate a more gradual and possibly acceptable winding down.

3. Against this background, we see little justification for French view that same multiples of access now available should be applied to the new, higher quotas. (This would increase cash access by 50-60% on average). Some scaling down of multiples seems necessary. Maintaining same access in cash terms implies reducing annual access from 150% of present quota to 100% of new quota (with a Fund of SDR 90 bn) or 90% of new quota (with a Fund of SDR 100 bn).

4. Providing Fund conditionality is maintained, we are willing to be a little flexible on the precise level of Enlarged Access, and to make concessions here if it helps to secure a more uniform shift of quotas towards relative economic positions. At the very minimum it will probably be necessary to safeguard the existing cash access of those LDCs who are going to lose quota share. Alternatively, we could go along with a 20% increase in cash access for all. Hopefully we could be rather more generous on the cumulative access limit (at present 600%). All this of course depends on availability of borrowed resources to finance it.

4. On CFF, the political difficulties of formally converting the facility from a low-conditional to a high-conditionality one may be considerable. A more straightforward approach, possibly as effective, would be to continue the de facto tightening up seen over the last year.

5. Tactics There are dangers in trying to negotiate all aspects of access as part of the package at the next Interim Committee. Agreement on access would then require an 85% majority. Perhaps better to finesse the detail if possible and simply get a general understanding within the package; that as a minimum existing access to all facilities will be maintained in cash terms for an initial period after the Eighth Review is implemented. Details could then be hammered out separately; this way they would require only a 50% majority.

BACKGROUND

6. The following table sets out the three access limits in force, at present, and the multiples required to achieve the same cash access with a Fund of SDR 90 bn and SDR 100 bn.

	Present	SDR 90 bn	SDR 100 bn
Programme Limit (Annual)*	150	100	90
Cumulative Limit**	600	400	360
CFF***	100	66	61

Notes

*Hence limit on a maximum 3 year programme is 450% at present.

**Cumulative Limit is the maximum a member may have outstanding under a succession on programmes.

***Compensatory Financing Facility. Present Limit can rise to 125% if cereals facility is involved.

7. Most programmes are nowadays financed by a package of borrowed resources (at market rates) and ordinary, quota-based resources (at concessional rates). The ordinary element is limited to a maximum of 165%. It is mathematically constrained to around this multiple, irrespective of the size of Fund, because the availability of quota-based resources is limited (no member can be asked to supply more than 100% of his quota-subscription to the Fund). This assumes normal borrowing patterns.

8. On Enlarged Access, US, Japan and Germany propose cutting the present multiple to a level which offers precisely the same cash access as at present for the average member. This is understandable. It reflects the view that the size of LDC deficits should fall from now on, and should hopefully be distributed in a more sustainable pattern once the Latin American upheavals are properly addressed. The need for very large individual programmes should begin to fall away as a result. But in practice this may be difficult to sell to LDCs. At the Seventh Quota Review access was increased in cash terms by over 10% for all members. More importantly, in the present review there are to be selective adjustments of quota shares for most if not all members. Maintaining the same cash access for the average member means a loss of access for those who lose quota share. If a quota increase to SDR 100 bn is distributed according to the Australian method, the countries most affected would be:-

	Loss of Quota Share (%)
Sri Lanka	31
Bangladesh	30
Zimbabwe	28
Zaire	27
Zambia	27
Pakistan	27
Sudan	26
Ghana	26
India	26
China	20

9. Most of these would be worried at their loss of access, particularly those (China, Ghana, Zimbabwe) who have not already got, or recently had, a large Fund programme. If they are to accept such a loss of quota share, we may need to safeguard their access by allowing them individually to draw the same cash amount after the Review as they technically can now. An alternative which we mooted in the G5 Deputies meeting is to allow a 20% increase in cash access to all members.

10. There may at any rate be a case for a more generous limit on cumulative access. This reflects the view that commercial bank flows will grow more slowly than in the past, and the recession may be protracted. By the mid-1980s there will be a large number of countries who have already drawn heavily on the Fund but whose economies are either well stuck in the doldrums of debt and low commodity prices or who are still highly vulnerable to sudden squalls. Examples are:

	% of Present Quota Projected Drawn at end - 1985
Jamaica	600
Hungary	550
Turkey	490
Somalia	490
Yugoslavia	485
Zambia	465
Mexico	450
Morocco	445
Sudan	420
Pakistan	410
Gambia	400

If the Fund is to pilot them through this period, there must be some headroom of further access available to them. On this view, an increase in the cumulative limit in cash terms might be appropriate (to say 500% of new quota), irrespective of the decision on the individual programme limit.

11. On the CFF limit, there is a generally shared view in the G5 and Monetary Committee that CFF access should not rise automatically as in the past. Larosiere has privately accepted the need to limit CFF access, but believes it would be difficult to secure agreement on a formal tightening up of CFF conditionality: he has pointed to the more rigorous de facto application of CFF conditionality in the last year or so.

6 + 7

FLAG F

REMUNERATION AND CHARGES, SUBSCRIPTION PAYMENTS, TIMETABLE

Points to Make

1. Inclusion of remuneration and charges in the package risks overloading it, and certainly would delay the Interim Committee beyond January/February. Besides the case for a remuneration increase next year is strong on its own merits. Why jeopardise it by including it in a package requiring an 85% majority, when there is good prospect of independently securing it anyway by a simple majority in the Executive Board?

2. Similarly the question of subscription payments should not be included the package, but left to the Executive Board for pragmatic resolution.

3. Acceleration of the Ninth Quota Review (to secure implementation by January 1989) is an important element of the package for us.

4. A mid-1984 target for ratification of the quota increase is more credible than end-1983. This might not preclude an augmented GAB being put in place beforehand.

Background

5. The proposal to include in the package an increase in the rate of remuneration and rate of return on Fund lending is an American one. It is designed presumably for presentational purposes, ie to demonstrate to US domestic opinion that the Fund is not an aid vehicle. There is widespread support within G10 for the rate of remuneration on currencies sent by the Fund to be increased from its present 85% to 100% of the SDR rate. This would improve the reserve asset character of reserve position in the Fund. On the other hand it would increase the cost of Fund lending, and ought therefore to be timed to coincide with a period (such as 1983 perhaps) in which interest rates are falling. There is little merit in the proposal to increase the return on Fund lending. It runs counter to the concept of the Fund as a cooperative institution, and unnecessarily pushes up the cost of Fund money to LDCs at a time when we are trying to encourage them to approach the Fund at an early stage of emerging imbalances.

6. The method of subscription is clearly defined in the Articles. "Each member shall, within a period determined by the Fund, pay 25% of the increase in SDRs, but

tne Board of Governors may prescribe that this payment may be made, on the same basis for all members, in whole or in part in the currencies of other members specified, with their concurrence, by the Fund, or in the member's own currency, ... provided that the Fund's holdings of a member's currency shall not be increased (above 100% of quota) ... as a result of payments by other members ..." (Article III, 3). A quota increase of SDR 40 bn (ie to SDR 100 bn) implies a subscription of SDR 10 bn in SDR form, against a total stock of just over SDR 20 bn. It is just possible to conceive of SDR subscriptions being recycled rapidly through the Fund to allow the full SDR 10 bn to be subscribed in SDRs over a period of time. Otherwise a partial subscription in foreign currency will be necessary: this would almost certainly involve sterling. This largely technical issue can be left on one side for the time being. The important thing is to avoid any presumption that a fresh SDR allocation will be needed to allow payment of 25% of the quota increase in SDRs.

7. We are considering what legislative action is needed in the UK. Powers already exist to ratify by order an increase in the UK quota, and an increase in the GAB could also be ratified by order, though some of the other possible changes in the GAB (especially the supply of foreign exchange rather than sterling) might need primary legislation. There is a reasonable chance, that the UK could ratify the package quite quickly, and certainly by the end of 1983 if Ministers agreed that any primary legislation should be included within the 1983 Finance Bill (assuming of course that early agreement is reached in the IMF).

FLAG G

NOTE ON PROBLEM COUNTRIES - DECEMBER 1982

LATIN AMERICA

Argentina

Total indebtedness is about $37 billion. Argentina is making progress in dealing with the pressing debt problems, but there are still serious difficulties. With mounting arrears on repayments of capital and interest, there seems no prospect that Argentina can meet the massive debt service due in the remainder of the year. Payments of $15 billion in principal and interest are due in the second half of this year. Debt service arrears amounted to some $2.3 billion at the end of June and may be building up towards $6 billion by the end of the year. Faced with the impossibility of meeting a sizeable proportion of these commitments the Argentines are seeking a combination of further roll-overs and fresh credits.

2. Following negotiations, which began after the joint removal of financial sanctions in September, Argentina reached agreement in early November with the four main UK clearing banks on the settlement of debt service arrears built up while the sanctions were in force. Debts of about $440 million are involved: short term debts will be rolled over for six months from the original due date and other debt service obligations are to be paid. This agreement helped to clear the way for other negotiations, in particular with the IMF where they have agreed on a letter of intent on an economic programme supported by a $1.5 billion standby with the further possibility of a $500 million CFF drawing. At the same time Argentina has reached broad agreement with a consortium of ten international banks on the terms of a 15 month, $1.35 billion bridging loan, three-quarters of which is expected to be dispersed in December or January ahead of the first drawing under the proposed IMF package. Argentina has also applied for assistance (reported as $750 million) from the BIS.

3. However, the banking consortium has made their facility conditional on other forms of support. The draw-down of the first tranche ($600 million) of the bridging credit is conditional not only on the implementation of the Argentine agreement with the British banks but also, reportedly, on the achievement of assistance from the BIS. The second tranche ($400 million) would be released only after the IMF has formally approved the economic

LW

FLAG G

FROM: P E DENISON
DATE: NOVEMBER 1982

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adjustment programme. Any delay in the conclusion of an IMF agreement could push back even further the major rescheduling which appears inevitable, but which the Argentines still seem intent on avoiding. ECGD remain off cover.

Brazil (see note behind)

4. The Brazilian official estimate of medium and long term foreign debt at the end of 1982 is $72 billion. Previous estimates that short term debt would amount to a further $8 billion now seem too low: total indebtedness now seems likely to be almost $90 billion. The government was forced to introduce a series of emergency measures from mid-September in a belated response to an increasing current account deficit, expected to reach $14 billion in 1982. The measures reflected the need to retain international banking confidence in order to meet the higher than expected 1982 borrowing requirement and reduce the country's vulnerability to the knock-on effects of the debt servicing difficulties facing other Latin American countries.

5. The recognition by the Brazilian authorities that they could not raise the funds necessary to meet their external obligations in the final quarter of the year, led them to embark on a series of fund raising missions to various financial centres. In late October and early November short term bridging finance of up to $1 billion was reportedly raised from US banks to avert a major liquidity crisis. Short term credits are also being sought from European banks.

6. Following the elections on 15 November, Brazil has approached the IMF for support, requesting an immediate CFF drawing of SDR 500 million ($535 million) and an EFF over three years of SDR 4½ billion ($4.8 billion). ECGD remains open for cover, but new commitments are being carefully controlled.

Cuba

7. Debts are small but rescheduling negotiations are currently in progress with Western creditors. Total indebtedness is about $3 billion which includes substantial debts to the Soviet block. The Cuban authorities formally approached the UK and other Western creditor countries at the end of August to request a rescheduling of medium and long term debts amounting to over $1 billion. We and other creditors have insisted on multilateral negotiations. Cuba's non-membership of the IMF is a complicating factor. A team representing

Western creditors, headed by Spain (the major creditor), has been in Cuba discussing the economic package that would support any rescheduling agreement. They reported back to the Paris Club at the end of November. Provisionally, the UK view was that rescheduling hardly seemed justified: the economic ajdustment measures required to enable Cuba to meet her debts seems minimal by comparison with other countries requesting rescheduling. The UK is not a major creditor. ECGD is off cover.

Mexico

8. Total indebtedness is about $80 billion. (It was $77.9 billion at the end of August 1982.) Mexico's difficulties in raising finance and their inability to halt substantial capital outflows suddenly came to a head in August and the authorities appealed to international institutions and governments for emergency help. In additon to Mexico's own economic measures, international assistance included several forms of support including a BIS bridging facility in which the Bank of England participated with a Treasury indemnity. The three tranches of the BIS loan are dependent on the progress towards an IMF arrangement and its implementation. The first tranche has been fully drawn. The second has been made available (conditionally - because of slow progress in the IMF talks) but this has not been announced. Longer term support must come from the IMF in conjunction with an economic adjustment to programme that will have to be severe. A letter of intent has been signed but the terms are too imprecise for it to be wholly satisfactory. The next stage is for the arrangements to be put to the IMF Executive Board on 23 December, by which time we would hope there will be a more specific economic adjustment programme for approval. The Mexican application is for a facility of $3.8 billion over three years.

9. An agreement made in August with private banks deferring for 90 days repayment of capital on public sector debt (excluding debt guaranteed by other countries' export credit agencies) expired on 23 November but was extended for a further four months. The IMF Managing Director met commercial bankers recently to explain IMF intentions towards Mexico and to emphasize the need for commercial banks to play their part in maintaining some flow of credit. Reports suggest that this was not very well received initially by the banks. There is a risk that they might expect a corresponding contribution from Central Banks in the form of an extention of the BIS facility. It is not known whether the Mexicans will ask to reschedule their officially guaranteed debts, but they have not done so yet. ECGD remains technically on cover, but with a limit that allows very little new business.

10. The change in the Presidency has been an added complication in handling this crisis. President De La Madrid succeeded President Lopez Portillo on 1 December.

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EASTERN EUROPE

East Germany - GDR

11. Total indebtedness has been as high as $16 billion but is probably now declining at some considerable cost in terms of economic disruption. Existing undrawn credit facilities remain sizeable but are being taken up at an increasing rate. However, GDR is unable to raise substantial new credits from Western banks. Figures recently released by the BIS show that gross debts to BIS banks (excluding banks in West Germany) have declined from over $10 billion at the end of December 1981 to $8¾ billion at the end of June 1982. The decline is at least partly due to savage cutbacks in imports, which cannot be sustained indefinitely. Payments delays and approaches to suppliers for longer than normal credit terms have become more frequent. We understand, in confidence, that an approach has been made to the West German Government for assistance in raising a deutschmark financing credit equivalent to some $1.5 billion. Serious debt servicing problems (and perhaps rescheduling) are still possible. ECGD has introduced tighter market limits but is still on cover.

Hungary

12. Total convertible currency indebtedness was $7.4 billion at the end of June 1982 having fallen from $8.7 billion at the end of December 1981. Hungary has been helped over short term liquidity problems this year by several tranches of bridging finance from the BIS in which the Bank of England participated (without official guarantees). The amount outstanding at any one time has varied but is currently $400 million of which the Bank share is 10 per cent. In response to a deteriorating convertible currency balance of payments position, and under the aegis of the IMF, the Hungarians have introduced a number of measures, including devaluation and increases in consumer prices, but even so are having to take additional administrative measures to curb imports. On 8 December the IMF Board will meet to approve an economic adjustment programme supported by a 13 month standby of SDR 475 million and a CFF of SDR 72 million (together equivalent to some $585 million). However, Hungary still faces a substantial debt burden over the next few years. The country will remain highly vulnerable to the weakness of banking confidence in Eastern Europe until large enough current account surpluses are achieved to repay some maturing debt and rebuild reserves. ECGD commitments are modest and under tight control.

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Hungary

12. Total convertible currency indebtedness was $7.4 billion at the end of June 1982 having fallen from $8.7 billion at the end of December 1981. Hungary has been helped over short term liquidity problems this year by several tranches of bridging finance from the BIS in which the Bank of England participated (without official guarantees). The amount outstanding at any one time has varied but is currently $400 million of which the Bank share is 10 per cent. In response to a deteriorating convertible currency balance of payments position, and under the aegis of the IMF, the Hungarians have introduced a number of measures, including devaluation and increases in consumer prices, but even so are having to take additional administrative measures to curb imports. On 8 December the IMF Board will meet to approve an economic adjustment programme supported by a 13 months standby of SDR 475 million and a CFF of SDR 72 million (together equivalent to some $585 million). However, Hungary still faces a substantial debt burden over the next few years. The country will remain highly vulnerable to the weakness of banking confidence in Eastern Europe until large enough current account surpluses are achieved to repay some maturing debt and rebuild reserves. ECGD commitments are modest and under tight control.

Poland

13. Total convertible currency indebtedness is about $27 billion. Banks and official creditors both negotiated rescheduling agreements in respect of debts due in 1981. Following the declaration of martial law in December 1981 virtually none of the $10 billion convertible currency obligations falling due in 1982 have been paid. On 3 November this year the banks signed a rescheduling agreement covering 95 per cent of the $2.4 billion repayments of principal due in 1982. Under the agreement interest due this year must still be paid but the Poles will get half back in the form of new three year credits. Western official creditors agreed after the imposition of martial law not to resume talks on official rescheduling for the time being and have not attempted to negotiate a rescheduling agreement for 1982. In practice, the effect of this refusal has been to allow Poland to stop all payments, thereby gaining 100 per cent defacto relief on both principal and interest. We (and many other Western creditors, but excluding the US and France) would like to have a rescheduling agreement in place, so as to resume payments of at least some of the debt. If, as seems possible, martial law is lifted in the near future this might provide an opportunity to begin negotiations. To some extent Polish insolvency has been discounted by the banks, many of which (e.g. in West Germany) have written off a proportion of their loans, but total default would still impose a burden. The loss of US Most Favoured Nation status is likely to have only a marginal impact since the US currently accounts for less than 6 per cent of hard currency exports. ECGD is completely off cover.

Rumania

14. Total convertible currency debt is about $10 billion. In July the Paris Club agreed the general terms of a rescheduling of debts due in 1982. Bilateral agreements with each creditor country are now being negotiated to implement these arrangements, and the UK bilateral has just been signed. The separate negotiations on the rescheduling of bank debts are progressing and an agreement is likely to be signed soon. Further reschedulings will clearly be needed in 1983 when some $2.3 billion debt service falls due. Governments have already agreed in principle to consider this provided that access to IMF resources remains open. But there must be considerable doubts whether the Rumanian authorities are prepared to take the adjustment measures necessary to maintain IMF access. ECGD is off cover.

Yugoslavia (See further pps below)

15. Total indebtedness is about $20 billion. Notwithstanding an IMF upper tranche programme, Yugoslavia have failed to come to grips with increasingly severe payments imbalances resulting from high growth and investment rates in the late 1970s. There are now increasing signs that financial collapse in Yugoslavia is imminent, requiring urgent international measures of some kind involving financial support or debt rescheduling. The Yugoslavs continue to maintain that they will not reschedule. Imports have been cut drastically and other recent economic measures include the 16.7 per cent devaluation (initially reported as 20 per cent). A $200 million short term facility being arranged by Citibank has encountered considerable problems but may now have been signed. An application to the BIS for a $500 million standby over three years has been rejected but the possibility of a short term facility is still open. The Governor of the National Bank of Yugoslavia visited London in September to assess the prospects of further loans from British banks. They were not enthusiastic at the time. Current reports of the seriousness of Yugoslavia's position may have ended any prospect of further lending of this kind. ECGD has a substantial exposure (more than £700 million) but is now virtually off cover except for short term business.

<u>Yugoslavia</u> (See further para below)

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THE INTERNATIONAL FINANCIAL SCENE

Conditions in the international money markets have eased somewhat since September. Falling interest rates and official action in managing the crisis have encouraged most banks to be patient and responsible in their market behaviour. Recent announcements that the IMF managementhas reached agreement in principle with Mexico and Argentina on stabilisation programmes have been helpful to sentiment. But banks remain anxious about their exposure to problem countries, and many small ones are looking for opportunities to reduce it, so that the situation in the banking markets has not yet stabilised fully.

