~~01.~~ Part. A.

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Begins: 31/3/81.
Ends: 10/4/81.

PO -CH /GH/0081
PART A

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PART A

Chancellor's (Howe) Papers:

MEETING OF GROUP FIVE
MINISTERS AND GOVERNERS
LONDON APRIL 1981

Disposal Directions: 25 Years

26/7/95.

1. c. Mr Halligan [initials] 6/4 1
cd X be covered in the brief, pl.

2. BF with other G5 pps on 10/4

MINISTRY OF FINANCE
TOKYO

March 31, 1981

The Right Honorable
Sir Geoffrey Howe
Chancellor of the Exchequer
H. M. Treasury
London SW1
United Kingdom

G5 BRP

Dear Mr. Chancellor,

Thank you very much for your message covering the United Kingdom Budget, which was presented to your House of Commons on March 10. I find the concise explanation about the management of the economic and financial policies in your country, with a clear medium-term perspective, most informative and full of useful suggestions to us.

As for our budgetary problems and economic prospects, you might perhaps be familiar with from a memo Vice Minister Sagami has sent to Sir Kenneth on December 29.

In any event, as we have many similar problems, exchange of views on budgetary and economic policies is significantly important. I look forward to seeing you soon in London.

With my best regards,

Very sincerely yours,

Michio Watanabe

Michio Watanabe
Minister of Finance

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MINISTRY OF FINANCE

TOKYO 100 JAPAN

December 29, 1980

Vice Minister
for International Affairs

Sir Kenneth E. Couzens, K.C.B.
Second Permanent Secretary
H. M. Treasury
Parliament Street
London SW1P 3AG
England

Dear Sir Couzens,

The Japanese Government today decided on the budgetary and tax package proposal for FY1981 beginning April 1, 1981. I would like to take this opportunity to inform you of the outline of Japan's economic outlook and the national budget for FY1981.

The economic outlook (summarized in Annex 1) and the basic stance in the management of the economy for FY1981, which was approved by the Cabinet on December 20, aim at (1) a steady expansion of the economy led by active domestic private demand, (2) stabilization of the price situation, (3) securing stable supply of energy resources and revision of the oil-dependent economic structure, and (4) contribution to international economic cooperation.

Under these policies, the GNP growth rate in FY1981 is expected to reach 5.3% in real terms, which is to be located as a step toward a stable medium-term growth path mainly supported by domestic demand. In the international balance of payments, imports are projected to increase further with the steady expansion of the economy, while exports will continue to grow although the pace will slow-down. As a result, the current account deficit will be of the order of 1.3 trillion yen (6 billion U.S. dollars*) in FY1981 as compared with the envisaged 2 trillion yen (9.1 billion U.S. dollars) in FY1980.

* For the purpose of conversion, after December 1980 exchange rate of US$=¥213, average rate for end-October to end-November, 1980 has been used.

The Japanese national budget since FY1975 persistently depended on extremely large portion of revenues by issuance of government bonds, with their outstanding amount reaching tremendous levels. Consequently, our capability to adapt to changes in the economic and social environment through fiscal means has been seriously constrained, creating numerous difficulties in the management of economic and monetary policies.

To restructure the national budget, utmost emphasis has been placed to reduce public spendings, and the budget will increase only 9.9%, the lowest growth rate since FY1959 (Annex 2). Excluding expenditures for local allocation tax** and national debt service which increase automatically, the average increase rate is 4.3%, much lower than the expected nominal GNP growth rate of 9.1%.

On the revenue side, increases in tax rates of corporate income tax, liquor tax, commodity tax, revenue stamp tax and securities transaction tax are proposed, thereby bringing the estimated total increase in tax revenues to around 1.39 trillion yen (6.5 billion U.S. dollars) for FY1981 (Annex 3).

As a result of these efforts, the amount of government bonds to be issued in FY1981 will be reduced by 2 trillion yen (9.4 billion U.S. dollars) and the deficit financing would account for 26.2% of the budget, down from 33.5% of the initial FY1980 budget.

** The "Local Allocation Tax", which equals a fixed share (32.0%) of the revenue from income tax, corporate income tax and liquor tax, is distributed as grants by the national government to local governments.

The outline of the Fiscal Investment and Loan Program*** for FY1981 is given in Annex 4. The total size of the Program for FY1981 will increase by 7.2% compared with the initial program for the current fiscal year.

*** The Program is designed to allocate efficiently the funds, financed through postal savings, welfare pensions and other sources, to various Special Accounts, government-affiliated agencies, local governments, public corporations, and other special institutions.

These budgetary and tax measures will be submitted to the Diet in January, 1981 for its deliberation and approval.