Mexico remains the chief worry for the markets. The immediate liquidity position of the Mexican banks in London and New York has improved. The activities of the Advisory Group (of thirteen major banks co-ordinating the approach of the very many banks with claims on Mexico), the Bank of England and the Federal Reserve Bank, together with the funds provided by the joint BIS/US facility, have played a crucial part in bringing this about. Nevertheless the Mexican banks' overseas offices continue to lose liquidity from withdrawals of some interbank deposits, the attitude of small and regional US banks being of particular concern in this respect. At the same time, although the Mexicans are keeping interest payments on their public sector debt current (having proposed with the support of the Advisory Group a four months' extension from 23 November of the moratorium on repayments of the principal), there is a continued build-up of interest arrears (now amounting to some $750 mn) on private sector debt which is creating difficulties for the banks. Beyond this the banks have become more acutely aware of the amounts of new lending being sought from them next year even on favourable assumptions about the rescheduling or roll-over of existing debt. Thus there are still serious problems for them in consolidating the improvement recorded in recent weeks. However, the agreement in principle between the IMF and Mexico is a positive development which - as well as triggering the release of the remainder of the BIS/US joint facility - should offer encouragement to the banks to continue to play their part in dealing with Mexican liquidity needs.

SECRET

THE INTERNATIONAL FINANCIAL SCENE

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re are a number of other, potential problems facing the market at the moment of which Brazil is the biggest. A payments interruption by Brazil, whose financial situation is precariously balanced, would deal a very severe blow to confidence at a time when the market had not fully recovered from the previous shock. Brazilian banks in London have already experienced some funding problems in the last three months, although these have receded somewhat in recent weeks. The position of Brazil, like that of Mexico, depends critically on the provision of new money by the commercial banks. The government has already achieved some success in arranging further short-term finance from US banks and is seeking similar assistance from British and other European banks. It is commonly expected that the Brazilian authorities will approach the IMF for a loan following the recent election and this will help confidence. Even so the large financing requirement in 1983 is a source of concern to banks facing other demands domestically as well as internationally next year.

Among other debtor countries adding to the strain on market confidence is Argentina. Its immediate problems have been eased by an agreement with major UK banks on the treatment of outstanding arrears and by the apparently satisfactory outcome of negotiations on an IMF programme, but some rescheduling of existing debts seems unavoidable. Further debt difficulties are in prospect in Eastern Europe and much depends on their being handled in an orderly manner. Yugoslavia is a clear case for rescheduling, although its leaders seem for the moment to have set their face against it, and East Germany could follow. Meanwhile IMF assistance should gradually take over from the BIS in shoring up confidence in Hungary.

The fall in interest rates has brought an easing of conditions in the international money markets but some larger banks still have to pay a (now marginally) higher-than-normal price for their funds. The markets remain cautious about certain major banks from the industrialised countries whose names have been associated with well publicised difficulties of various kinds. Some banks, including the UK clearing banks, have taken advantage of their relatively good standing to strengthen their balance sheets by raising new capital. Equity and bond markets, though disturbed

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The fall in interest rates has brought an easing of conditions in the international money markets but many lesser names still have to pay a (now marginally) higher-than-normal price for their funds. The markets remain cautious about certain major banks from the industrialised countries, which names have been associated with small problems difficulties in particular sectors. Some banks, including the UK clearing banks, have taken advantage of their relatively good standing to strengthen their balance sheets by raising new capital. Profits and, so, markets, though disturbed latterly by the possibility that the fall in interest rates may have stalled, seem to have been relatively untouched by international debt problems. The shares of US banks, however, remain generally depressed in the United States and the share prices of the UK clearing banks have dipped in November first on fears of a prospective rise in provisions against bad debts and later on the announcement of a substantial increase by LBI.

In their immediate response to present difficulties the authorities and the banks have demonstrated that they can act rapidly to sustain confidence in the international financial system. Conditional lending by the IMF, as well as the continuing commitment of the banks, will be an important element in carrying matters forward and recent indications that a quicker and substantial increase in Fund resources may be possible have also helped to improve sentiment. Meanwhile the banks are proposing to establish an international institute to facilitate communication with borrowing countries and enhance the capacity of its members to make their own more informed judgments about lending decisions with a view in the medium term to the avoidance of crises rather than the management of them.

Bank of England

November 1982

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Bank of England
December 1982

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G5 FINANCE MINISTERS MEETING, KRONBERG, 9/10 DECEMBER
GATT MINISTERIAL

The GATT Ministerial ended on 29 November. The final declaration included a reaffirmation in realistic terms of signatories' commitment to the open trading system, and launched a number of studies. Those of most interest to the UK(and US) concerned the problems of international trade-in services, and the possibility of increased acceptance by the NICs of GATT obligations and of an increase in trade with them. The meeting did not result in any changes in signatories' obligations under the GATT - this was not its purpose.

2. The UK and EC went into the meeting with no very high hopes, and the outcome was no better than we had expected. The US set themselves some difficult and probably unrealistic objectives, and may have more reason to be disappointed, though they appear to be setting a brave face on it and unlike the Community entered no reservations on any of the final document. The points on which they conspicuously failed to achieve their aims were their idea for a "cease-fire" on new protectionist measures linked with their suggestion for new GATT rules on the imposition of temporary import restraints ("safeguards"); and their attempt to launch a GATT-based attack on agricultural subsidies. These were the two themes to which Mr Regan gave most prominence in his recent letter to the Chancellor.

3. Mr Regan suggested in his letter that he might wish to raise these issues at the G5. If he does so - we have no particular wish to do so ourselves at this time - the following are some points which could be made to him bilaterally:

(a) Refer to the Shultz/Pym exchange of letters below. This identified a substantial area of agreement between the US and the UK/EC as regards objectives for the GATT Ministerial; as well as diagnosing (correctly, as events showed) differences of view on such matters as dispute settlements procedure and safeguards.

(b) Remind him that in the present difficult world economic situation many of the expectations from the meeting were exaggerated. The outcome was in fact very much as the Community had consistently forecast and urged.

(c) Emphasise (cf final paragraph of Mr Pym's letter) the importance of the macro-economic dimension, and the role of the US and Japan in that perspective.

(d) Reaffirm UK/EC commitment to the open trading system,and our determination to make a success of the studies agreed at Geneva.

(e) [If raised] Although the Americans were unable to obtain all they hoped for on agriculture, some progress was made in that it was agreed to set up new machinery to examine trade of agricultural products, including the questions of access and subsidies. (Mr Regan should not need to be reminded that the UK is pretty close to the US in its view of the protectionist nature of the CAP.)

4. Copies are attached of Mr Regan's letter to the Chancellor and the Shultz/Pym exchange of letters.

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

It'd be nice if
Someone cd cast
a German eye on
this & offer a view
before I take it
off to Frankfurt
with me.

Ken
Yours I think ?

ROM SIR CHARLES VILLIERS M. C.

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9 ALBERT EMBANKMENT
LONDON SE1 7SN
TELEPHONE: 01-735 7654
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P 8/12

EXCHEQUER
-8 DEC 1982
Mr Pirie 9.12
FST
Mr Chivers

The Rt.Hon. Sir Geoffrey Howe, Q.C., M.P.,
Chancellor of the Exchequer,
Treasury,
Parliament Street,
London. SW1P 3AG.

7 December 1982.

Dear Geoffrey,

Kreditanstalt für Wiederaufbau.

We spoke of this at MacAlpine's party last week, and you said you would like a note before your forthcoming visit to Frankfurt.

KfW is a fund in Frankfurt which financies small and medium sized businesses in Germany. It has other interesting functions as well.

It is Government owned and it originated in counterpart Dms withdrawn when Marshall Aid $ were received. Its new funds come from retained profits and from the markets, generally in Germany. Its capital is £250m plus reserves of £300m. Its balance sheet total is £14bn. It pays no tax or dividends and need not conform to Central Bank deposit regulations. Its staff is under 200 employed on loans to small and medium sized businesses.

The highlights are that it made 22,000 loans last year at an average rate of interest of 8.5%, with a life of up to ten years; total lent over £1bn (compare this with I.C.F.C.'s £100m). The credit risk is taken by the commercial banks for an annual commission of 1%, paid out of the 8.5%.

I believe that Britain should have a similar institution, which could push small business and subsume the Guarantee scheme plus other odd jobs.

Shell U.K. (John Raisman) has funded me with £10K to study this, and I have engaged The Economist Intelligence Unit, who have produced an interim report.

I was at KfW (third visit) on 19 November with Mike West of E.I.U., whose short report is attached.

If you want to pursue this, Dr. Gerhard Stoltenberg, Minister of Finance, is Chairman of the Board of Directors, Count Lamsdorff is Deputy Chairman, and Mr Abs is founder and Hon. Chairman.

/...

I have thought of the English version as "Small and Medium Business Credit Organisation" (SAMBO). I have studied Credit National in France, S.B.A. in America and S.B.F.C. in Japan, and they all have points to contribute, but KfW seems the best model. Perhaps I.C.F.C. should handle SAMBO, but perhaps not!

If you would like more on this after your visit to Frankfurt, I would, with E.I.U. be happy to supply.

Sincerely

Charles Villiers

A SMALL & MEDIUM BUSINESS CREDIT ORGANISATION (SAMBO)

Objective: to reduce the financial disadvantage faced by small/medium firms by providing loan finance for medium/long periods on terms at least as good as those obtainable by larger firms. Secondarily, to provide other forms of finance - working capital, equity - as needed. Thirdly, to foster such particular industries - computing, energy-saving, high-technology - as the Government may from time to time require, and, if required, to administer special schemes, i.e., for Assisted Areas.

Method: to establish a SAMBO with capital subscribed by Government, with no interest or dividends payable, but with the requirement to break even over a run of years. Main type of lending to be term loans, at fixed or variable rates, for terms of five to fifteen years, repayable by equal annual instalments after a "period of grace" of up to three years. Loans to be made through the banks who would check credit-worthiness and assume the credit risk for a commission. Qualifying companies would be those with less than 500 employees ("medium size") or 50 employees ("small").

Background: there are six propositions upon which the proposal is founded:-

- that the real performance of the economy has been poor compared with that in other countries;
- that the level of investment in Britain remains inadequate and that new technology - e.g. micro-chip - will not be quickly introduced without new investment programmes;
- that British business has relied heavily on own funds;
- that small/medium-sized businesses play a smaller role in the British economy than they do in most other developed economies; and
- that financial support for such businesses is much less in Britain than in competitor countries.

The full report considers and discusses the evidence of these propositions. Space precludes it being rehearsed here but:

- in the 1950s UK income per head was three times that of Japan and well above France or Germany: in the late 1970s it was 35% below Japan and 27% below the EEC average;
- gearing ratios (i.e., ratio of shareholders funds to total liabilities) in 1977 for listed companies were 19% in Japan, 23% in Germany and nearly 42% in the UK;

/...

- in 1979 there were 3 million small firms in France, 2 million in Germany, 5½ million in Japan, under 1½ million in the UK;

- the balance sheet totals for public and semi-public institutions serving small/medium businesses in 1981/82, range from £33 billion in Japan through £17 billion in Germany to £1 billion in the UK.

Kreditanstalt fur Wiederaufbau - Frankfurt.

While there are elements identified in many of the foreign institutions studied in the report which would be worthy of consideration in establishing a UK Corporation, the best example of the kind of institution which it is suggested is needed is the Kreditanstalt fur Wiederaufbau of West Germany. Founded in 1948 and initially based on European Recovery Programme (Marshall Aid) funds, this body has a capital of £250 million, eighty percent subscribed by the Federal Government and twenty per cent by the states. It has accumulated £300 million of reserves. Its small business programme was initially based on ERP funds but is now financed from KfW's own resources. The on-going programmes of lending to small/medium businesses, described below, have been supplemented occasionally by special programmes, such as the anti-recessionary programme of 1981/82.

Companies with turnovers under DM300m (£75m)qualify for "M" loans (but some KfW executives would prefer to use a maximum number of employees as the criterion). All sectors of trade and industry, including the professions, are eligible, although some energy-saving/high-technology are given some "indicative priority". Loans are made for periods up to ten years, repayable in equal annual instalments (after a period of grace - up to one year), at a fixed interest rate and repayment in advance is permitted with no penalty. Up to ten thousand such loans have been made in a year and in 1981 loans made to small/medium-sized businesses from all KfW programmes totalled nearly 22,000, worth over Dm five bn and creating an identified 57,700 new jobs.

The funds are currently made available at an effective interest rate of about 8½%. The borrower pays 7½%, of which the handling bank receives 1%. KfW thus receives 6½% but since only 96% of the nominal value of the loan is disbursed, KfW receives an effective 7½%. This currently probably represents at least a 1% shortfall over the cost to KfW of obtaining funds and administering them, and the difference is made up from KfW's reserves and its other activities.

The lessons to be learned seem to be:

1. That the borrowers value most highly the fact that interest rates are fixed; second, that they are long-term; third that they are at the lower end of the range paid by big companies; and fourth, that there is considerable freedom in:

   - choosing a bank through which to borrow
   - choosing to take up a loan at the rate current at the time of the commitment <u>or</u> at the time of disbursement
   - choosing to repay if the market or the firm's circumstances change so that other, cheaper, monies can be obtained.

/...

2. That administration costs are relatively lower where the lending institution has other activities which help to meet overheads. (KfW also handles export finance, foreign investment and foreign aid for the German Government and has other domestic functions.)

3. That the relative and absolute size of the resources and activities of KfW encourage applications since the borrowers' chances of receiving loans are good.

4. That the simplicity of the application procedure, a single-sheet form, backed by the credit-worthiness and other knowledge of the bank which is to be the agent, fosters efficiency, speed and effectiveness.

---ooOoo---

Illustrative participation in expanded GAB (assumed size: SDR 15 billion)

Country	Keys presently under consideration: Present GAB shares 1)	Present IMF quotas	Calculated IMF quotas 2)	Average of shares of GDP and non-gold reserves 3)	Pro memoria: GAB shares of 1962	Other keys: Non-gold reserves 4)	Foreign exchange reserves 5)	Foreign trade 6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A. Participation in percent								
United States	28.0	36.7	27.0	25.0	29.0	12.5	33.3	20.5
United Kingdom	8.5	12.8	9.0	7.9	14.5	8.1	6.0	9.7
Germany	22.2	9.4	14.4	18.7	14.5	25.5	19.8	16.3
France	5.3	8.4	9.8	9.1	8.0	9.6	6.6	10.8
Japan 7)	17.7	7.3	11.7	15.2	13.7	16.0	11.3	11.6
G-5	81.7	74.6	71.9	75.9	79.7	71.7	77.0	68.9
Canada	2.4	5.9	5.0	2.8	2.9	1.5	1.5	5.6
Italy	3.4	5.4	6.4	7.9	8.0	9.6	8.1	7.6
Netherlands	3.7	4.1	5.3	3.8	2.9	5.2	3.8	6.5
Belgium	2.1	3.9	4.8	2.2	2.2	2.3	1.6	5.8
Sweden	1.1	2.0	2.5	1.9	1.4	2.0	1.5	2.8
Switzerland 8)	5.6	4.1	4.1	5.5	2.9	7.7	6.6	2.8
Total	100	100	100	100	100	100	100	100
B. Present commitment (SDR billion)								
United States	1.9							
United Kingdom	.6							
Germany	1.5							
France	.4							
Japan 7)	1.2							
G-5	5.4	Same as in column (1)						
Canada	.2							
Italy	.2							
Netherlands	.2							
Belgium	.1							
Sweden	.1							
Switzerland 8)	.4							
Total	6.7							
C. New commitment (SDR billion)								
United States	4.2	5.5	4.1	3.8	4.4	1.9	5.0	3.1
United Kingdom	1.3	1.9	1.4	1.2	2.2	1.2	.9	1.5
Germany	3.3	1.4	2.2	2.8	2.2	3.8	3.0	2.4
France	.8	1.3	1.5	1.4	1.2	1.4	1.0	1.6
Japan 7)	2.7	1.1	1.8	2.3	2.1	2.4	1.7	1.7
G-5	12.3	11.2	10.8	11.4	12.0	10.8	11.6	10.3
Canada	.4	.9	.8	.4	.4	.2	.2	.8
Italy	.5	.8	1.0	1.2	1.2	1.4	1.2	1.1
Netherlands	.6	.6	.8	.6	.4	.8	.6	1.0
Belgium	.3	.6	.7	.3	.3	.3	.2	.9
Sweden	.2	.3	.4	.3	.2	.3	.2	.4
Switzerland 8)	.8	.6	.6	.8	.4	1.2	1.0	.4
Total	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
D. Increase in commitment (SDR billion)								
United States	2.3	3.6	2.2	1.9	2.5	.0	3.1	1.2
United Kingdom	.7	1.4	.8	.6	1.6	.7	.3	.9
Germany	1.9	(- .1)	.7	1.3	.7	2.3	1.5	1.0
France	.4	.9	1.1	1.0	.8	1.1	.6	1.3
Japan 7)	1.5	(- .1)	.6	1.1	.9	1.2	.5	.6
G-5	6.8	5.8	5.3	5.9	6.5	5.3	6.1	4.9
Canada	.2	.7	.6	.3	.3	.1	.1	.7
Italy	.3	.6	.7	1.0	1.0	1.2	1.0	.9
Netherlands	.3	.4	.6	.3	.2	.5	.3	.7
Belgium	.2	.4	.6	.2	.2	.2	.1	.7
Sweden	.1	.2	.3	.2	.1	.2	.1	.3
Switzerland 8)	.5	.2	.2	.5	.1	.8	.6	.0
Total	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3

1) At exchange rates of September 30, 1982. - 2) Based on formula scheme 5 F-20. - 3) GDP 1980; non-gold reserves as of end August 1982. - 4) As of end August 1982. - 5) As of end August 1982; US arbitrarily assigned one third share. - 6) Exports and imports 1980. - 7) Japan unilaterally raised its GAB commitment by Y 250 billion to Y 340 billion in 1976. - 8) Switzerland, a non IMF member, is associated with the GAB with a total potential commitment of SF 865 million, equivalent to 5.6 percent of present total commitments. IMF quota was assumed to be SDR 1.4 billion, with share of calculated quotas set at the same level as in current quotas.

Details may not add to totals due to rounding.

Illustrative participation in expanded GAB (assumed size: SDR 18.7 billion)

	Keys presently under consideration				Pro memoria:	Other keys		
	Present GAB shares 1)	Present IMF quotas	Calculated IMF quotas 2)	Average of shares of GDP and non-gold reserves 3)	GAB shares of 1962	Non-gold reserves 4)	Foreign exchange reserves 5)	Foreign trade 6)
Country	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A. Participation in percent								
United States	28.0	36.7	27.0	25.0	29.0	12.5	33.3	20.5
United Kingdom	8.5	12.8	9.0	7.9	14.5	8.1	6.0	9.7
Germany	22.2	9.4	14.4	18.7	14.5	25.5	19.8	16.3
France	5.3	8.4	9.8	9.1	8.0	9.6	6.6	10.8
Japan 7)	17.7	7.3	11.7	15.2	13.7	16.0	11.3	11.6
G-5	81.7	74.6	71.9	75.9	79.7	71.7	77.0	68.9
Canada	2.4	5.9	5.0	2.8	2.9	1.5	1.5	5.6
Italy	3.4	5.4	6.4	7.9	8.0	9.6	8.1	7.6
Netherlands	3.7	4.1	5.3	3.8	2.9	5.2	3.8	6.5
Belgium	2.1	3.9	4.8	2.2	2.2	2.3	1.6	5.8
Sweden	1.1	2.0	2.5	1.9	1.4	2.0	1.5	2.8
Switzerland 8)	5.6	4.1	4.1	5.5	2.9	7.7	6.6	2.8
Total	100	100	100	100	100	100	100	100
B. Present commitment (SDR billion)								
United States	1.9							
United Kingdom	.6							
Germany	1.5							
France	.4							
Japan 7)	1.2							
G-5	5.4	Same as in column (1)						
Canada	.2							
Italy	.2							
Netherlands	.2							
Belgium	.1							
Sweden	.1							
Switzerland 8)	.4							
Total	6.7							
C. New commitment (SDR billion)								
United States	5.2	6.9	5.0	4.7	5.4	2.3	6.2	3.8
United Kingdom	1.6	2.4	1.7	1.5	2.7	1.5	1.1	1.8
Germany	4.2	1.8	2.7	3.5	2.7	4.8	3.7	3.0
France	1.0	1.6	1.8	1.7	1.5	1.8	1.2	2.0
Japan 7)	3.3	1.4	2.2	2.8	2.6	3.0	2.1	2.2
G-5	15.3	14.0	13.4	14.2	14.9	13.4	14.4	12.9
Canada	.4	1.1	.9	.5	.5	.3	.3	1.0
Italy	.6	1.0	1.2	1.5	1.5	1.8	1.5	1.4
Netherlands	.7	.8	1.0	.7	.5	1.0	.7	1.2
Belgium	.4	.7	.9	.4	.4	.4	.3	1.1
Sweden	.2	.4	.5	.4	.3	.4	.3	.5
Switzerland 8)	1.0	.8	.8	1.0	.5	1.4	1.2	.5
Total	18.7	18.7	18.7	18.7	18.7	18.7	18.7	18.7
D. Increase in commitment (SDR billion)								
United States	3.4	5.0	3.2	2.8	3.6	.5	4.4	2.0
United Kingdom	1.0	1.8	1.1	.9	2.1	1.0	.6	1.3
Germany	2.7	.3	1.2	2.0	1.2	3.3	2.2	1.6
France	.6	1.2	1.5	1.3	1.1	1.4	.9	1.7
Japan 7)	2.1	.2	1.0	1.7	1.4	1.8	.9	1.0
G-5	9.8	8.5	8.0	8.8	9.5	8.0	9.0	7.4
Canada	.3	.9	.8	.4	.4	.1	.1	.9
Italy	.4	.8	1.0	1.3	1.3	1.6	1.3	1.2
Netherlands	.4	.5	.7	.5	.3	.7	.5	1.0
Belgium	.3	.6	.8	.3	.3	.3	.2	.9
Sweden	.1	.3	.4	.3	.2	.3	.2	.4
Switzerland 8)	.7	.4	.4	.7	.2	1.1	.8	.2
Total	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0

1) At exchange rates of September 30, 1982. - 2) Based on formula scheme 5 F-20. - 3) GDP 1980; non-gold reserves as of end August 1982. - 4) As of end August 1982. - 5) As of end August 1982; US arbitrarily assigned one third share. - 6) Exports and imports 1980. - 7) Japan unilaterally raised its GAB commitment by Y 250 billion to Y 340 billion in 1976. - 8) Switzerland, a non IMF member, is associated with the GAB with a total potential commitment of SF 865 million, equivalent to 5.6 percent of present total commitments. IMF quota was assumed to be SDR 1.4 billion, with share of calculated quotas set at the same level as in current quotas.

Details may not add to totals due to rounding.

Illustrative participation in expanded GAB (assumed size: SDR 20 billion)

Country	Keys presently under consideration: Present GAB shares 1)	Present IMF quotas	Calculated IMF quotas 2)	Average of shares of GDP and non-gold reserves 3)	Pro memoria: GAB shares of 1962	Other keys: Non-gold reserves 4)	Foreign exchange reserves 5)	Foreign trade 6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A. Participation in percent								
United States	28.0	36.7	27.0	25.0	29.0	12.5	33.3	20.5
United Kingdom	8.5	12.8	9.0	7.9	14.5	8.1	6.0	9.7
Germany	22.2	9.4	14.4	18.7	14.5	25.5	19.8	16.3
France	5.3	8.4	9.8	9.1	8.0	9.6	6.6	10.8
Japan 7)	17.7	7.3	11.7	15.2	13.7	16.0	11.3	11.6
G-5	81.7	74.6	71.9	75.9	79.7	71.7	77.0	68.9
Canada	2.4	5.9	5.0	2.8	2.9	1.5	1.5	5.6
Italy	3.4	5.4	6.4	7.9	8.0	9.6	8.1	7.6
Netherlands	3.7	4.1	5.3	3.8	2.9	5.2	3.8	6.5
Belgium	2.1	3.9	4.8	2.2	2.2	2.3	1.6	5.3
Sweden	1.1	2.0	2.5	1.9	1.4	2.0	1.5	2.8
Switzerland 8)	5.6	4.1	4.1	5.5	2.9	7.7	6.6	2.8
Total	100	100	100	100	100	100	100	100
B. Present commitment (SDR billion)								
United States	1.9							
United Kingdom	.6							
Germany	1.5							
France	.4							
Japan 7)	1.2							
G-5	5.4	Same as in column (1)						
Canada	.2							
Italy	.2							
Netherlands	.2							
Belgium	.1							
Sweden	.1							
Switzerland 8)	.4							
Total	6.7							
C. New commitment (SDR billion)								
United States	5.6	7.3	5.4	5.0	5.8	2.5	6.7	4.1
United Kingdom	1.7	2.6	1.8	1.6	2.9	1.6	1.2	1.9
Germany	4.4	1.9	2.9	3.7	2.9	5.1	4.0	3.3
France	1.1	1.7	2.0	1.8	1.6	1.9	1.3	2.2
Japan 7)	3.5	1.5	2.3	3.0	2.7	3.2	2.3	2.3
G-5	16.3	14.9	14.4	15.2	15.9	14.3	15.4	13.8
Canada	.5	1.2	1.0	.6	.6	.3	.3	1.1
Italy	.7	1.1	1.3	1.6	1.6	1.9	1.6	1.5
Netherlands	.7	.8	1.1	.8	.6	1.0	.8	1.3
Belgium	.4	.8	1.0	.4	.4	.5	.3	1.2
Sweden	.2	.4	.5	.4	.3	.4	.3	.6
Switzerland 8)	1.1	.8	.8	1.1	.6	1.5	1.3	.6
Total	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
D. Increase in commitment (SDR billion)								
United States	3.7	5.5	3.5	3.1	3.9	.6	4.8	2.2
United Kingdom	1.1	2.0	1.2	1.0	2.3	1.1	.6	1.4
Germany	3.0	.4	1.4	2.3	1.4	3.6	2.5	1.8
France	.7	1.3	1.6	1.5	1.2	1.6	1.0	1.8
Japan 7)	2.4	.3	1.2	1.9	1.6	2.0	1.1	1.1
G-5	10.9	9.5	8.9	9.7	10.5	8.9	10.0	8.3
Canada	.3	1.0	.8	.4	.4	.1	.1	1.0
Italy	.5	.9	1.1	1.4	1.4	1.7	1.4	1.3
Netherlands	.5	.6	.8	.5	.3	.8	.5	1.1
Belgium	.3	.6	.8	.3	.3	.3	.2	1.0
Sweden	.1	.3	.4	.3	.2	.3	.2	.5
Switzerland 8)	.7	.4	.4	.7	.2	1.2	.9	.2
Total	13.3	13.3	13.3	13.3	13.3	13.3	13.3	13.3

1) At exchange rates of September 30, 1982. - 2) Based on formula scheme 5 F-20. - 3) GDP 1980; non-gold reserves as of end August 1982. - 4) As of end August 1982. - 5) As of end August 1982; US arbitrarily assigned one third share. - 6) Exports and imports 1980. - 7) Japan unilaterally raised its GAB commitment by Y 250 billion to Y 340 billion in 1976. - 8) Switzerland, a non IMF member, is associated with the GAB with a total potential commitment of SF 865 million, equivalent to 5.6 percent of present total commitments. IMF quota was assumed to be SDR 1.4 billion, with share of calculated quotas set at the same level as in current quotas.

Details may not add to totals due to rounding.

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Sir ~~K~~ Couzens } HM Treasury
Mr Lavelle
Mr Gilchrist Bank of England
R.C.

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TELEGRAM NUMBER 3909 OF 7 DECEMBER

WORLD MONETARY SYSTEM: TREASURY SECRETARY REGAN'S REMARKS TO REPORTERS

1. THE NEW YORK TIMES (CLYDE FARNSWORTH) REPORTS TODAY THAT TREASURY SECRETARY REGAN SAID TO REPORTERS YESTERDAY THAT HE WOULD BE TAKING AN INITIATIVE AT THE MEETING OF G5 FINANCE MINISTERS ON THURSDAY FOR AN INTERNATIONAL CONFERENCE TO IMPROVE THE WORLD'S MONETARY SYSTEM AND TO DEAL WITH THE MOUNTING DEBT OF DEVELOPING COUNTRIES AND RISING WORLDWIDE UNEMPLOYMENT. REGAN IS QUOTED AS SAYING ''WHAT I AM SUGGESTING IS THAT WE HAVE TO HAVE SOME BETTER WAY OF OPERATING''. THE SAID THAT HIS OBJECTIVES FOR THE PROPOSED MONETARY CONFERENCE WOULD INCLUDE EXPLORING WAYS TO CONTROL INFLATION, CHANGE MONETARY PRACTICES AND DEAL WITH CURRENCY PROBLEMS: HE WAS SEEKING TO ACHIEVE ''VISCOSITY'' OR LESS FLUCTUATION IN THE VALUE OF THE WORLD'S MAJOR CURRENCIES, TO BE ACHIEVED THROUGH A CONVERGENCE OF ECONOMIC POLICIES, ESPECIALLY THOSE DEALING WITH TAXATION AND MONEY SUPPLY. REGAN DESCRIBED HIS CALL FOR A CONFERENCE AS A PERSONAL INITIATIVE WHICH HAD NOT YET BEEN CLEARED BY THE ADMINISTRATION, ALTHOUGH HE SAID HE HAD TAKEN IT UP WITH OTHER MEMBERS OF THE REAGAN CABINET. HE IS QUOTED AS MAKING

DEALING WITH TAXATION AND MONEY SUPPLY. REGAN DESCRIBED HIS CALL FOR A CONFERENCE AS A PERSONAL INITIATIVE WHICH HAD NOT YET BEEN CLEARED BY THE ADMINISTRATION, ALTHOUGH HE SAID HE HAD TAKEN IT UP WITH OTHER MEMBERS OF THE REAGAN CABINET. HE IS QUOTED AS MAKING IT CLEAR THAT HE WAS NOT CALLING FOR A RETURN TO FIXED EXCHANGE RATES NOR FOR US INTERVENTION IN FOREIGN EXCHANGE MARKETS (UNLESS CONDITIONS BECOME CHAOTIC).

2. THE WASHINGTON POST (HOBART ROWEN), IN A SIMILAR REPORT, QUOTES REGAN AS CALLING FOR AN OVERHAUL OF THE ECONOMIC MONETARY SYSTEM TO DEAL WITH THE GLOBAL PROBLEMS CAUSED BY THE RECESSION. IN PARTICULAR REGAN IS QUOTED AS SAYING THAT HE WILL ASK FINANCE MINISTERS OF THE MAJOR INDUSTRIAL COUNTRIES TO CONSIDER WAYS TO ENSURE A FASTER AND MORE COORDINATED RESPONSE BY GOVERNMENTS AND LENDING AGENCIES TO COPE WITH CRITICAL CREDIT SHORTAGES IN THE THIRD WORLD AND THAT HE WOULD BRING THIS QUESTION UP AT THE G5 DINNER. HE TOLD REPORTERS THAT THE PRESENT AD HOC BASIS OF RELATIONS AMONGST THE IMF, THE BANK FOR INTERNATIONAL SETTLEMENTS AND CENTRAL BANKS MUST BE ADANDONED SO THERE CAN BE A FASTER RESPONSE TO THE NEEDS OF LESS FORTUNATE NATIONS, AND SAID THAT '' THERE IS NO OVERALL SYMMETRY - I AM NOT KNOCKING THE IMF, BUT WE DON'T GET THE NEEDY NATIONS TO THE IMF SOON ENOUGH''.

3. THE WALL STREET JOURNAL CONTAINS A MUCH MORE RESTRAINED REPORT THAN IN THE WASHINGTON POST OR THE NEW YORK TIMES. (UNDER SECRETARY SPRINKEL'S OFFICE CLAIMS THAT IT CONTAINS THE MOST AUTHORITATIVE GENERAL INDICATIONS OF THE WAY THE TREASURY IS THINKING.) THE JOURNAL REPORTS THAT REGAN SAID HE WOULD PROPOSE THE CREATION OF A FASTER LOAN-DISBURSING AGENCY TO HELP DEBT-RIDDEN COUNTRIES KEEP AFLOAT WHILE WAITING FOR INTERNATIONAL MONETARY FUND LOANS TO BE APPROVED, REDUCTION OF PROTECTIONIST TRADE BARRIERS, AND CLOSER COORDINATION OF BROAD ECONOMIC POLICIES TO HELP MINIMIZE VOLATILITY IN THE FOREIGN EXCHANGE MARKETS. HE IS QUOTED AS SAYING THAT ''THE SITUATION CONTINUES TO GROW MORE SERIOUS AND THE POTENTIAL IS OUT THERE FOR AN EVEN MORE SERIOUS SITUATION. WE HAVE GOT TO TRY TO HEAD IT OFF''. THE REPORT CONTRADICTING THE REPORT IN THE NEW YORK TIMES, QUOTES REGAN AS SAYING THAT ''WE ARE NOT YET READY'' FOR A BRETTON WOODS CONFERENCE.

COMMENT

4. CONTACTS THAT WE HAVE HAD WITH THE US TREASURY SUGGEST THAT REGAN'S STATEMENTS TO REPORTERS DID NOT RESULT AS THE CULMINATION OF THE WORKING OUT OF TECHNICAL PROPOSALS. THEY WERE PURELY SPONTANEOUS AND PERSONAL. THIS WOULD NOT BE THE FIRST TIME THAT

REGAN'S STATEMENTS TO REPORTERS DID NOT RESULT AS THE CULMINATION OF THE WORKING OUT OF TECHNICAL PROPOSALS. THEY WERE PURELY SPONTANEOUS AND PERSONAL. THIS WOULD NOT BE THE FIRST TIME THAT R. AN HAS SPOKEN INJUDICIOUSLY TO REPORTERS, ALTHOUGH HIS COMMENTS SEEM TO CONSTITUTE THE MOST SERIOUS BREACH OF G5 CONFIDENTIALITY TO DATE.

5. REGAN MAY HAVE BEEN INFLUENCED BY HIS RECENT VISIT TO LATIN AMERICA WITH THE PRESIDENT AND IN PARTICULAR BY THE DECISION OF THE US TO GRANT A MAJOR SHORT-TERM LOAN TO BRAZIL AND THE NEED FOR FURTHER FINANCE FOR THAT COUNTRY. HE MAY ALSO WISH TO SOFTEN UP CONGRESS TO PREPARE FOR A LARGE IMF QUOTA INCREASE. HIS REMARKS SEEM TO REFLECT INCREASING AMERICAN GENERAL CONCERN ABOUT THE ABILITY OF THE WORLD MONETARY SYSTEM TO COPE WITH THE STRAINS BEING PUT UPON IT. THE REFERENCE BY REGAN TO HAVING DISCUSSED THE PROBLEM WITH CABINET COLLEAGUES MAY BE A REFERENCE TO SHULTZ, WHO IS KNOWN TO BE CONCERNED ABOUT INTERNATIONAL ECONOMIC DEVELOPMENTS.

6. THE MAIN SUBSTANTIVE PROPOSAL WHICH SEEMS TO HAVE EMERGED IS THAT REGAN WOULD WISH TO HAVE IMPROVED COORDINATION IN ARRANGEMENTS FOR PROVIDING LIQUIDITY TO UNDER-DEVELOPED COUNTRIES, OR OTHER PROBLEM COUNTRIES, IN THE PERIOD BEFORE THEY HAVE ACCESS TO THE IMF, AND IT MAY BE THAT THIS IS THE PROPOSAL THAT REGAN WILL MAKE AT THE G5 MEETING. THE REFERENCE TO THE NEED FOR A CONVERGENCE OF INTERNATIONAL ECONOMIC POLICIES TO BRING ABOUT VISCOSITY IN EXCHANGE RATES WILL NEED TO BE FURTHER ELABORATED BEFORE CONCLUSIONS CAN BE DRAWN AS TO WHETHER THE AMERICANS ARE SAYING ANYTHING NEW.

7. COPIES OF PRESS REPORTS FOLLOW BY BAG.

8. FCO PLEASE PASS TO COUZENS AND LAVELLE (TREASURY), GILCHRIST (BANK) AND APPLEYARD (ERD).

WRIGHT

NNNN

To Raise Gasoline Tax Encounters Resistance

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—The Senate Commerce Committee approved the use of wider and longer trucks on federally financed highways as part of the Senate's gasoline-tax increase package.

But the administration's plan to more than double the tax on gasoline to pay for highway and transit projects ran into stronger-than-expected opposition in House debate last night. The legislation, which has been embraced by congressional leaders of both parties, is opposed by trucking industry groups and others. Besides raising the federal gasoline tax to nine cents a gallon from four cents, the measure would sharply increase taxes on heavy trucks, which are considered most responsible for road wear.

Last night, a fragile bipartisan coalition in the House tried to maintain support for the bill by adding a series of administration-backed amendments designed to please some labor, construction and state groups. The bill seeks to raise $5.5 billion annually for road and transit work and to create as many as 320,000 jobs.

The Senate panel voted to require states to allow truck tractor-trailer combinations, involving twin trailers, of as long as 65 feet and trucks as wide as 102 inches, on all roads built with federal money. Currently, 13 states and the District of Columbia don't permit the 65-foot, two-trailer rigs, while 47 states don't allow trucks wider than 96 inches.

The committee also approved provisions aimed at prodding the Reagan administration and states to issue tougher safety regulations for big trucks. It approved authorization of $150 million over five years to help states issue and enforce the rules. Separately, the commerce panel voted to add a total of $250 million to finance work at airports through fiscal 1985. The panel also voted to allow $225 million—currently scheduled for use in later years—to be used during fiscal years 1983 to 1985. The effect would be to boost fiscal 1983-85 airport funds by $475 million.

The truck-size changes, which were backed by the Reagan administration, would go into effect 90 days after Congress enacts a gasoline-tax package. The administration had proposed giving the states two years to put the changes into effect.

The Senate Public Works Committee will consider increased truck weights today.

Truckers want even more-liberalized truck sizes than the Senate panel approved, as a price for paying higher fuel and other "user fees." But they also oppose the amount of user-fee boosts that the administration is seeking or that the House Ways and Means Committee had recommended for House action yesterday.

TIME-DC Trust Buys 6.4% of LLC's Convertible Preferred

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—A pension trust for employees of T.I.M.E.-DC Inc. said it acquired 6.4% of LLC Corp.'s 5.5% cumulative convertible preferred stock as "equity interest."

In a filing with the Securities and Exchange Commission, the pension trust said it acquired 10,000 of the preferred shares Nov.

The UAW's Canadian chief, Robert White, said in Toronto, that Chrysler's proposal—aimed at settling a month-long strike by 10,000 Canadian workers—"still leaves us miles apart" and "in no way comes close to what it will take to get a settlement" of the walkout. Mr. White said the union wouldn't counter Chrysler's offer in Canada but simply would wait for the company to increase its proposal.

UAW President Douglas Fraser said in Detroit that the auto maker's U.S. proposal fell short of the union's wage demands on behalf of about 43,000 hourly workers and that UAW bargainers would make a counterproposal today and "drive for a settlement" by around midnight tonight. But he said the proposals provided a "foundation" for a settlement of the Canadian strike and of a continuing contract stalemate in the U.S.

Chrysler Chairman Lee Iacocca said Friday that the Canadian dispute must be settled in time for workers there to return to

U.S. Says It Is Ready To Help Stabilize Economy of World

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—The Reagan administration signaled it is worried enough about growing world economic strains to go along with expanded international efforts to cope with the problem, but it still isn't backing any sweeping new proposals.

Treasury Secretary Donald Regan told reporters at a briefing yesterday that he thinks the major industrial powers should consider various approaches to stabilize the troubled global financial system. He said these include creation of a faster loan-disbursing agency to help debt-ridden countries keep afloat while waiting for International Monetary Fund loans to be approved; reduction of protectionist trade barriers, and closer coordination of broad economic policies to help minimize volatility in the foreign-exchange markets.