With the hope that the information summarized above and in the Annexes will be helpful to you, I wish you a Very Happy New Year,

With my best regards,

Sincerely yours,

Takehiro Sagami

Takehiro Sagami

Economic Outlook for 1981

(at current prices)

	Unit	FY1979 Actual	FY1980 Estimates	FY1981 Prospects	FY1980/FY1979 (%)	FY1981/FY1980 (%)
Gross National Product	¥trillion ($billion)*	224.9	242.8	264.8 (1,243.2)	108.0 (104.8)**	109.1 (105.3)**
Private Final Consumption Expenditure	"	132.2	143.1	157.2 (738.0)	108.3	109.9
Private Housing	"	15.4	15.1	16.4 (77.0)	98.4	108.5
Private Enterprise Plant and Equipment Investment	"	34.3	37.7	41.8 (196.2)	110.1	110.7
Employment						
Labor Force	thousand	56,070	56,650	57,150	101.0	100.9
Number of the Employed	"	54,930	55,500	56,050	101.0	101.0
Index of Industrial Production					104.5	105.3
Wholesale Price Index					114.0	104.1
Consumer Price Index					107	105.5
Balance of Payments						
Current Balance	¥trillion ($billion)*	-3.2 (-13.9)	-2.0 (-9.1)	-1.3 (-6.0)	-	-
Trade Balance	"	-0.6 (-2.4)	0.9 (4.0)	1.7 (8.0)	-	-
Exports	"	24.2 (105.1)	29.2 (133.1)	32.4 (152.2)	120.8	111.0
Imports	"	24.8 (107.5)	28.3 (129.1)	30.7 (144.2)	114.3	108.4

* For the purpose of conversion, exchange rate of US$=¥213, average rate for end-October to end-November, 1980 has been used.

** Ratios in real terms

Note: Estimates and prospects in this table have been prepared with a number of assumptions as presently envisaged about the policies and developments in Japan's and the world's economy. Allowances must be taken into account for these figures since Japan has a market economy and in international field unexpected developments might evolve that affect the economic outlook.

FY1981 General Account Budget by Sources of Revenue

(billion yen)

	FY1980 (Initial) (A)	FY1981* (Initial) (B)	(B)-(A)	Percentage Increase (%)
Tax and Stamp Receipts	26,411.0	32,284.0 (151.6)	5,873.0	22.2
Miscellaneous Receipts	1,907.8	2,234.1 (10.5)	326.3	17.1
Proceeds from National Bond Issues	14,270.0	12,270.0 (57.6)	-2,000.0	-14.0
Grand Total	42,588.8	46,788.1 (219.7)	4,199.3	9.9
Proceeds from National Bond Issues / Grand Total	(%) 33.5	(%) 26.2	-	-

FY1981 General Account Budget by Major Expenditure Programs

(billion yen)

	FY1980 (Initial)	FY1981 * (Initial)	Percentage Increase (%)
Social Security	8,212.4	8,836.9 (41.5)	7.6
Education and Science	4,525.0	4,742.0 (22.3)	4.8
Local Finance	7,387.7	8,766.6 (41.2)	18.7
National Defense	2,230.2	2,400.0 (11.3)	7.6
Pensions for Veterans and Others	1,639.9	1,803.0 (8.5)	9.9
Public Works	6,655.4	6,655.4 (31.2)	0.0
External Aid	382.6	425.4 (2.0)	11.2
Energy Measures	424.1	497.5 (2.3)	17.3
National Debt Service	5,310.4	6,654.2 (31.2)	25.3
Others	5,821.1	6,007.1 (28.2)	3.2
Grand Total	42,588.8	46,788.1 (219.7)	9.9

* Figures in brackets are expressed in billions of US dollars. For the purpose of conversion, exchange rate of US$=¥213, average rate for end-October to end-November, has been used.

A Summary of the Proposed FY1981 Tax Reforms

I. Proposed Tax Reforms

With an aim to restore the soundness of budget financing and to accommodate the tax system to the recent economic and social changes, a variety of tax reforms are proposed.

Major proposed reforms are as follows:

1. The rates of Corporate Income Tax are proposed to increase by a uniform 2%.

Total Amount of Taxable Income	Undistributed Profits		Distributed as Dividends	
	(present)	(proposed)	(present)	(proposed)
Ordinary Corporations				
(i) first ¥7 million* of annual income for a corporation which capital amounts to ¥100 million or less	28%	30%	22%	24%
(ii) others	40%	42%	30%	32%
Cooperatives and Public Interest Corporations	23%	25%	19%	21%

* The proposal also includes a change of the maximum income entitled to reduced rates from ¥7 million to ¥8 million.