At the same time, however, Mr. Regan rejected any more sweeping proposals, such as abandoning the current system of floating exchange rates in an effort to limit the range within which currency values may fluctuate. He again turned thumbs down on suggestions that the U.S. increase its intervention in the international currency markets to keep exchange rates from getting out of line, as some European officials have proposed.

Finance ministers of the U.S., West Germany, Britain, France and Japan are scheduled to meet in Frankfurt Thursday to complete work on a plan to expand the IMF's lending resources.

Mr. Regan said U.S. officials were becoming more concerned because "the situation" internationally "continues to grow more serious and the potential is out there for an even more serious situation. We've got to try to head that off," he said.

The secretary said the finance ministers ought to begin laying the groundwork in Frankfurt for a meeting to consider the whole financial and economic issue. But he asserted it probably shouldn't come too soon because policymakers aren't sure yet what ought to be on the agenda. Asked about a second Bretton Woods conference, such as the one in 1944 that established the IMF and World Bank, he replied: "We're not ready for that yet."

The U.S. already has broached most of the proposals Mr. Regan listed in earlier international economic meetings.

fered a Canadian contract that would ex[pire] in September 1984. Last week, in the U... the company and the union agreed te[ntatively] to a September 1984 expiration ... for any pact, rather than the September ... date provided in a proposed accord ... members rejected this fall.

Yesterday, Mr. Fraser said Chrys[ler's] U.S. offer is an improvement on the ea[rlier] agreement. Union officials declined to ... details of the U.S. and Canadian propo[sals] or to say whether they included a si... wage increase, restoration of cost-of-li[ving] payments, or both. Chrysler's chief neg[otia]tor in Canada said, however, that in its ... there, the company recognized that the ... of living is higher than in the U.S. bec[ause] of higher inflation rates and the lower ... of Canadian currency.

Mr. Fraser said Chrysler's U.S. an[d Ca]nadian agreements would be "no more ... ferent" under the company proposals ... are the American and Canadian versi[ons of] accords with General Motors Corp. ... Ford Motor Co. The union in Canada s... two-year contracts this fall with those ... makers in which that nation's higher c... living is reflected in the second year ... agreements.

In a related matter, Marc Stepp, a ... vice president and director of the u... Chrysler department, said Chrysler ... yet begun production in Detroit-area ... of seat springs and assemblies that ... made in a Canadian Chrysler plant ... the strike.

The union has said its U.S. me[mbers] won't perform such "struck work" i[f it in]volves production of parts for Chrysle[r ve]hicles. U.S. union members are invol[ved in] the production of some parts formerly ... in Canada that Chrysler sends to oth[er] makers.

However, Thomas Miner, Chrysler ... president for industrial relations, sa[id yes]terday that production of the springs ... semblies is scheduled to begin soon. ... that if UAW members refuse to do th... Chrysler could have other compani[es] ... production of the parts within days.

S. California Edison Cleared of Allegati... Of Bad Welding at ...

By a WALL STREET JOURNAL *Staff R...*

WALNUT CREEK, Calif.—The ... Regulatory Commission's staff said ... found any evidence to substantiate ... that builders used defective weldi[ng] ... Southern California Edison Co. ... power plant.

The findings were in a report ... response to allegations by E. Ear[l] ... former quality-control engineer fo[r] ... Power Corp. Mr. Kent had char[ged] ... welding on the San Onofre nuclear ... ing station in Southern California ... gerously defective. Bechtel, an en[gineering] and construction concern, had ... plant.

The agency's regional office ... cluded that NRC regulations hadn['t been] ... olated in the construction of safe[ty] ... equipment at Units 1 and 2, gener[ating] ... at the San Onofre plant.

The report also concluded tha[t] ... Mr. Kent's concerns already had ... dressed and resolved by Bechtel ... ern California Edison. The report ... with Mr. Kent's contention that th[e] ... sion's standards for welding a[re ade]quate.

Last March, Mr. Kent was dis[missed by] Bechtel after he allegedly failed a[n ex]amination on quality control. M...

in September 1984. Last week, in the the company and the union agreed tively to a September 1984 expiration for any pact, rather than the September date provided in a proposed accord members rejected this fall.

Yesterday, Mr. Fraser said Chrys U.S. offer is an improvement on the agreement. Union officials declined to details of the U.S. and Canadian prop or to say whether they included a wage increase, restoration of cost-of payments, or both. Chrysler's offer for its Canada said, however, that there the company recognized that living is higher there than in the U.S. of higher inflation rates and the lower of Canadian currency.

Mr. Fraser said Chrysler's U.S. modified agreements would be "no diff ferent" under the company proposals are the American and Canadian vers accords with General Motors Corp Ford Motor Co. The union in Canada two-year contracts this fall with those makers in which that nation's higher living is reflected in the second year agreements.

In a related matter, Marc Stepp, vice president and director of the Chrysler department, said Chrysler yet begun production in Detroit-area of seat springs and assemblies that made in a Canadian Chrysler plant the strike.

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WALNUT CREEK, Calif.—The Regulatory Commission's staff sai found any evidence to substantiate that builders used defective weld Southern California Edison Co. power plant.

The findings were in a report response to allegations by E. Ear former quality-control engineer for Power Corp. Mr. Kent had cha welding on the San Onofre nuclea ing station in Southern California primarily defective. Bechtel, an e and construction concern, had plant.

The agency's regional office cluded that NRC regulations had olated in the construction of equipment at Units 1 and 2, pres at the San Onofre plant.

The report also concluded Mr. Kent's concerns already dressed and resolved by Bechtel ern California Edison. The report with Mr. Kent's contention that sion's standards for welding quate.

Last March, Mr. Kent was Bechtel after he allegedly faile explanation on quality control. W

The UAW's Canadian chief, Robert White, said in Toronto, that Chrysler's proposal—aimed at settling a month-long strike by 10,000 Canadian workers—"still leaves us miles apart" and "in no way comes close to what it will take to get a settlement" of the walkout. Mr. White said the union wouldn't counter Chrysler's offer in Canada but simply would wait for the company to increase its proposal.

UAW President Douglas Fraser said in Detroit that the auto maker's U.S. proposal fell short of the union's wage demands on behalf of about 43,000 Chrysler workers and that UAW bargainers would make a counterproposal today and "strive for a settlement" by around midnight tonight. But he said the proposals provided a "foundation" for a settlement of the Canadian strike and of a continuing contract stalemate in the U.S.

Chrysler Chairman Lee Iacocca said Friday that the Canadian dispute must be settled in time for workers there to return to

U.S. Says It Is Ready To Help Stabilize Economy of World

By a WALL STREET JOURNAL Staff Reporter

WASHINGTON—The Reagan administration signaled it is worried enough about growing world economic strains to go along with expanded international efforts to cope with the problem, but it still isn't backing any sweeping new proposals.

Treasury Secretary Donald Regan told reporters at a briefing yesterday that he thinks the major industrial powers should consider various approaches to stabilize the troubled global financial system. He said these include creation of a faster loan-disbursing agency to help debt-ridden countries keep afloat while waiting for International Monetary Fund loans to be approved; reduction of protectionist trade barriers, and closer coordination of broad economic policies to help minimize volatility in the foreign exchange markets.

At the same time, however, Mr. Regan rejected any more sweeping proposals, such as abandoning the current system of floating exchange rates in an effort to limit the range within which currency values may fluctuate. He again turned thumbs down on suggestions that the U.S. increase its intervention in the international currency markets to keep exchange rates from getting out of line, as some European officials have proposed.

Finance ministers of the U.S., West Germany, Britain, France and Japan are scheduled to meet in Frankfurt Thursday to complete work on a plan to expand the IMF's lending resources.

Mr. Regan said U.S. officials were becoming more concerned because "the situation" internationally "continues to grow more serious and the potential is out there for an even more serious situation. We've got to try to head that off," he said.

The secretary said the finance ministers ought to begin laying the groundwork in Frankfurt for a meeting to consider the whole financial and economic issue. But he asserted it probably shouldn't come too soon because policymakers aren't sure yet what ought to be on the agenda. Asked about a second Bretton Woods conference, such as the one in 1944 that established the IMF and World Bank, he replied: "We're not ready for that yet."

The U.S. already has broached most of the proposals Mr. Regan listed in earlier international economic meetings.

To Raise Gasoline Tax Encounters Resistance

By a WALL STREET JOURNAL Staff Reporter

WASHINGTON—The Senate Commerce Committee approved the use of wider and longer trucks on federally financed highways as part of the Senate's gasoline-tax increase package.

But the administration's plan to more than double the tax on gasoline to pay for highway and transit projects ran into stronger-than-expected opposition in House debate last night. The legislation, which has been embraced by congressional leaders of both parties, is opposed by trucking industry groups and others. Besides raising the federal gasoline tax to nine cents a gallon from four cents, the measure would sharply increase taxes on heavy trucks, which are considered most responsible for road wear.

Last night, a fragile bipartisan coalition in the House tried to maintain support for the bill by adding a series of administration-backed amendments designed to please some labor, construction and state groups. The bill seeks to raise $5.5 billion annually for road and transit work and to create as many as 320,000 jobs.

The Senate panel voted to require states to allow truck tractor-trailer combinations, involving twin trailers, of as long as 65 feet and trucks as wide as 102 inches, on all roads built with federal money. Currently, 12 states and the District of Columbia don't permit the 65-foot, two-trailer rigs, while 47 states don't allow trucks wider than 96 inches.

The committee also approved provisions aimed at prodding the Reagan administration and states to issue tougher safety regulations for big trucks. It approved authorization of $150 million over five years to help states issue and enforce the rules. Separately, the commerce panel voted to add a total of $250 million to finance work at airports through fiscal 1985. The panel also voted to allow $225 million—currently scheduled for use in later years—to be used during fiscal years 1983 to 1985. The effect would be to boost fiscal 1983-85 airport funds by $475 million.

The truck-size changes, which were backed by the Reagan administration, would go into effect 90 days after Congress enacts a gasoline-tax package. The administration had proposed giving the states two years to put the changes into effect.

The Senate Public Works Committee will consider increased truck weights today.

Truckers want even more-liberalized truck sizes than the Senate panel approved, as a price for paying higher fuel and other "user fees." But they also oppose the amount of user-fee boosts that the administration is seeking or that the House Ways and Means Committee had recommended for House action yesterday.

TIME-DC Trust Buys 6.4% of LLC's Convertible Preferred

By a WALL STREET JOURNAL Staff Reporter

WASHINGTON—A pension trust for employees of T.I.M.E.-DC Inc. said it acquired 6.4% of LLC Corp.'s 5.5% cumulative convertible preferred stock as "equity interest."

In a filing with the Securities and Exchange Commission, the pension trust said it acquired 10,000 of the preferred shares Nov.

PWN

FROM: J O KERR
7 December 1982

MR BOTTRILL

cc - Sir K Couzens

JAPAN

The Chancellor was very grateful for your brief for his meeting with Mr Pym yesterday morning. (I am writing a record.)

2. The Chancellor noted that, on Japan, the brief argued - as he has in the past - that a more relaxed fiscal stance, and tighter monetary policy, would be appropriate. It also suggested that the IMF agreed. The Chancellor got the firm impression, from discussion with Larosiere on his recent visit, that the IMF no longer think that the Japanese should be urged to relax their fiscal policy. He wonders whether we are sure that we want to stick to our previous line.

JOK.

J O KERR

7/12/82,

See Butler? on Japan: last paper in this section - gw.

G5 MINISTERS' MEETING, KRONBERG 9-10 DECEMBER 1982

WORLD ECONOMIC PROSPECTS

POINTS TO MAKE

(i) Prospects for world economic activity both this year and next have been revised downwards. But slowdown in inflation has also been greater than anticipated.

(ii) Most forecasters still expect some recovery next year in the US although the timing remains uncertain. Japan's growth picks up next year based largely on domestic demand. Growth in the European economies next year has been revised down sharply and prospects are for very little growth.

(iii) The present depressed level of activity is part of the transitional cost of moving to a lower level of inflation. Monetary conditions, however, may have been tighter than intended in some cases and the effects more severe than expected. Financial strains on developing countries and their impact on trade have been greater than most expected.

(iv) Delayed recovery does not call for an abandonment of the counter-inflation strategy followed by major industrial countries since OPEC 2. But countries need to interpret carefully the impact of policies and tailor them to make allowance for the protracted nature of the recession.

(v) For monetary policy this implies taking account of a wide range of factors when setting monetary targets. Welcome, therefore, more flexible US approach.

(vi) In judging fiscal policy the cyclical and structural elements of budget deficits must be distinguished. Deficits may be allowed to reflect at least in part the effect of the recession, as long as the underlying trend is firmly downwards. Important, though, that the US should regain control of public finances and put its budget deficit on a declining medium-term path.

(vii) Important, too, that countries should take account of international repercussions of their policies, particularly monetary policies - especially as we may be heading into another period of growing current account imbalances and volatile exchange rates.

(viii) The international financial situation remains fragile and requires adherence to firm policies by the major reserve currency countries. It also requires adjustment by the major debtors among the developing countries together with the provision of adequate finance by the international financial institutions and the commercial banks. (See separate briefs on IMF matters.)

(ix) Protectionism, whether by trade barriers, devaluation or unfair competition must be avoided. Open trading system and associated healthy world trade offer best prospect for sustained recovery. Recent GATT meeting reaffirmed support for open trading system.

BACKGROUND

Developments and Prospects

GDP growth in the industrial countries is now estimated to have fallen slightly this year on average, and the OECD Secretariat estimates that it will increase by less than 2 per cent next year. The fall in output has been particularly steep in the US and Canada, although output has also fallen in Germany and remains depressed in much of Europe. Only Japan has achieved modest growth. Next year, the US is expected to grow by some 2 per cent and Japan by 3 per cent. But the major European countries are likely to growth by less than 1 per cent on average.

2. The prolongation of the recession reflects weak growth of real incomes, high savings ratios, depressed investment, a prolonged stock adjustment by companies and recently a sharp decline in demand from developing countries. This last which reflects the growing financing strains on many debtor countries has meant that world trade has fallen this year for the first time since 1975. Any recovery next year is likely to be modest.

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2. The prolongation of the recession reflects weak growth of real incomes, high savings ratios, depressed investment, a prolonged stock adjustment by companies and recently a sharp decline in demand from developing countries. This last which reflects the gravity financing strains on many debtor countries has meant that world trade has fallen this year for the first time since 1975. Any recovery next year is likely to be modest.

3. Unemployment has continued to rise in all major economies except Japan, and now averages almost 9 per cent.

4. Inflation, however, has slowed more rapidly than expected, the rate of increase in consumer prices which was more than 12 per cent in the major economies in 1980, had slowed to 6½ per cent by October of this year, although there were still wide divergences with Japan, Germany, the US and the UK well down into single figures, France and Canada around 9-10 per cent and Italy still at 17 per cent.

5. The prolongation of the recession and the slowdown in inflation have been accompanied by lower interest rates. Three-month money market rates in the US which were around 14-15 per cent at the start of the year have now fallen to around 9 per cent. Falls in interest rates elsewhere have also been marked, although they have been smaller than those in the US, and in Japan rates have tended to be firmer.

6. The narrowing of interest differentials between the US and other countries has been accompanied most recently by some modest decline in the dollar's exchange rate from the peaks reached last summer. The DM and the yen have tended to be firmer. These movements have been encouraged by growing signs that the US current account may be on a weakening trend while the Japanese and German current balances are strengthening. The OECD forecasts that the US will be in deficit by $24 billion next year with surpluses of $15 billion for Japan and $5 billion for Germany.

7. These changes in current balances among major countries come at a time when the group as a whole appears to be moving towards a position of broad balance as the OPEC surplus disappears. The smaller OECD countries, however, still appear to be in deficit as a group, as do the non-oil developing countries, although financial strains are forcing them to reduce their deficits faster than earlier seemed likely.

Policies

8. The present situation offers several considerations for policy. First, the slowdown in inflation and reduction in interest rates should improve the prospects for recovery next year. They should improve the cash flow of companies, and encourage households to increase spending. They will also mean that given cash targets for public spending will imply larger volume increases or increase the scope for lower taxes.

9. A second consideration, however, is that on present indications the recovery will be modest by past standards and not fast enough to stop unemployemnt rising further. This may to some extent reflect the fact that in some cases policies may have turned out tighter than originally intended and the restrictive effects more severe. This has been revealed perhaps by the high real interest rates of recent years, the sharppressures on companies and in the case particularly of the dollar of pressure on the exchange rate. The cumulative effects of many industrial countries trying simultaneously to pursue restrictive policies have alsobeen difficult to judge, as has the effect on non-industrial economies.

10. The series of Ministerial meetings over the summer at the OECD, the Versailles Summit and Toronto all agreed that the broad counter-inflation strategy should be sustained. But at the same time there has been recognition of the need to tailor policies to the present situation.

11. A particular difficulty has been to decide the correct stance of monetary policy at a time of institutional change and shifting liquidity preferences. We have therefore welcomed the more flexible approach adopted by the US Federal Reserve as long as it does not lapse into laxity. The US authorities have suspended the M1 target for the rest of this year due to technical distortions, but have increased the target range for M2 for the last few months of 1982 up to $8\frac{1}{2}$-$9\frac{1}{2}$ per cent (the earlier target was 6-9 per cent). Recently M2 growth has been within the higher range though, measured from the base period, it has overshot the original target. Canada has recently abandoned monetary targets for similar reasons and

substituted an exchange rate target. Monetary growth in Germany is running at 6½ per cent and remains at the top of the 4-7 per cent target range which is being continued for next year. In France, however, monetary growth at 18 per cent is well above the 12½-13½ per cent target range.

12. Progress in reducing fiscal deficits has been hampered by the effectof the recession. The OECD estimates that general government financial deficits in the major countries which were equivalent to less than 2 per cent of GDP in 1979, are likely to have risen to 4 per cent of GDP in 1982 and may not fallnext year. Only the UK and Japan have actually managed to reduce deficits. Germany has managed to offset much of the effect of the recession by restrictive measures. In the US and France, however, expansionary fiscal measures have added to the effectof the recession in increasing deficits.

13. Ministers of the major countries have agreed on the need to reduce deficits in the medium-term, but again there has been recognitionof the need to tailor policies to countries' circumstances. In particular, there has been recognitionof the need to distinguish between the cyclical and structural elements of the deficit, and to make at least some allowance for the effectsof the recession. We have also argued the case for those countries, such as Japan, which have good inflation and external performance to use what scope they have to encourage greater reliance on domestic demand. This autumn's yen 2 trillion fiscal package, therefore, was welcome. The US deficit, however, remains a cause for concern. Forecasts now suggest that it may rise from $110 billion in FY 1982 to around $200 billion. The Administration will announce its budget plans for FY 1984 in January and we shall be looking for convincing signs that the deficit is to be put on a declining medium-term path.

14. The prospect of current account imbalances and potentially volatile exchange rates over the next yearor so reinforces theneed - recognised at Versailles - for co-ordination of policies between the major countries. Careful handling of both US monetary and fiscal policy will be required if confidence in the dollar is to be maintained. Other countries, such as Japan and Germany, with potentially strong currencies

will need to strike a balance between reducing domestic interest rates and allowing their exchange rates to appreciate.The objective of an orderly adjustment to a realistic pattern of exchange rates will not be easy to achieve.

14. The maintenance of firm but flexible policies
- together with adequate co-operation between countries
- has been seen as the essential framework for sustainable

world economic recovery and the stability of the international financial system. The financial strains caused by the liquidity problems of a few major debtor countries have also stressed the need for appropriate adjustment policies supported by finance from the international financial institutions (see separate brief on IMF matters). Lastly, the prolongation of the recession and the associated strains on the open trading system have reinforced the need to avoid protectionis and to rely instead on free but fair trade.

CONFIDENTIAL

FROM: C J CAREY
DATE: 7 December 1982

1. MR LITTLER Ah 9/12
2. CHANCELLOR OF THE EXCHEQUER

cc Sir Kenneth Couzens
Mr Lavelle
Mr Bottrill
Mr Hawtin

Copies attached for:

Chief Secretary
Economic Secretary
Sir Douglas Wass
Mr Ridley

YUGOSLAVIA: ECONOMIC CRISIS

I attach a self-explanatory draft reply to the Foreign Secretary's minute of today. The line is broadly agreed at official level with FCO and ECGD, with whom we have been in touch separately. The draft goes slightly further than the line suggested in the interim report you have already had from Mr Littler, in two respects. In the first place it accepts, in the light of last week's discussion in Paris that it may be difficult to hold the line that we are not interested in any type of solution for the Yugoslav problem beyond a tough dose of IMF medicine plus rescheduling. The draft also accepts, by implication, Mr Pym's view that at next week's resumed official meeting in Paris, and quite possibly at any Ministerial discussions beforehand, the UK is likely to come under pressure to respond pretty specifically to the question how much we would be prepared to put up and in what form by way of help to Yugoslavia other than debt relief.

2. The refinancing suggestion has no direct impact on public expenditure, PSBR or ECGD's trading accounts (though being medium term money it would be a useful measure of reflief for the Yugoslavs, and helpful for confidence). To go much above $60 million could be more difficult, because it would add to our exposure.

3. This exchange of minutes with Mr Pym, if the attached draft is agreed, might serve as briefing for any discussion on Yugoslavia at G5 and at Mr Pym's pre-NATO meeting.

CJC

(C J CAREY)

CONFIDENTIAL

FROM: [illegible]
DATE: 7 December 19[illegible]

1. MR [illegible]
2. CHANCELLOR OF THE EXCHEQUER

cc Sir Kenneth Couzens
Mr Lavelle
Mr Bottrill
Mr Newton

[illegible]

Chief Secretary
Economic Secretary
Sir Douglas Wass
Mr Middleton

YUGOSLAVIA: ECONOMIC CRISIS

I attach a self-explanatory draft reply to the Foreign Secretary's minute of today. The line is broadly agreed at official level with FCO and [illegible], with whom we have been in touch separately. The draft goes slightly further than the line suggested in the interim [illegible] you have already sent from [illegible], in two respects. In the first place it accepts, in the light of last week's discussion in Paris that it may be difficult to hold the line that we are not interested in any type of solution for the Yugoslav problem beyond a straight dose of IMF medicine plus rescheduling. The draft also accepts, by implication, [illegible] views that [illegible] next week's informal official meeting in Paris, and [illegible] the possibility of any bilateral discussions beforehand, the UK is likely to come under pressure to respond pretty specifically to the question how much we would be prepared to provide, and in what form, by way of help to Yugoslavia other than debt relief.

2. The refinancing operation has no direct impact on public expenditure, [illegible] ECGD's trading accounts, (though being medium term money it would [illegible] special [illegible] and [illegible]). [illegible] would be more difficult, because it would add to our exposure.

3. This exchange of minutes [illegible], if the [illegible] agreed, might [illegible] material for [illegible] discussion [illegible] Yugoslavia's [illegible].

([illegible])

CONFIDENTIAL

~~DRAFT~~ MINUTE FROM: CHANCELLOR OF THE EXCHEQUER
TO: FOREIGN AND COMMONWEALTH SECRETARY

YUGOSLAVIA: ECONOMIC CRISIS

Thank you for your minute of 7 December.

2. ~~As you say,~~ The Yugoslav~~ia~~ problem will indeed be discussed at my ~~is one of the country problems on the agenda of the~~ meeting with the other G5 ~~of the five~~ Finance Ministers tomorrow. ~~on 9-10 December. Under the same item~~ (We shall also be discussing Brazil; for which ~~where as you know the Americans are now looking to their European and other allies to make~~ a ~~substantial contribution towards~~ a bridging operation of similar size is envisaged, and the Americans look to their European and other allies to make a substantial contribution)

3. I think you know my view, and agree with it, that a credible and realistic solution to Yugoslavia's financial crisis must include a substantial element of rescheduling. The other essential element of course, as you say, ~~will be~~ a tight IMF programme. It is unfortunate that the Yugoslavs have taken such a firm stand to date against rescheduling, and doubly unfortunate that they appear to have been encouraged in this attitude by the Americans, whose own analysis of the gravity of the Yugoslav financial crisis ~~has~~ seems to have been amateurish and superficial.

4. I understand that ~~There were some signs~~ at the meeting of officials on 2 December it was evident that our other allies are closer to our own diagnosis than that of the Americans. ~~I suggest that~~ At

CONFIDENTIAL

[illegible] SECRETARY OF THE [illegible]
[illegible]

[illegible]

Thank you for your minute of 1 December.

2. As you say, unemployment is one of the country problems on the agenda of the meeting of the European Council on 9-10 December. [illegible] discussing [illegible] now looking to their European and other allies to make a substantial contribution towards a [illegible] solution of similar size. [illegible]

3. I think you know my views, and agree with it, that a credible and realistic solution to [illegible] financial crisis must include a substantial element of [illegible]. The other essential element of course will be [illegible] economic [illegible]. taken such action [illegible], and [illegible] in this [illegible] of the [illegible] which has been [illegible] and [illegible].

the forthcoming ~~pre-NATO and G5~~ Ministerial gatherings with our closest allies, ~~I think~~ I think, we should build on this. ~~and~~ We need to continue to impress on the Americans that both their analysis of the Yugoslav, situation and their proposed solution of a major international rescue operation involving new money or new credit, are unrealistic. (The tactless way in which they have inspired the latest Brazilian approach to European creditors makes it even less likely of course that official funds will be forthcoming for Yugoslavia on anything like the scale which would be required even on the Americans' own optimistic analysis.)

5. At the same time I agree with you that it would be difficult for us to decline to make any contribution to a collective rescue operation if other creditors and allies were prepared to ~~contribute~~ chip in. Other reasons apart, our claim that the American approach is an inadequate response to the Yugoslav problem would look like self-interest. I would not therefore exclude some indication to the Americans and others of willingness to make a modest contribution to a rescue package, if that is essential to avoid ~~the UK~~ our being identified as the only country not prepared to do anything over and above debt relief. Any such offer ought in my view to be subject to the following three pre-conditions being met:

(i) The Fund staff would need to put forward, and the Yugoslavs accept, an adequate IMF programme.

(ii) The burden of any assistance package ~~should~~ would have to be widely spread.

(iii) The need to consider rescheduling, and to explain the advantages of it to the Yugoslavs, should be accepted among the creditors.

6. As to the form and amount of any contribution we might make to a special assistance package, I would hope that we could avoid being too specific at this stage. But, ~~I would see no objecti~~on subject to Arthur Cockfield's views, I would see no objection to ~~to the provision by~~ ECGD's ~~of~~ providing guarantees of new commercial bank lending, on a medium term basis and at commercial rates of interest, to refinance 1983 maturities of ECGD-guaranteed loans. $60 million, or perhaps a bit more, should be available by this route, and I understand there may be some other ways in which ECGD would be able to make modest amounts of additional short term credit available consistently with their statutory and other obligations.

7. I am copying this minute to the recipients of yours.

FROM: A R H BOTTRILL
DATE: 8 DECEMBER 1982

C

MR KERR

cc Sir K Couzens
Mr Lavelle
Mr Graham

JAPAN

Tha Chancellor asked whether we should modify our view of the appropriate macroeconomic policies to be followed by Japan. In particular, he said that the IMF Managing Director no longer believes that the Japanese should be urged to relax their fiscal policy.

2. There is clearly room for debate here. The Fund staff in their last public pronouncement in the World Economic Outlook in August said that signs of a recovery in activity in the Japanese economy remained 'weak and tentative'. It added:

> 'One can understand the importance attached by the authorities to bringing about a substantial reduction in the fiscal deficit over the longer-run. But if the recovery of domestic demand is accorded high priority, caution would be appropriate in determining the pace at which that reduction is to be accomplished in the short-run. More specifically, adherence to such a priority would mean that the authorities should not aim to withdraw fiscal stimulus faster than private demand can expand to absorb an equivalent amount of net saving.'

3. Larosiere himself in his paper for G5 Ministers in September singled out Japan as the only major country where the downward adjustment of the budget deficit had gone so far that 'it could allow the adoption of a somewhat different stance of fiscal policy in the short-term'.

4. The Fund and the Managing Director, therefore, appear to have changed their views over the course of the autumn. The major factor behind this no doubt has been Japan's announcement in

October of a Yen 2 trillion increase in public spending - equivalent to about 1 per cent of GDP. This is to be spread over both the current financial year ending in April and over next year. It includes the bringing forward of spending on disaster relief from the countingency funds of the next two years, together with extra public works by both central government and local authorities. This additional spending is certainly a welcome step in the direction we have advocated and should help support Japanese domestic activity next year.

5. On the monetary side, Japanese short-term interest rates have remained relatively steadyover the autumn at around 7 per cent while US interest rates have fallen from 13 per cent to 9 per cent. This has sharply narrowed the interest differential in favour of the dollar. The combination of this with the recognition that the US current account is likely to move into deficit while Japan moves into increasing surplus, has been accompanied by a 10 per cent appreciation in the Yen/dollar rate since October. Again, this is in line with what we have urged.

6. Any remarks on Japanese policy, therefore, clearly need to acknowledge these favourable developments. They perhaps also need to recognise Japan's longer-term potential structural fiscal problems as a result of its ageing population, as well as the contribution of the nationalised industries in increasing the overall public sector deficit.

7. Nevertheless, when all this is said there is still some cause for concern about the outlook for the Japanese economy and the impact of this on the international trade and payments system as a whole.

8. The OECD Secretariat in the draft for its December Economic Outlook estimates that Japanese fiscal policy on the conventional measures will still be restrictive next year. The low level of activity seems likely to increase the ex ante fiscal deficit by about ½ per cent of GDP but this should be more than offset by the restrictive stance of policy (even allowing for the October measures)

so that the overall deficit is forecast to fall by 1 per cent of GDP to around 2-2½ per cent - the lowest of major countries except for the UK.

9. A major influence, as we have described previously, is that fiscal drag should ensure that direct tax receipts rise about twice as fast as personal incomes (16 per cent against 8 per cent). At the same time public consumption will rise less than 1 per cent in volume and, despite the extra spending measures, overall public investment including nationalised industries will fall.

10. Domestic demand as a whole is expected to rise by about 2¾ per cent - broadly similar to that forecast for the UK in the November Industry Act. But whereas in the UK import growth is likely to exceed export growth and the current account deteriorate, in Japan exports seem likely to rise about twice as fast as imports (6 per cent against 3½ per cent) and the current surplus is forecast to rise to $15 billion. The OECD expects that by early 1984 it will be running at an annual rate of more than $20 billion.

11. This is a prospect with which we have become familiar. It is a recipe for continuing trade tensions between Japan and the rest of the world. It suggests to me that although we have made some progress in the right direction, continued steady pressure may still be needed to ensure the Japanese sustain domestic activity while the yen appreciates.

12. The vital corollary, however, is that the need for parallel adjustment by the United States is all the more urgent. It is precisely this subject of where the onus for adjustment should lie that we should like the IMF Managing Director to address in his discussion with the SDR countries before we reach the Williamsburg Summit. We should perhaps see rather more of the Fund's analysis as to why pressure on Japan should be relaxed before conceding the point too readily.

A Bottrill

A BOTTRILL

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10. Domestic demand as a whole is expected to rise by about 2½ per cent - broadly similar to that forecast for the UK in the November Industry Act. But whereas in the UK import growth is likely to exceed export growth and the current account deteriorate, in Japan exports seem likely to rise about twice as fast as imports (6 per cent against 3 per cent) and the current surplus is forecast to rise to $25 billion. The OECD expects that by early 1984 it will be running at an annual rate of more than $30 billion.

11. This is a prospect with which we have become familiar. It is a recipe for continuing trade tensions between Japan and the rest of the world. It suggests to me that although we have made some progress in the right direction, continued steady pressure may still be needed to ensure the Japanese sustain domestic activity while the yen appreciates.

12. The vital challenge, however, is that the need for parallel adjustment by the United States is all the more urgent. It is precisely this subject of where the onus for adjustment should lie that we should like the new Managing Director to address in his discussion with the G10 countries before we reach the Williamsburg Summit. We should perhaps see rather more of the Fund's own views as to why pressure on Japan should be relaxed before pressing the point too readily.

A Rothwell

A ROTHWELL

ADVANCE COPY

IMMEDIATE

WONFO 21/8

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CONFIDENTIAL
DESKBY 080900Z
FROM UKDEL IMF/IBRD WASHINGTON 080100Z DEC 82.
TO IMMEDIATE F C O
TELEGRAM NUMBER 279 OF 7 DECEMBER.

Mr Evans
Mr Thomas
Hd/ERD
~~Mr K Couzens~~
Mr Lavelle } HM Trea
Mr Gilchrist B/Eng Our
RC

IMF: TIMING OF INTERIM COMMITTEE MEETING.

1. THE MANAGING DIRECTOR HELD AN INFORMAL MEETING OF EXECUTIVE DIRECTORS THIS AFTERNOON TO DISCUSS THE PROSPECTS FOR ADVANCING THE DATE OF THE NEXT INTERIM COMMITTEE MEETING. HE SAID THAT LATE FEBRUARY WOULD BE DIFFICULT AND MARCH WOULD NOT BE A SOLUTION. GIVEN THE TIME NEEDED TO PREPARE FOR A MEETING THIS LEFT END-JANUARY OR SOME TIME IN THE FIRST TEN DAYS OF FEBRUARY AS THE ONLY PRACTICAL DATES FOR AN EARLY MEETING. HE THEN LISTED A SERIES OF TESTS WHICH NEEDED TO BE FULFILLED IF AN EARLY MEETING WERE TO BE WORTHWHILE. HIS LIST WAS THE SAME AS THAT DISCUSSED WITH ERB AND ANSON ON 2 DECEMBER (OUR TELNO 272), NAMELY SATISFACTORY PROGRESS ON THE SIZE OF THE QUOTA INCREASE, ON WHICH THE ISSUES HAD ALREADY BEEN CLARIFIED: THE DISTRIBUTION OF QUOTAS, ON WHICH A FURTHER DISCUSSION IN THE BOARD WOULD BE NEEDED: MODALITIES OF SUBSCRIPTION, WHICH HAD NOT YET BEEN DISCUSSED AND ON WHICH A PAPER AND AT LEAST A PRELIMINARY BOARD DISCUSSION WOULD BE DESIRABLE: AND THE ENLARGEMENT OF BORROWING ARRANGEMENTS, ON WHICH GAB MEMBERS WERE MAKING PROGRESS. HE AVOIDED MENTIONING ACCESS LIMITS AT THIS STAGE BUT THEY WERE RAISED LATER (SEE PARAGRAPH 6 BELOW).

2. THE MD SAID THAT IF THERE WERE TO BE A REASONABLE PROSPECT OF AN EARLY INTERIM COMMITTEE MEETING IT WOULD BE NECESSARY TO GET THE SECOND, THIRD AND FOURTH OF THE ABOVE TOPICS ON TO THE BOARD AGENDA BEFORE CHRISTMAS. ON BORROWING ARRANGEMENTS, HE HOPED THAT IT WOULD BE POSSIBLE TO COME TO THE BOARD WITH A PALER VERY QUICKLY AFTER THE MEETING OF G10 DEPUTIES ON 10 DECEMBER. A PRELIMINARY DISCUSSION MIGHT BE ARRANGED ON, SAY, 17 DECEMBER BUT THERE WOULD

ADVANCE COPY

IMMEDIATE

WONFO 21/5

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CONFIDENTIAL

DESKBY 080900Z

FROM UKDEL IMF/IBRD WASHINGTON 080100Z DEC 82.

TO IMMEDIATE F C O

TELEGRAM NUMBER 279 OF 7 DECEMBER.

Mr Evans
Mr Thomas
Hd/ERD
Mr Kooyman
Mr Tanelle
Mr Gilchrist B/Eng
HM Treas
PC

IMF: TIMING OF INTERIM COMMITTEE MEETING.

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3. DIRECTORS THEN GAVE THEIR REACTIONS. LASKE (GERMANY) SAID THAT END-JANUARY/EARLY FEBRUARY SEEMED THE ONLY PRACTICAL POSSIBILITY FOR AN EARLY MEETING. THE GERMAN AUTHORITIES WOULD FIND IT DIFFICULT TO ATTEND AFTER 12 FEBRUARY. DALLARA (US) CONCURRED WITH THE MD'S SUGGESTIONS ON TIMING AND ON THE TESTS FOR A WORTHWHILE MEETING. HIS AUTHORITIES WERE KEEN TO TACKLE MODALITIES OF SUBSCRIPTION AT AN EARLY STAGE. THEY WOULD ALSO WELCOME AN EARLY BOARD DISCUSSION OF BORROWING ARRANGEMENTS AND HOPED FOR AN EARLY STATEMENT FROM THE G10 DEPUTIES. I SAID THAT THE CHANCELLOR STILL HAD HIS SIGHTS SET ON AN END-JANUARY DATE, PROVIDED THAT SATISFACTORY PROGRESS HAD BEEN MADE BEFOREHAND. I AGREED WITH THE MD THAT 10/11 FEBRUARY WAS PROBABLY THE END OF THE PRACTICAL RANGE OF DATES FOR HOLDING AN EARLY MEETING. OF THE VARIOUS ISSUES LISTED BY THE MD, MODALITIES OF SUBSCRIPTION MIGHT BE GIVEN LOWER PRIORITY IF NECESSARY TO ACHIEVE AN EARLY MEETING.

4. HIRAO (JAPAN) MUCH PREFERRED THE END-JANUARY DATE: LATER WOULD BE LESS CONVENIENT FOR HIS MINISTERS. DE MAULDE (FRANCE) THOUGHT THAT THE CHOICE WAS BETWEEN END-JANUARY AND 10/11 FEBRUARY: HE AGREED WITH ME THAT THE MODALITIES QUESTION MIGHT BE SHELVED UNTIL AFTER THE INTERIM COMMITTEE.

5. MALHOTRA (INDIA) PREFERRED END-JANUARY OR VERY EARLY FEBRUARY. BUDGET SESSIONS IN THE INDIAN PARLIAMENT STARTED AT 15 FEBRUARY. HE HAD DOUBTS ABOUT MAKING SATISFACTORY PROGRESS ON THE BORROWING ARRANGEMENTS QUESTION IN TIME FOR AN EARLY MEETING. SO FAR THE DISCUSSION HAD BEEN CONFINED TO A FEW MEMBERS AND OTHERS HAD HAD VERY LITTLE CHANCE TO CONSIDER THE ISSUES. HE WOULD HAVE AN OPEN MIND BUT PLEADED FOR THE BOARD NOT TO BE RUSHED. THE MANAGING DIRECTOR AGREED THAT ALL THE OUTSTANDING TOPICS SHOULD PRECEIVE PROPER CONSIDERATION. IT MIGHT INDEED BE NECESSARY TO HAVE TWO SESSIONS ON THE BORROWING ARRANGEMENTS BEFORE REPORTING TO THE INTERIM COMMITTEE. FINAISH (LIBYA ETC) PREFERRED THE SECOND HALF OF FEBRUARY BUT 10 FEBRUARY WOULD BE BETTER than END-JANUARY. LOVATO'S ADVISER (ITALY) SAID THAT EITHER END-JANUARY OR MID-FEBRUARY WERE ACCEPTABLE. JOYCE (CANADA

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6. PROWSE (AUSTRALIA ETC) AGREED WITH JOYCE THAT A MEETING IN JANUARY WOULD BE VERY DIFFICULT. HE DOUBTED THAT THE BOARD WOULD BE ABLE TO GIVE FULL CONSIDERATION TO THE ISSUES AND PREPARE ADEQUATE DOCUMENTATION FOR THE GOVERNORS BY END-JANUARY. HE ALSO RAISED THE QUESTION OF ACCESS POLICY. PROWSE RECALLED THAT ERB HAD SAID THAT ACCESS POLICY HAD TO BE AGREED AS PART OF THE REVIEW AND OTHER DIRECTORS HAD SUPPORTED HIM. HAD THE MD CONSIDERED HAVING AN APRIL MEETING IN ADDITION TO AN EARLY MEETING? THE MD REPLIED THAT THE WHOLE POINT OF ADVANCING THE TIMETABLE WAS TO REACH DECISIONS EARLY ENOUGH TO OBTAIN SUBSTANTIAL RATIFICATION OF THE 8TH QUOTA INCREASE NEXT YEAR. HE THEREFORE HOPED THAT AN APRIL MEETING WOULD NOT BE NEEDED. ON ACCESS, IT WAS A TOPIC THAT WOULD HAVE TO BE ADDRESSED BUT HE HOPED THAT IT COULD BE IN THE CONTEXT OF ''ANOTHER DECISION-MAKING PROCESS''. HE THEN TURNED TO DALLARA, WHO ADMITTED THAT THE US AUTHORITIES HAD CALLED FOR EARLY BOARD CONSIDERATION OF ACCESS: HOWEVER, THE US AUTHORITIES WERE WILLING TO DEFER CONSIDERATION OF ACCESS IN THE INTERESTS OF ADVANCING THE MEETING. DALLARA NOTED THAT THERE WAS A FORMAL REQUIREMENT FOR A REVIEW OF ACCESS POLICY IN JUNE, WHICH MIGHT PROVIDE A SUITABLE OPPORTUNITY TO DISCUSS THE ISSUES.

7. THE MANAGING DIRECTOR DID NOT SUM UP OR ATTEMPT TO DRAW OUT A CONSENSUS, BUT HE SEEMED WELL CONTENT WITH DISCUSSION. HE NOTED THAT THE STAFF WOULD NEED TO PRODUCE EARLY PAPERS ON THE MODALITIES OF SUBSCRIPTION AND ON THE QUESTION OF MINIMUM INDIVIDUAL QUOTA INCREASES. THE FUND SECRETARY WOULD NEED TO REVISE THE PRE-CHRISTMAS AGENDA IN THE LIGHT OF THIS DISCUSSION.

TELEX ON THE CHAIRMANSHIP ELECTION

8. AT THE END OF THE MEETING, VAN HOUTVEN MENTIONED THAT HE WAS ABOUT TO SEND OUT THE TELEX WHICH WOULD SET IN MOTION THE SELECTION PROCESS FOR THE NEW CHAIRMAN AND SUGGESTED THAT IN VIEW OF THE EXIGENCIES OF THE TIMETABLE AND THE NEED TO INVOLVE THE NEW CHAIRMAN FULLY IN THE PROCESS OF PREPARATION FOR THE INTERIM

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US POSITION ON ACCESS POLICY

9. AFTER THIS AFTERNOON'S MEETING, DALLARA TOLD ME PRIVATELY THAT US ACQUIESCENCE IN DEFERMENT OF THE DISCUSSION ON ACCESS POLICY LEFT THEM WITH MISGIVINGS. HE THOUGHT THAT SECRETARY REGAN WOULD BE PARTICULARLY ANXIOUS TO OBTAIN AGREEMENT AND A COMMON LINE ON ACCESS POLICY WITH G5 AND G10 COLLEAGUES BEFORE ANY DECISIONS WERE REACHED ON SIZE AND DISTRIBUTION OF QUOTAS.

NORDIC POSITION ON THE CHAIRMANSHIP

10. JON SIGURDSSON CALLED ME THIS MORNING TO SAY THAT ALL HIS NODIC AUTHORITIES HAD NOW CONFIRMED TO HIM THAT THEY WOULD SUPPORT THE CHANCELLOR IN THE FORTHCOMING ELECTION. I THANKED HIM AND SAID THAT THIS SUPPORT WOULD BE VERY MUCH APPRECIATED IN LONDON.

11. FCO PLEASE ADVANCE TO COUZENS AND LAVELLE (HMT), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

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2336/8

[MONETARY]

MONFO 74/08

ADVANCE COPY

PP FCO

RR BRASILIA

~~MR~~ LAVELLE HMTSY

GR 250

MR GILCHRIST B/ENGLAND

CONFIDENTIAL

MR APPLEYARD ERD

FM UKDEL IMF/IBRD WASHINGTON 082244Z DEC 82

TO PRIORITY FCO

TELEGRAM NUMBER 282 OF 8 DECEMBER

X2

INFO BRASILIA

IMF: BRAZIL

1. AT HIS MEETING FOR G5 DIRECTORS LAST EVENING, WHICH DEALT MAINLY WITH MEXICO AND ARGENTINA (SEE MY TWO IPTS NOT TO BRASILIA), THE MANAGING DIRECTOR TOUCHED BRIEFLY ON BRAZIL. MATTERS IN THIS CASE WERE MUCH LESS ADVANCED. A STAFF MISSION HAD STARTED NEGOTIATIONS ON AN EFF ARRANGEMENT JUST OVER A WEEK PREVIOUSLY. THE REQUEST WAS FOR MAXIMUM ASSISTANCE OF ABOUT SDR ONE AND A HALF BN PER YEAR FOR 3 YEARS, TOGETHER WITH A CFF FOR 50% OF QUOTA. ROBICHEK (WESTERN HEMISPHERE DEPARTMENT) SAID THAT THE DATA MIGHT JUSTIFY A CFF OF 100% OF QUOTA (VIRTUALLY SDR1 BN) WHEN ALL WAS SAID AND DONE.

2. AMONG THE ECONOMIC OBJECTIVES WHICH HAD BEEN PUT TO THE BRAZILIANS WAS A MAJOR REDUCTION IN THE ECONOMY'S RELIANCE ON EXTERNAL FINANCING. ALTHOUGH THE AVERAGE MATURITY OF BRAZIL'S EXTERNAL DEBT WAS SIGNIFICANTLY LONGER THAN THAT OF MEXICO OR ARGENTINA, BRAZIL HAD OBTAINED SIZEABLE SHORT-TERM CREDITS AND HAD PROVED NOT EXEMPT FROM THE ASSOCIATED PERILS. A FURTHER IMPROVEMENT IN BRAZIL'S EXTERNAL DEBT STRUCTURE SHOULD THEREFORE BE SOUGHT.

3. FCO PLEASE ADVANCE TO LAVELLE (HMT), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

[MONETARY]

MR LANGLE }
MR ATKINSON } TSY

(X3)

MR GILCHRIST B/ENGLAND

MR APPLEYARD ERD

WONFO 002/09

PP FCO

GR 600

CONFIDENTIAL
FM UKDEL IMF/IBRD WASHINGTON 082240Z DEC 82
TO PRIORITY FCO
TELEGRAM NUMBER 280 OF 8 DECEMBER
INFO MEXICO CITY

ADVANCE COPY

IMF:MEXICO

1. THE MANAGING DIRECTOR HELD A MEETING FOR G5 DIRECTORS LAST EVENING TO BRING THEM UP TO DATE ON MEXICO. ARGENTINA AND BRAZIL WERE ALSO DISCUSSED (SEE MIFTS). ROBICHECK, WIESNER (HIS SUCCESSOR) AND BEZA (WESTERN HEMISPHERE DEPT) WERE ALSO PRESENT.

2. THE MD REMINDED US THAT NEGOTIATIONS BETWEEN THE FUND AND THE BANKS' ADVISORY GROUP HAD BEEN OPENED WITH A VIEW TO SECURING FINANCING COMMITMENTS FROM THE BANKS IN SUPPORT OF THE FUND PROGRAM. THE BANKS HAD BEEN ASKED TO CONTRIBUTE DOLLARS 5 BILLION OF FRESH MONEY IN 1983, AND CABLES HAD BEEN SENT BY THE GROUP TO ALL BANKS INVOLVED (PERHAPS 1300 IN TOTAL). MEANWHILE, OUTLINE AGREEMENT HAD BEEN REACHED BETWEEN THE BANKERS' GROUP AND MEXICO FOR A ''RESTRUCTURING'' OF OFFICIAL DEBTS TO COMMERCIAL BANKS, INCLUDING DEBTS OF LESS THAN ONE YEAR TO MATURITY. REPAYMENTS WERE TO BE RESCHEDULED OVER 8 YEARS, BEGINNING WITH A 4-YEAR GRACE PERIOD. IT HAD ALSO BEEN REQUESTED THROUGH THE ADVISORY GROUP THAT INTERBANK DEPOSITS WITH THE MEXICAN AGENCIES WOULD BE MAINTAINED AT THEIR PRESENT LEVEL. HE HAD ASKED THE BANKS FOR COMMITMENTS ON THE PROVISION OF NEW MONEY BY DECEMBER 15, SO THAT HE WOULD BE IN A POSITION TO COME TO THE BOARD BY DECEMBER 23. ANSWERS ON RESCHEDULING WOULD PROBABLY TAKE LONGER BECAUSE THE

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3. THE MD SAID THAT THIS REQUEST TO THE BANKS LINKED WITH HIS APPROACH TO THE SUPERVISORY AUTHORITIES (OUR TELNO 256 OF NOVEMBER 19).

4. THIS WAS NOT, HOWEVER, THE WHOLE OF THE PROBLEM, THE MEXICAN PRIVATE SECTOR WAS IN ARREARS TO FOREIGN CREDITORS, INCLUDING BANKS, TO THE TUNE OF DOLLARS 900 MILLION, MOST OF WHICH WAS OVERDUE INTEREST. NEGOTIATIONS BETWEEN MEXICO AND THE BANKS ON THESE ARREARS WERE PROCEEDING SATISFACTORILY.

5. FURTHERMORE, IF THE EXTERNAL FINANCING GAP FOR 1983, WHICH THE STAFF PUT AT SOME DOLLARS 7 BILLION, WERE TO BE SATISFACTORILY MET, A FURTHER DOLLARS 2 BILLION WOULD HAVE TO BE PROVIDED BY OFFICIAL ENTITIES. THE MD HAD BEEN WORKING WITH US TREASURY DEPUTY SECRETARY MCNAMAR TO SEE WHETHER SOME PART OF THIS FINANCING COULD MATERIALISE IN THE FORM OF SUPPLIERS' CREDITS UNDER US GOVERNMENT GUARANTEE.

6. THE FUND WOULD WORK TOGETHER WITH THE BANKS IN ENSURING THAT PROVISION OF NEW FINANCING WOULD TAKE PLACE IN ASSOCIATION WITH THE FUND PROGRAM. IT WAS INTENDED THAT DISBURSEMENTS BY THE BANKS WOULD TAKE PLACE BROADLY IN PARALLEL WITH MEXICO'S DRAWINGS FROM THE FUND. THERE WOULD, NEVERTHELESS, BE SOME ELEMENT OF FRONTLOADING IN THE NEW BANK CREDITS. HE WAS NOT PREPARED TO BE MORE SPECIFIC THAN THIS AT THE PRESENT TIME. AS TO THE NATURE OF THE DECEMBER 15 COMMITMENT, HE HAD NO SPECIFIC FIGURE IN MIND BUT THE CRUCIAL AMOUNT FOR PROMISES OF NEW MONEY MIGHT BE ABOUT DOLLARS 4.5 BILLION.

STAFF PAPER ON MEXICO

7. BEZA SAID THAT IT WAS HOPED TO FINALISE THE STAFF PAPER BY FRIDAY, DECEMBER 10, FOR CIRCULATION THE FOLLOWING MONDAY. THE MD REGRETTED THAT THIS WOULD GIVE ONLY 10 DAYS FOR CONSIDERATION OF THE PAPER BEFORE THE BOARD DICSUSSION BUT THE STAFF WERE DOING ALL THEY COULD. BEZA SAID THAT NEW MATERIAL WAS HAVING TO BE ADDED TO THE PAPER EVERY DAY.

8. FCO PLEASE PASS TO LAVELLE AND ATKINSON (TREASURY), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

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8. FCO PLEASE PASS TO LAVELLE AND ATKINSON (TREASURY), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (FCO).

TAYLOR

NNNN

MONETARY

SIR K. COUZENS } H.M.T.
~~MR LAVELLE~~

X3

MR GILCHRIST B/ENGLAND

MR APPLEYARD ERD

WONFO 75/08
PP FCO

RR BRASILIA

RR QUITO

GRS160
CONFIDENTIAL
FM UKDEL IMF/IBRD WASHINGTON 082245Z DEC 82
TO PRIORITY FCO
TELEGRAM NUMBER 283 OF 8 DECEMBER
INFO BRASILIA AND QUITO.

IMF: CHAIRMANSHIP OF THE INTERIM COMMITTEE

I HEARD FROM ROBALINO (ECUADOR) THIS MORNING, THE NEW ALTERNATE EXECUTIVE DIRECTOR FOR THE BRAZILIAN CONSTITUENCY, THAT HE HAD RECEIVED CONFIRMATION FROM ALL MEMBERS OF THE CONSTITUENCY THAT THERE WOULD BE QUOTE NO OBJECTION UNQUOTE TO THE CHANCELLOR'S SELECTION AS NEXT CHAIRMAN OF THE INTERIM COMMITTEE. HE HAD ALSO BEEN IN CONTACT WITH KAFKA (BRAZIL), NOT AT PRESENT IN WASHINGTON, WHO WAS HAPPY THAT THE UK AUTHORITIES BE NOTIFIED. YOU MAY RECALL THAT BRAZIL DID NOT COMMENT WHEN THE MANAGING DIRECTOR CONSULTED EXECUTIVE DIRECTORS ON 1 DECEMBER (OUR TELNO 267).

FCO PLEAS ADVANCE TO COUZENS AND LAVELLE (HMT), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

NNNN

[MONETARY]

WONFO 003/09

PP FCO

GR 620

Sir K. Couzens
~~Mr Lavelle~~ } HM TSY

X3

Mr Gilchrist B/England

CONFIDENTIAL

Mr Appleyard ERD

FM UKDEL IMF/IBRD WASHINGTON 082242Z DEC 82
TO PRIORITY FCO
TELEGRAM NUMBER 261 OF 8 DECEMBER

IMF: ARGENTINA

1. AT HIS MEETING FOR G5 DIRECTORS LAST EVENING, THE MANAGING DIRECTOR DESCRIBED THE LATEST DEVELOPMENTS ON ARGENTINA. MEXICO (SEE MIPT) AND BRAZIL (SEE MIFT) WERE ALSO DEALT WITH. IN ORDER TO SECURE ADEQUATE BALANCE OF PAYMENTS FINANCING IN SUPPORT OF THE PROGRAMME, AN APPROACH HAD BEEN MADE TO A WORKING GROUP OF COMMERCIAL BANKERS IN NEW YORK ON LINES SOMEWHAT SIMILAR TO THOSE FOLLOWED IN MEXICO'S CASE. ARGENTINA WAS SEEKING A VERY SHORT-TERM BRIDGING LOAN OF DOLLARS 1.1 BN, TO BE REPAID PARTIALLY DURING 1983 (DOLLARS 0.7 BN) AND THE REST BY END-FEBRUARY 1984. IN ADDITION, SOME DOLLARS 2 BN OF NEW MONEY FROM BANKS AND OTHER CREDITORS WOULD BE NEEDED IN 1983 TO SUPPORT THE PROGRAMME. OF THIS, SOME DOLLARS 1.5 BN WAS BEING SOUGHT FROM BANKS IN THE FORM OF MEDIUM-TERM LOANS AND THE OTHER DOLLARS 500 MN WOULD BE IN THE FORM OF A RENEWAL OF SWAPS BY OTHER CREDITORS, MAINLY MULTI-NATIONAL COMPANIES. A TELEX SETTING OUT THESE AMOUNTS HAD BEEN SENT TO THE WORKING GROUP ON 6 DECEMBER AND THE GROUP WOULD IN TURN CONTACT RELEVANT BANKS AS SOON AS POSSIBLE. MID-JANUARY HAD BEEN PUT IN AS A DEADLINE FOR RESPONSES FROM THE BANKS. IN ASSOCIATION WITH THIS A RESTRUCTURING OF EXISTING BANK CREDITS WAS BEING PURSUED.

2. IF THE REQUEST TO BANKS WAS SUCCESSFUL IT WOULD ENTAIL AN INCREASE IN THEIR EXPOSURE TO ARGENTINA OF ABOUT 5%, IE A SLOWDOWN IN THE RECENT RATE OF INCREASE OF EXPOSURE.

3. THE MD NOTED THAT CENTRAL BANKS AND THE US AUTHORITIES HAD BEEN VERY RESPONSIVE AND HELPFUL IN ASSISTING THE FUND TO PUT TOGETHER

A REALISTIC FINANCIAL PACKAGE FOR ARGENTINA.

4. THE NEGOTIATIONS WITH ARGENTINA HAD GOT ABOUT AS FAR AS THEY COULD FOR THE TIME BEING. THE LETTER OF INTENT HAD BEEN SIGNED AND A MEMORANDUM OF AGREEMENT AND A TECHNICAL ANNEX HAD BEEN COMPLETED BUT NONE OF THESE DOCUMENTS HAD YET BEEN CIRCULATED. AGREEMENT HAD BEEN REACHED WITH THE AUTHORITIES ON ALL THE OBJECTIVES AND OUTSTANDING POLICY ISSUES UNDER THE PROGRAMME. THE QUESTION NOW WAS WHETHER THE ARGENTINIANS COULD DELIVER WHAT HAD BEEN PROMISED IN THE LETTER OF INTENT. MANAGEMENT WERE WAITING TO SEE WHETHER THEY WOULD GO AHEAD TO IMPLEMENT THE SET OF AGREED PRIOR MEASURES, INCLUDING MODIFICATIONS TO THE WAGE ADJUSTMENT MECHANISM AND INTEREST RATE INCREASES. IN RESPONSE TO DIRECTOR'S QUESTIONS, BOTH ROBICHEK (WESTERN HEMISPHERE DEPARTMENT) AND THE MANAGING DIRECTOR SAID THAT THEY THOUGHT THERE WAS THE POLITICAL WILL TO IMPLEMENT THE PROGRAMME BUT IT WOULD NOT BE EASY. SOME OF THE REQUIREMENTS UNDER THE PROGRAMME WOULD COME AS A SHOCK TO THE PUBLIC AND IN PARTICULAR TO THE LABOUR UNIONS. ROBICHEK SAID THAT THE UNDERTAKINGS THAT HAD BEEN ENTERED INTO BY THE AUTHORITIES ON BEHALF OF THE UNIONS SEEMED ''TOO GOOD TO BE TRUE''. HE WAS NOT YET 100% CERTAIN THAT THEY HAD AN AGREEMENT WITH ARGENTINA.

TIMETABLE

5. THE STAFF HOPED TO HAVE A PAPER READY FOR CIRCULATION BY THE START OF THE NEW YEAR BUT THEY WOULD NOT RELEASE IT BEFORE THERE IS CONFIRMATION THAT THE MEASURES ARE BEING IMPLEMENTED. IF ALL WENT WELL, THE BOARD DISCUSSION WOULD TAKE PLACE IN LATE JANUARY.

6. FCO PLEASE ADVANCE TO COUZENS AND LAVELLE (HMT), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

NNNN

X 232-/8

[MONETARY]

ADVANCE COPY

SIR K. COUZENS } H.M.T.

~~MR LAVELLE~~

MR GILCHRIST B/ENGLAND

MR APPLEYARD ERD

X3

WONFO 71'/08

PP FCO

RR PEKING

GRS100
CONFIDENTIAL
FM UKDEL IMF/IBRD WASHINGTON 082246Z DEC 82
TO PRIORITY FCO
TELEGRAM NUMBER 284 OF 8 DECEMBER
INFO PEKING.

IMF: CHAIRMANSHIP OF THE INTERIM COMMITTEE

ZHANG (EXECUTIVE DIRECTOR FOR CHINA) TELEPHONED ME THIS MORNING TO CONFIRM THAT HIS GOVERNMENT, HAVING RECEIVED THE FUND'S TELEX DESPATCHED YESTERDAY, WOULD SUPPORT THE CHANCELLOR'S CHAIRMANSHIP.

FCO PLEASE ADVANCE TO COUZENS AND LAVELLE (HMT), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

NNNN

X

232-1/8

[MONETARY]

ADVANCE COPY

SIR K. COUZENS
~~MR LAVELLE~~ H.M.T.

MR GILCHRIST B/ENGLAND

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FCO PLEASE ADVANCE TO COUZENS AND LAVELLE (HMT), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

NNNN

8/12/82.

3/8

Chancellor

cc Couzens
Lavelle
Battishill.

VIA WUI
1741 12/07
262405 TRSY G
1741 12/07 027723 PTD388
0074
SIR GEOFFREY HOWE, Q.C., M.P.
CHANCELLOR OF THE EXCHEQUER
H.M. TREASURY, PARLIAMENT STREET
H.M. TREASURY
LONDON (ENGLAND)

I AM SENDING TODAY THE FOLLOWING CABLE TO YOUR COLLEAGUES OF THE INTERIM COMMITTEE. QUOTE.

THERE FOLLOWS FOR THE INFORMATION OF MEMBERS OF THE INTERIM COMMITTEE THE TEXT OF A LETTER DATED DECEMBER 6, 1982 BY WHICH THE HONORABLE ALLAN J. MACEACHEN OF CANADA HAS INFORMED THE MANAGING DIRECTOR OF HIS RESIGNATION AS CHAIRMAN OF THE COMMITTEE:

QUOTE. IN VIEW OF A REASSIGNMENT OF RESPONSIBILITIES WITHIN THE GOVERNMENT OF CANADA, IT WOULD BE INAPPROPRIATE FOR ME TO CONTINUE AS CHAIRMAN OF THE INTERIM COMMITTEE. HENCE, EFFECT SHOULD BE GIVEN TO MY RESIGNATION.

THE CONSTRUCTIVE AND COOPERATIVE RELATIONSHIP I ENJOYED WITH ALL MEMBERS OF THE COMMITTEE IS DEEPLY APPRECIATED. MY CLOSE ASSOCIATION WITH YOU AS MANAGING DIRECTOR AND THE EVER PRESENT SERVICES OF MR. LEO VAN HOUTVEN AND THE VALUED ASSISTANCE FROM ALL MEMBERS OF THE FUND STAFF WERE WELCOME AND ESSENTIAL ELEMENTS IN DISCHARGING THE WORK OF CHAIRMAN.

I HOPE THE PERSONAL LINKS WE HAVE BUILT WILL CONTINUE INTO THE FUTURE. UNQUOTE

THE CHAIRMANSHIP OF THE INTERIM COMMITTEE IS THEREFORE VACANT. AT ITS NEXT MEETING THE COMMITTEE WILL HAVE TO DEAL WITH VERY IMPORTANT ISSUES AFFECTING THE MEMBERSHIP OF THE FUND AND THE EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM. IT IS THOUGHT TO BE DESIRABLE THAT A NEW CHAIRMAN OF THE COMMITTEE BE SELECTED AT AN EARLY OPPORTUNITY.

SIR GEOFFREY HOWE, THE BRITISH CHANCELLOR OF THE EXCHEQUER, HAS INDICATED HIS WILLINGNESS TO SERVE AS THE NEXT CHAIRMAN OF THE INTERIM COMMITTEE PROVIDED THAT THIS SUGGESTION WOULD ATTRACT WIDE SUPPORT AMONG THE MEMBERS OF THE COMMITTEE.

INFORMAL CONSULTATIONS CONDUCTED BY EXECUTIVE DIRECTORS WITH THE MEMBERS OF THE COMMITTEE SUGGEST THAT THE CANDIDACY OF SIR GEOFFREY HOWE WOULD RECEIVE VERY BROAD SUPPORT. I WOULD BE HAPPY TO HEAR FROM YOU AT YOUR EARLY CONVENIENCE ABOUT THIS COURSE OF ACTION AND, UNLESS I RECEIVE VIEWS TO THE CONTRARY FROM MEMBERS, IT IS PLANNED TO ISSUE A PRESS RELEASE ON FRIDAY, DECEMBER 17, 1982 ANNOUNCING THAT SIR GEOFFREY HOWE HAS BEEN SELECTED TO SERVE AS THE NEXT CHAIRMAN OF THE INTERIM COMMITTEE.

WITH HIGHEST REGARDS,
VAN HOUTVEN
SECRETARY UNQUOTE

VAN HOUTVEN
SECRETARY

Restricted.

FROM: J.O. KERR
8 December 1982

cc: Sir Kenneth Couzens
Mr. Lavelle

MR. BOTTRILL

INTERIM COMMITTEE CHAIRMANSHIP

You have a copy of van Houtven's telex yesterday to the Chancellor's Interim Committee colleagues. A reply from us is clearly not essential, but might be courteous. Should the Chancellor send a short message thanking van Houtven and confirming his willingness to take on the chairmanship if this should command general support? If so, could he have a draft?

J.O. KERR

CONFIDENTIAL

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

CST
EST
SIR D. WASS
SIR. K. COUZENS
Mr LAVELLE.
MR LITTLER.
MR BOTTRILL
Mr HAWTIN
Mr CAREY
Mr RIDLEY

8/12/82.

FOREIGN AND COMMONWEALTH SECRETARY

YUGOSLAVIA: ECONOMIC CRISIS

Thank you for your minute of 7 December.

2. The Yugoslav problem will indeed be discussed at my meeting with the other G5 Finance Ministers tomorrow. (We shall also be discussing Brazil: for whom a bridging operation of similar size is envisaged, and the Americans look to their European and other allies to make a substantial contribution).

3. I think you know my view, and agree with it, that a credible and realistic solution to Yugoslavia's financial crisis must include a substantial element of rescheduling. The other essential element of course, as you say, is a tight IMF programme. It is unfortunate that the Yugoslavs have taken such a firm stand to date against rescheduling, and doubly unfortunate that they appear to have been encouraged in this attitude by the Americans, whose own analysis of the gravity of the Yugoslav financial crisis seems to have been amateurish and superficial.

4. I understand that at the meeting of officials on 2 December it was evident that our other allies are closer to our own diagnosis than that of the Americans. At the forthcoming Ministerial gatherings with our closest allies we should, I think, build on this. We need to continue to impress on the Americans that both their analysis of the Yugoslav situation, and their proposed solution of a major international rescue operation involving new money or new credit, are unrealistic. (The tactless way in which they have inspired the latest Brazilian approach to European

creditors makes it even less likely of course that official funds will be forthcoming for Yugoslavia on anything like thescale which would be required even on the Americans' own optimistic analysis.)

5. At the same time I agree with you that it would be difficult for us to decline to make any contribution to a collective rescue operation if other creditors and allies were prepared to chip in. Other reasons apart, our claim that the American approach is an inadequate response to the Yugoslav problem would look like self-interest. I would not therefore exclude some indication to the Americans and others of willingness to make a modest contribution to a rescue package, if that is essential to avoid our being identified as the only country not prepared to do anything over and above debt relief. Any such offer ought in my view to be subject to the following three pre-conditions being met:

(i) The Fund staff would need to put forward, and the Yugoslavs accept, an adequate IMF programme.

(ii) The burden of any assistance package would have to be widely spread.

(iii) The need to consider rescheduling, and to explain the advantages of it to the Yugoslavs, should be accepted among the creditors.

6. As to the form and amount of any contribution we might make to a special assistance package, I would hope that we could avoid being too specific at this stage. But, subject to Arthur Cockfield's views, I would see no objection to ECGD's providing guarantees of new commercial bank lending, on a medium term basis and at commercial rates of interest, to refinance 1983 maturities of ECGD-guaranteed loans. $60 million, or perhaps a bit more, should be available by this route, and I understand there may be some other ways in which ECGD would be able to make modest amounts of additional short term credit available consistently

CHANCELLOR OF THE EXCHEQUER

with their statutory and other obligations.

7. I am copying this minute to the other recipients of yours.

(G.H.)
8 December 1982

CONFIDENTIAL

FROM: C J CAREY
DATE: 8 December 1982

CHANCELLOR OF THE EXCHEQUER

cc Sir D Wass
Sir K Couzens
Mr Littler
Mr Lavelle
Mrs Hedley-Miller
Mr Bottrill
Mr Hawtin

Your telegram went off at which time, and seems to have shut them up, temporarily

G5 MINISTERS MEETING, KRONBERG, 9-10 DECEMBER, 1982
COUNTRY QUESTIONS: BRAZIL

This is the further note promised in the briefing already submitted. Despite heroic efforts by the Bank of England to make sense of the available data, including material submitted by the Brazilians to the BIS in support of their request for help from that source, there is still great uncertainty about the nature and scale of the financing problem which the G5 have been asked to deal with.

2. But it does seem reasonably clear that Brazil's short term debt has risen rapidly (reflecting their failure to raise longer term money) and that debt repayments will start falling into arrears before the end of the year without bridging help. It is known that the Brazilians are hoping to fix up (on 20 December) a jumbo commercial bank loan of $4 billion; that the Americans have already provided $1.23 billion of official support (terms etc unknown) and are willing to provide another $0.4 billion; and it is believed that the Fed may have made available some $800 million through a swap arrangement.

3. There is uncertainty about the amount of additional official assistance needed between now and the end of the calendar year, but informal contacts we have had with the American and French authorities suggest that the requirement from non-US sources may be $1 billion (ie $1.4 billion including the US offer of a further $0.4 billion). The Americans appear to be confident that if the Brazilians can raise $1.4 billion from Governments they will not need the $1.5 billion which SR Galveas told you in his message they have requested from the BIS. The Brazilians say they want bridging finance, but it is unclear what take-out, if any, we could rely on eg would it be the IMF or the commercial bank jumbo loan? Looking further ahead to 1983,

[illegible]

From: C J [illegible]
Date: 8 December 1982

CHANCELLOR OF THE EXCHEQUER

cc Sir [illegible]
Sir K Couzens
Mr Littler
Mr Lavelle
Mrs Hedley-Miller
Mr [illegible]
Mr [illegible]

[illegible]

[illegible]

This is the further note promised in the [illegible] already submitted. Despite heroic efforts by the Bank of England to make sense of the available data, including material submitted by the Brazilians to the BIS in support of their request for help from that source, there is still great uncertainty about the nature and scale of the financing problem which the UK have been asked to deal with.

2. But it does seem reasonably clear that Brazil's short term debt has risen rapidly (reflecting their failure to raise longer term money) and that debt repayments will start falling into arrears before the end of the year without bridging help. It is known that the Brazilians are hoping to fix up (on 10 December) a jumbo syndicated bank loan of $4 billion; that the Americans have already provided $1.25 billion of official support (terms unknown) and are willing to provide another $0.4 billion; and it is believed that the BIS may have made available some $0.5 billion through [illegible] arrangements.

3. There is uncertainty about the amount of additional official assistance needed between now and the end of the calendar year, but informal contacts we have had with the Americans and Brazilians suggest that the requirement from other sources may be $1 billion (ie $1.4 billion including the US offer of a further $0.4 billion). The Americans appear to be confident that if the Brazilians can raise $1.5 billion from [illegible] and the BIS, and the $0.9 billion [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] bridging finance, but it is unclear [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] to [illegible].

there is the same sort of uncertainty about the size of the financing requirement. The Brazilians put it at $14.5 billion, but the Bank of England think it cannot be less than $18 billion.

4. US banks' exposure in Brazil is believed to be over $16 billion. That of British-owned banks is under $5 billion. We do not have reliable figures for other countries, but in terms of officially guaranteed export credit we think the UK ranks about fifth, well below the US and the Germans, with the Germans apparently having a particularly big though very long term commitment in Brazil.

5. All this is uncomfortably speculative, but clearly we cannot deny the existence of a potentially major problem, nor do we think the UK can or should stay out of a collective rescue operation if others are prepared to join in. Preliminary soundings suggest that the French and Germans take the same view. We suggest the key objectives for discussion with G5 colleagues will be -

(a) To go for the widest possible spread of contributors.

(b) To maximise the US share (and also the Japanese) in relation to others. (NB the link here with Yugoslavia.)

(c) To get agreement (unlikely to be difficult) that the response of G5 and other Governments to Brazil should be via the BIS. Apart from collapsing two requests into one this has the operational advantage that the BIS (or more probably the Fed on its behalf, as with Mexico) would effectively become the agent of Governments in drip-feeding the support as required, monitoring any compliance with conditionality which might be arranged etc.

6. I ought to add one important qualification to (c) above. It is implicit in this notion that HMG would again need to indemnify the Bank of England's participation, as with Mexico. But we do not think we can properly repeat that experiment without at least a promise of specific legislation (which it might in the event be possible to combine with other legislation which we believe could be needed in connection with enlargement of IMF resources). Unwelcome though this may be, we would not regard it as a decisive objection,

C. I think we're going to have to put this in the Finance Bill anyway.

there is the usual sort of uncertainty about the size of the financing requirement. The Brazilians put it at $4.5 billion, but the Bank of England think it cannot be less than $5½ billion.

4. UK banks' exposure in Brazil is believed to be over $3½ billion. That of British-owned banks is under $3 billion. We do not have reliable figures for other countries, but in terms of officially guaranteed export credit we think the UK [illegible] about fifth, well below the US and the Germans, with the Germans apparently having a particularly big, though very long term commitment in Brazil.

5. All this is uncomfortably speculative, but clearly we cannot deny the existence of a potentially major problem. Nor do we think the UK can or should stay out of a collective rescue operation if others are prepared to join in. Preliminary soundings suggest that the French and Germans take the same view. We suggest the key objectives for discussion with my colleagues will be -

(a) to go for the widest possible spread of contributors.

(b) to maximise the US share (and thus the exposure) in relation to others. (NB the link here with Yugoslavia.)

(c) in any agreement (unlikely to be difficult) that the proportion of UK and other Governments' contributions should be [illegible] [illegible] the operational advantage that the IMF (or more probably the Fed on its behalf, as with Mexico) would effectively become the agent of Governments in [illegible] the support operation, including any negotiations with conditionality which might be required etc.

6. I ought to add one important qualification to (c) above. It is implicit in such a notion that the IMF would need to be indemnified [illegible] [illegible] contribution, [illegible]. But we do not think we can necessarily regard such an arrangement as [illegible] of specific legislation (which it might in the event be possible to combine with [illegible] legislation which we will [illegible] be needed in connection with [illegible] of IMF [illegible]). [illegible] [illegible] we would not [illegible]

especially if other Governments are disposed to favour this course as we expect.

D. T. Smith
pp (C J CAREY)

CHANCELLOR OF THE EXCHEQUER

From: MISS J E COURT
8 December 1982

NB
Pym is talking to Cheysson tomorrow about coming to London in Jan — ostensibly to see him. This may not come off: I suggest you don't raise it with JD now.

Financial Secretary
cc Sir K Couzens
Mr Littler
Mrs Hedley-Miller
Mr Edwards
Mr Donovan
Mr Peet

<u>EC 1982 BUDGET : UK REFUNDS</u>

You may like to take the opportunity when you meet H. Stoltenberg and M. Delors at G5 to raise the problem of the EC 1982 amending budget now before the European Parliament.

2. The Financial Secretary has told you of the potential difficulties in getting through the European Parliament the draft 1982 supplementary and amending budget which contains, inter alia, provision for refunds to the UK and to Germany for the period ending 31 December 1982. He has taken every opportunity to ensure a smooth passage of the budget by visiting Strasbourg where he talked to MEPs from a number of member states of various parties. He has talked separately to UK members of the European Parliament and saw the Budgetary Control Committee when they were in London last week. Other member states have been urged through COREPER to make similar approaches to their MEPs.

3. The latest information we have provides no firm indication of how the Parliament will vote next week. But it appears they will not make any final decisions until 16 December after the further Budget Council which is being called for 15 December, when Ministers will consider representations made by the Parliament. The three Presidents are meeting this evening to discuss a compromise on the 1983 budget. The President of the Council will make clear to Mr Dankert that a compromise would presuppose Parliament's agreement to the 1982 amending budget.

4. We need to keep up pressure on two fronts to secure a favourable outcome. First we need to ensure that other members of the Council are unflagging in their resolve to see through

CONFIDENTIAL

[illegible] OF [illegible]   From: [illegible]

[illegible]

[illegible]: [illegible]

You may like to have the opportunity, when you see [illegible] and Mr. Delors at [illegible] to raise the problem of the [illegible] 1988 [illegible] budget now before the European Parliament.

2. The Financial Secretary has told you of the potential difficulties in getting through the European Parliament the draft [illegible] supplementary and amending budget which contains, inter alia, provision for refunds to the UK and to Germany for the period ending 31 December 1987. He has taken every opportunity to [illegible] by visiting Strasbourg, where he talked to MEPs from a number of [illegible] of various parties. [illegible] personally to UK members of the European Parliament and [illegible] the Budgetary Control [illegible]. Other member states have been urged to [illegible] take a similar approach to their MEPs.

3. The latest information we have provides no firm indication of how the Parliament will vote next week. But it appears that it will not take any final decisions until it reconvenes after the further Budget Council which is being called for [illegible] when Ministers will consider [illegible] Parliament. The three Presidents are meeting this evening to discuss a compromise [illegible] 1988 budget. The President of the Council will make clear to the Parliament that a compromise would presuppose Parliament's agreement to the 1988 [illegible] budget.

4. We need to [illegible] two routes to a favourable outcome. First we need to ensure that other Members of the Council are [illegible] in their resolve in the [illegible]

the amending budget. Second they need to bring all the influence they can to bear on their MEPs.

5. The Annex contains points which might be made to your colleagues.

J

MISS J E COURT

Points to make

1. Essential to avoid renewed discussion of 26 October settlement

Settlement was only reached after difficult negotiations between member states. It was made on the assumption that payments to the UK and to Germany would be financed from the 1982 budget. If the 1982 amending budget now before Parliament is not adopted by the end of the month it will mean new discussions to provide equivalent benefits in the 1983 budget.

2. Disastrous for the wellbeing of the Community if agreement is not implemented in the way agreed by the Council

We cannot be sure how Parliament will vote, but we must maintain our attempts to persuade them to adopt the budget. Apart from our national interests it is not good for Parliament's image to prevent the implementation of an agreement which has such a high political significance for the EC as a whole.

3. Council must not be too obdurate about 1983 budget

The position is complicated by the fact that the draft 1983 budget is before Parliament at the same time. Some MEPs want to link the two to secure for themselves a larger margin in 1983. The last Budget Council moved towards the Parliament by increasing the margin. There are signs that a further increase could be agreed at the Budget Council now fixed for 15 December which would placate the Parliament on this aspect. But this means that a majority of member states at the Budget Council must be willing to concede a reasonable margin. [The Germans seem willing to make this conciliatory step towards Parliament. But the French voted against any increase at the first round and are likely to do so again.]

4. Parliament should be reassured about the Council's intention to find a permanent solution and about the nature of the refunds

Other MEPs are likely to raise more fundamental objections to the budget proposals on the grounds that they are ad hoc solutions to a permanent problem. This may be reflected in disagreement about the classification of both the UK and the German budget line and to

Points to make

1. Essential to avoid another rejection of the budget by Parliament

Parliament can only achieve [illegible] of its [illegible] between member states. [illegible] rejection [illegible] to the [illegible] which [illegible] the 1981 budget. If the 1981 [illegible] is not before Parliament, it is not adopted by the end of the year, it will mean new discussions to provide [illegible] about [illegible] the 1982 budget.

2. [illegible] the [illegible] of the [illegible] of [illegible] in
and [illegible] in the [illegible] proposed by the Council

We cannot be sure how Parliament will vote, but we must maintain our attempts to persuade them to adopt the budget. Apart from our national interests it is not good for Parliament's image to prevent the implementation of an agreement which has such a political significance for the EC as a whole.

3. Council must not be too generous about 1981 budget

The position is complicated by the fact that the draft 1981 budget is before the Parliament at the same time. Some MEPs want to link the two to secure for themselves a larger [illegible] in 1981. The last Budget Council moved towards the Parliament by increasing the margin. [illegible] would be agreed at the Budget Council now fixed for 15 December which would placate the Parliament on this aspect, but this means that a majority of member states at the Budget Council must be willing to concede a reasonable margin. [The Germans seem willing to make this conciliatory move towards Parliament. But the French resisted any increase at the first round and are likely to do so again.]

4. Parliament would be resentful about the Council's taking [illegible]
the UK budget solution and the nature of the refunds

Other MEPs are likely to raise more fundamental objections to the budget proposals on the grounds that they are ad hoc solutions to a permanent problem. This may be reflected in disagreement about the classification of both the UK and the German budget line and to disagreement about the wording in the regulations providing the legal base for the expenditure. It is important to reassure these MEPs about the Council's commitment to a permanent solution. Other points which we have made and which the Germans may like to repeat are that the refunds in question will be used in fulfillment of agreed Community policies and that all three institutions have accepted that UK refunds should be classified as obligatory. It would not make sense, therefore, to classify German refunds as non-obligatory. They are entered in energy chapter of budget largely because of political difficulties.

5. [For M. Delors] Not just national considerations which make it desirable to avoid a conflict with Parliament.

The 30 June agreement is still fresh and an increase in the margin available to Parliament for the 1983 budget is a small price to pay for the avoidance of a further dispute, particularly if it also secures the 1982 amending budget. The technical arguments are not straightforward and this is not the time to become embroiled with Parliament on detailed issues.

From: I P Wilson
8 December 1982

PRINCIPAL PRIVATE SECRETARY

cc: Chief Secretary
Sir Anthony Rawlinson
Sir Kenneth Couzens
Mr Mountfield
Mr Kitcatt
Mr Kemp

NATO 3% GROWTH COMMITMENT

I understand that the Chancellor will be attending a small international gathering of Finance Ministers later this week. He has previously indicated that if suitable opportunities arise he would like to lobby his opposite numbers against the NATO commitment to increase defence spending by 3% pa in real terms.

2. Of those likely to be present at the meeting, it would probably be appropriate to lobby only the German Finance Minister. The French would no doubt sympathise (their recent expenditure plans make it clear that they have no intention of achieving 3% growth during current economic difficulties) but they are not full members of NATO. The US Treasury Secretary must be conscious that it is mainly Mr Reagan's military spending increases that have jeopardised any chance he had of pursuing the economic strategy of the balanced budget; but in the present highly charged atmosphere between the US and her partners, he might well see any questioning of the expenditure target as a further sign of European reluctance to contribute to defence.

3. General Rodgers (SACEUR - Supreme Allied Commander Europe) has recently won some publicity for his view that annual growth in NATO spending of 4% is necessary to meet the Warsaw Pact conventional threat. It is unclear what supporting evidence, if any, SACEUR had for such a judgement, which probably reflects the propagandist aims of the military lobby more than anything else. The German Defence Minister is reported already to have rejected the idea.

4. I attach a short speaking note for use as appropriate on the UK's current commitment and our reservations about the NATO target.

/ 5.

On a lighter and more informal note, our calculations show that if the trend of the last three years continues, UK defence expenditure will consume 100% of GDP by 2056. This is of course not a forecast (!) but might offer a throwaway for the Chancellor.

I P WILSON

SPEAKING NOTE

Th UK fully supported the NATO 3% growth target when it was introduced. Our subsequent achievement has been good. Our expenditure plans provide for real growth of 3% each year up to and including 1985-86. Defence spending in 1985-86 should be 21% higher in real terms than when this Government came to office.

2. Moreover, HMG has announced that all defence Falklands costs will be met by additions to the defence budget on top of the NATO commitment. So defence will cost an extra £3 billion over the next three years. Defence will take up nearly 5.5% of GDP next year (in Germany about 3.5%).

3. All this has been achieved despite severe economic difficulties. UK GDP declined in 1980 and 1981. Growth this year has been sluggish; next will be little better.

4. HMG has to be concerned about the massive and growing defence burden. It produces a severe squeeze on civil programmes. It will put increasing pressure on the overall public expenditure total - and thus on our economic strategy. 3% real growth cannot be achieved each year every year ad infinitum.

5. How does Germany view the NATO 3% target? Does it override FRG economic circumstances or vice versa?

6. How far is Germany planning to meet the 3% target in the future (probably not)? Would there be domestic problems in not doing so? How would Germany handle the US dimension?

7. The underlying problem is the nature of the NATO target itself. It is crude and simplistic. It measures only expenditure input, not defence output. It takes no account of absolute levels of defence contributions (in absolute terms FGR's annual defence spend is probably slightly lower than the UK's; but this depends partly on exchange rates).

8. The 3% aim was useful in 1977, and subsequently. It is now increasingly irrelevant. NATO ought to take stock, and substitute some more meaningful criterion - something that measures output and military effectiveness.

9. How would Germany suggest this might be done? Would they lead or support an initiative in NATO to review the use and aims of Alliance resources? Would the FMOD or Foreign Ministry resist such a proposal (the UK MOD would resist it; and the FCO continues to show no regard for resource efficiency)?

DM1 DIVISION
8 December 1982

8/12/82.

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-233 3000
Direct Dialling 01-233 ....

Chancellor

One of us will come out with you to clear any last minute texts and collect any last minute instructions

Your programme for the G5: Thursday 9 December

11.25 Depart London Heathrow on BA 726 from the Hounslow Suite with Ken Couzens and the Governor

13.50 Arrive Frankfurt. You will be collected by a German "host" and an armoured car and driven rapidly to the Schloßhotel Kronberg. (about ½ hour).

15.00 Ambassador (Sir Jock Taylor) will arrive for brief talk (he is delivering a lunchtime speech at Frankfurt)

16.00 G5 commences, followed by dinner.

Friday 10 December

8.00 - 9.30 Working G5 breakfast

9.30 Consul-General arrives at Kronberg. German car is at your disposal. You can use the time up to about 10.45 as you wish. (C-G is called Hutson)

11.40 BA 725 Frankfurt to London HR *

12.10 Arrive London

One of us will meet, with the next box-full!

* Ken Couzens will not be accompanying you back to London as he is going to G10 Deputies in Paris; the Governor has an open ticket.

JR
8/12.

Hutson, John Whiteford, OBE (1966); Consul-General Frankfurt since December 1979; born 21.10.27; HM Forces 1949–51; FO 1951; Third Secretary Prague 1953; FO 1955; Second Secretary Berlin 1956; Saigon 1959; First Secretary 1961; Consul (Comm) San Francisco 1963; First Secretary and Head of Chancery Sofia 1967; FCO 1969; Counsellor 1970; Counsellor (Comm) Baghdad 1971; Inspector DS ~~1972; Head~~ of Communications Operations Dept, FCO 1974; Counsellor (Comm) Moscow 1976; m 1954 Doris Kemp (1s 1956; 2d 1958, 1960).

8/12/82

TELEX

POUR M. VAN HOUTVEN, SECRETAIRE DU COMITE INTERIMAIRE, F.M.I.
COPIE : M. de MAULDE.

THANK YOU FOR YOUR CABLE OF DECEMBER 7, INDICATING Mr MAC EACHEN'S DECISION TO RESIGN AS CHAIRMAN OF THE INTERIM COMMITTEE AND SIR GEOFFREY HOWE'S WILLINGNESS TO SERVE AS THE NEXT CHAIRMAN OF THE COMMITTEE PROVIDED THAT THIS SUGGESTION WOULD ATTRACT WIDE SUPPORT AMONG THE MEMBERS OF THE COMMITTEE

I WOULD BE MOST GRATEFUL IF YOU WOULD CONVEY TO Mr. MAC EACHEN MY DEEP APPRECIATION ABOUT THE EXCELLENT WORK HE HAS PERFORMED AS CHAIRMAN OF THE COMMITTEE -UNDER HIS CHAIRMARSHIP WE MADE SIGNIFICANT PROGRESS TOWARD AN AGREEMENT ON A LARGE INCREASE OF IMF RESOURCES.

AS Mr. de MAULDE, THE FRENCH EXECUTIVE DIRECTOR ON THE IMF BOARD, ALREADY INDICATED TO Mr. de LAROSIERE, I FULLY SUPPORT SIR GEOFFROY HOWE'S CANDIDACY - HIS EXPERIENCE, HIS SKILL AND HIS KWNOWLEDGE OF MONETARY AFFAIRS THAT I HAVE BEEN ABLE TO APPRECIATE ON MANY OCCASIONS, MAKE HIM THE BEST POSSIBLE CANDIDATE .

SIGNE DELORS.

Delors

SECRET

From: Sir Kenneth Couzens
Date: 8 December 1982

C.
A good paper to read first will be the telegram from Washington which (logically) I've put at the v. back of this folder.)

cc: Sir Douglas Wass
Mr Littler
Mr Lavelle
Mr Carey
Mrs Hedley-Miller
Mr Odling-Smee
Mr Atkinson
Mr Graham

Mr Anson
PS/Governor } B/E
Mr Gilchrist }

CHANCELLOR

G5 MINISTERS' MEETING, KRONBERG, 9-10 DECEMBER 1982

I think you will find Mr Bottrill's brief for the G5 meeting a very good conspectus. In this note I try to add some suggestions for the handling of the discussion on the IMF resources package.

2. I am afraid we have to submit to an introduction by Mr Sprinkel. However, I very much hope that it will be possible for you to speak immediately after him in order to give some direction to the discussion. I think it would be a mistake for the G5 to attempt to agree, point by point, a "G5 package" which they then attempt to sell to other IMF members. If we are to bring the negotiation to an early successful conclusion, what is needed from the G5 is a broad framework of agreement and negotiating position. There has to be flexibility within certain limits. It would be positively counter productive to thrust on others a neatly pre-cooked package. It follows that we do not want individual members of the G5 publicly to abandon all signs of difference at this stage. What we want is a private understanding of readiness to move. With that would go the need to avoid adopting too entrenched positions in public statements; and also to avoid "new initiatives" which are not agreed between the G5.

3. This approach involves a squeeze on the Americans and Japanese at Kronberg. One has to give notice to the Japanese that while their aspirations on size of quotas will be accommodated as far as possible, they will probably have to temper those ambitions for the sake of agreement. They will get no support if they jeopardise agreement by

insisting on equality with the French, if the French will not concede that. Even more importantly, there can be no guarantee to override the Indians and Chinese on quota distribution in order to meet Japanese aspirations.

4. As for the Americans, the requirement is to get them to drop the attempt to load the agreement with various tough and probably non-negotiable stipulations about access, the rate of interest on Fund drawings and the corresponding charges to borrowers, and hard currency requirements about quota subscriptions. Most of this is probably Sprinkelism and there are some signs that he is backing off. He talks now of agreement not at the Interim Committee but among the G10 on these points. However, on several of them there won't be agreement in the G10. The Americans are going to have to modify their ambition (if they really have one) to Be Tough (in the words of Mr Heath).

5. At the working level, some of the Germans may need shaking out of the idea that there is going to be a neat G5 position on most items. That approach appeals to their bureaucratic hankering for order and their fear of the undefined. There is some degree of reflection of that in H. Stoltenberg's agenda. But I think that he, and also H. Tietmeyer, will see the point about flexibility fast enough if it is put squarely to them.

6. Applying this approach to the details, I suggest the following:

i. Quota Increase. Keep open the span of 85-100 billion SDRs. We want to be able to score negotiating points for moving the Americans up from 85, and we need to be ready to trade between the quota number and the GAB number; and also between the quota number and the method of distribution of quota shares;

ii. GAB. We should get to the point where the G10 can offer the GAB reform, but strictly conditionally on agreement on the rest of the package. The span 15-20 billion SDRs should be kept open. It would be helpful to get rid of the silly American

15-19 billion SDRs which quite obviously means $20 billion. They only need to assent to 15-20 billion SDRs as arranged; that doesn't commit them to 20 billion SDRs. We might also leave open the question whether possible extra participants (eg Saudi Arabia) in lending arrangement with the Fund were outside the 15-20 or within it. I am inclined to think too that we should squash the idea of bringing Spain into the G10. They are more likely to end up as a borrower than a lender. But that is a detail;

iii. Quota Shares. We shall have to move both the G5 and the G10 to a readiness to accept some equiproportional element in the final quota method. It seems to me the key point is that countries like China, India, Pakistan, Zimbabwe and Bangladesh are just not going to accept a reduction in their level of cash access to the Fund brought about by a combination of quota share reduction and policy on access. Even under the very moderate "Australian" method of quota distribution we favour they would all lose between 20-30 per cent of quota share. They command at least 3 of the 22 IMF constituencies, perhaps more. The best way of carrying them along may be a combination of a tempering of the quota distribution method (which means an equiproportional element); and some flexing of the present American-Japanese-German position on no cash increase in Extended Access. We can say we favour the Australian method (Method 3), but that real life is going to impose an equiproportional element. The Japanese will hate it;

iv. Access. Larosiere wants to leave access to the Board, and that would be nice if we can get it. But the LDCs may insist on some minimum commitment about access as part of the package. Indeed, such a commitment may be the only way to get by on the argument about quota shares for the reasons given above. If we have to contemplate a commitment at the Interim Committee, I think our position should be that ordinary quotas rise in proportion to the quota increase (agreed by all); that there should be no cash increase in the Compensatory Financing Facility, but also no attempt to impose extra conditionality

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v. Remuneration, Charges, Subscription Payments. All this is trench war against the LDCs. We should leave it entirely to the Board, and not complicate the main bargaining. Another meal for Sprinkel to swallow.

7. I would hope that if we can arrange for you to speak after Sprinkel and lay down the philosophy of a negotiating margin or framework, we could apply that to the successive points on the agenda about quotas, GAB etc as we come to them. But when we get to Timetable (paragraph 9 under Item 1) I suggest you might return to the charge by saying that the final responsibility for calling an early Interim Committee looks like falling on you. If you are to make such a decision you have to have an assurance from colleagues that they will not let you down and that they will show the necessary flexibility to make an agreement possible within the limits which you have indicated in the course of the discussion. This is a very clear application of the principle of joint responsibility to which we all subscribed in a statement of monetary undertakings at Versailles. It is understandable that people may feel strongly about particular aspects of a possible package but if there were a failure, it will not be possible to conceal who is responsible for it.

8. This may sound a bit portentous, but it seems to me that you are fully entitled to press on the colleagues the requirement not to let you down; and to give a strong hint that you will make it clear who is responsible if anything goes wrong.

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Other Items

9. The attached telegram No.3909 of 7 December from Washington comments on what Mr Regan said to reporters at a briefing on Monday. The Financial Times has made much of what he said as being a significant initiative. As the telegram says, the US Treasury is meanwhile playing it all down and they are referring us to the restrained report in the Wall Street Journal of yesterday.

10. The only really new elements in the Wall Street Journal report are the suggestions of a "faster loan-disbursing agency to help debt-ridden countries keep afloat while waiting for IMF loans to be approved"; and the idea that Frankfurt might "begin laying the groundwork for a meeting to consider the whole financial and economic issue". The second proposition is extremely cautious and vague and might indeed turn out to be Williamsburg. The first proposition is to do with leaving the United States with less of the burden of rescuing Latin America and perhaps East Asia. The only halfway possible prospect there is the use of the BIS as in the Mexico case. And there is no reason why the rest of us should be keen either on making default look easy or on taking over some of the burdens imposed on the United States by geography and history.

11. There will be separate briefing on Brazil.

KEC

K E COUZENS

8/12/82

PARAGRAPH 3 DISTRIBUTION OF QUOTA SHARES FLAG D

MINISTERS AND GOVERNORS MAY WISH TO CONFIRM THE UNDERSTANDINGS REACHED BY OUR DEPUTIES. THE OTHER ISSUES RELATING TO THE DISTRIBUTION OF QUOTA SHARES COULD BE LEFT TO THE EXECUTIVE BOARD OF THE IMF.

PARAGRAPH 4 ACCESS TO IMF RESSOURCES FLAG E

PARAGRAPH 4 A NORMAL ACCESS

MINISTERS AND GOVERNORS MAY WISH TO CONFIRM THE UNDERSTANDING REACHED BY OUR DEPUTIES.

PARAGRAPH 4 B ENLARGED ACCESS

OUR DEPUTIES HAVE DISCUSSED FUTURE DRAWING LIMITS UNDER THE POLICIY OF ENLARGED ACCESS. I WOULD NOTE HERE THAT THESE DRAWINGS LIMITS AND THE UTILIZATION OF THE ENLARGED ACCESS MUST TAKE ACCOUNT OR THE POSSIBILITIES TO FINANCE THE ENLARGED ACCESS.

PARAGRAPH 5 COMPENSATORY FINANCING FACILITY

MINISTERS AND GOVERNORS MAY WISH TO CONFIRM THE UNDERSTANDING REACHED BY OUR DEPUTIES.

PARAGRAPH 6 AND 7 REMUNERATION AND CHARGES FLAG.F.

SHOULD WE MAINTAIN OR DROP THE DEMAND TO ADJUST REMUNERATION AND CHARGES IN THE CONTEXT OF THE PACKAGE?

PARAGRAPH 8 SUBSCRIPTION PAYMENTS

MINISTERS AND GOVERNORS MAY WISH TO CONFIRM THE UNDERSTANDING REACHED BY OUR DEPUTIES.

PARAGRAPH 9 TIMETABLE

MINISTERS AND GOVERNORS MAY WISH TO REACH AN UNDERSTANDING ON THE DESIRABILITY OF ADVANCING THE NEXT MEETING OF THE INTERIM COMMITTEE TO LATE JANUARY OR EARLY FEBRUARY, 1983. CAN WE AIM FOR IMPLEMENTATION BY END-83, OR IS IT MORE REALISTIC TO AIM AT MID-84?
HOW SHOULD WE PRESENT THE RESULTS OF OUR DISCUSSION TO THE OTHER MEMBERS OF THE IMF?

ITEM 2: COUNTRY QUESTIONS FLAG.G.

I SUGGEST THAT WE HAVE AN EXCHANGE OF VIEWS ON DEVELOPMENTS RELATING TO, IN PARTICULAR,
YUGOSLAVIA –
MEXICO –
ARGENTINA –
BRAZIL. –

ITEM 3: ''MULTILATERAL SURVEILLANCE'' FLAG.H.

MINISTERS AND GOVERNORS MAY WISH TO DISCUSS PROCEDURAL QUESTIONS OF THE ''MULTILATERAL SURVEILLANCE'' AGREED AT VERSAILLES, ESPECIALLY THE DATE AND THE FRAMEWORK OF THE NEXT MEETING.

ITEM 4: ECONOMIC PROSPECTS AND POLICIES FLAG J.

IF TIME PERMITS, WE COULD HAVE AN EXCHANGE OF VIEWS ON THESE ISSUES.

ITEM 5: OTHER BUSINESS

STOLTENBERG ++ FLAG K: GATT MINISTERIAL.

NNNN
1314+
262405 TRSY G
886645Z BMF D

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-233 3000
Direct Dialling 01-233 ....

9/12/82

Chancellor

Kreditanstalt für Wiederaufbau

Some key points are:

a) Capital is provided by the Federal Government and Länder – it's publicly owned.

b) It provides loans to small/medium-sized businesses on terms similar to those for large ones – removing the disadvantage of smallness.

c) It can afford b) because of earnings on a) and cross-subsidisation from other activities it carries out for the German government, notably export credit and administration of overseas aid. The German government presumably has to tolerate this profit-making/cross subsidisation.

d) The origins of KfW go back to the end of Marshall aid, the divided Germany with massive migration etc. This may explain readiness to use a publicly-owned body in a market-oriented economy.

e) – p. 1 of attachment to Villiers letter: high UK gearing needs equity rather than loan finance, though 10 years loans may be better than overdrafts

Apologies for having scribble.

A. Fire

9 Dec. 1982