2. The specific rates of Liquor Tax are proposed to increase by 10-25%.

3. Various kinds of items are proposed to be newly subject to Commodity Tax, and the tax rates of some commodities already subject to this tax are proposed to increase.

4. The rate of Stamp Tax are proposed to be doubled.

5. The rate of Securities Transaction Tax are proposed to increase by 22-50%.

6. A variety of Special Tax Measures are proposed to be curtailed or repealed.

II. Estimated Revenue Effects of Tax Reforms

Total increase of tax revenue is estimated to be around ¥1.39 trillion for FY1981. Total tax revenue of the General Account Budget for FY1981 is estimated to be around ¥32.28 trillion.

Outline of the Fiscal Investment and Loan Program

I. Sources of Funds

(billion yen)

	FY1980 *	FY1981 *	Percentage Increase (%)
Industrial Investment Special Account	16.9	18.9	11.8
Trust Fund Bureau Fund	17,389.4	19,480.2	12.0
Postal Savings	7,900.0	8,900.0	12.7
Welfare Pensions	3,300.0	3,900.0	18.2
Repayments, etc.	6,189.4	6,680.2	7.9
Postal Life Insurance Fund	1,692.0	1,890.0	11.7
Government-Guaranteed Bonds and Borrowings	1,581.6	1,600.6	1.2
Total	20,679.9	22,989.7 (US$107.9 bil.)**	11.2

* These figures include the subscription of government bonds of ¥2,500 billion for FY1980 and of ¥3,500 billion for FY1981 by the Trust Fund Bureau.

** For the purpose of conversion, exchange rate of US$=¥213, average rate for end-October to end-November, 1980 has been used.

II. Investment and Loan Program Classified by Function

(billion yen)

	FY1980	FY1981	Percentage Increase (%)
Housing	4,761.9	5,111.4	7.3
Water Supply, Sewage and Other Living Environment	2,571.7	2,716.3	5.6
Welfare	628.0	658.4	4.8
Education	808.9	794.3	-1.8
Small- and Medium Size Enterprises	3,400.4	3,825.2	12.5
Agriculture, Forestry and Fishery	885.9	916.6	3.5
Land Conservation and Disaster Reconstruction	312.0	276.6	-11.3
Roads	1,031.4	1,182.6	14.7
Transportation and Communication	1,743.7	1,953.8	12.0
Regional Development	469.4	455.9	-2.9
Basic Industries	547.3	593.6	8.5
Foreign Trade and External Aid	1,019.3	1,005.0	-1.4
Total	18,179.9	19,489.7 (US$ 91.5 bil.)*	7.2

* For the purpose of conversion, exchange rate of US$=¥213, average rate for end-October to end-November, 1980 has been used.

ANNEX II

Energy

In order to encourage the installment of energy conservation equipment by industry the tax incentives stated in my minute to you on 22 December (on FY 1981 tax reform), para 6, will be introduced in FY 1981.

2. For the purpose to help obtain the support of local community toward power plant locations the following three subsidies, involving

a total of ¥8,865 million, will be provided:

(a) Discounts on power service rates for the benefit of local residents and companies in cities and towns where nuclear power plants are located. On a point of detail, the monthly bill of a household will be reduced by between ¥200 and ¥900 depending on the size of nuclear power generation capacity; the rate for companies will be reduced by between ¥75 and ¥250 per kwh contract, again depending on the size of nuclear power generation capacity. These cost ¥3,027 million to the government per year. The date of enforcement: October 1981.

(b) Special grants to prefectures that generate more electricity than consumed in the prefectures concerned and "export" it to other prefectures. Between ¥50 million and ¥400 million per prefecture per year depending on the amount of electricity exported. These grants, which total ¥2,300 million a year, are intended to be used for the purpose to attract industry into those prefectures. (Enforcement Date: April 1981)

(c) Special grants to cities and towns with hydro power plants in operation for more than fifteen years. Between ¥3 million and ¥30 million per city or town per year. These grants, which total ¥3,538 million a year, will be issued beginning from April 1981.

3. In order to maintain private sectors' oil stockpiles at the level of the country's 90-day supply the interest subsidies to private oil companies will be increased by 1% (point) PA from the present 2% - 5.5%. A similar interest subsidization scheme will be introduced for LPG stockpiles. The current LPG stockpiles amount to the country's 10-day supply (carried out through the government's administrative guidance; planned to be increased to 15-day supply by the end of FY 1981) but by a planned legislative measure companies will be forced to increase these stockpiles to 50-day supply by the end of FY 1988. The FY 1981 interest subsidies for oil and LPG stockpiles total ¥30,200 million, up 81.1% from FY 1980. In addition ¥58,600 million is earmarked for constructing the government's (i.e. Japan Petroleum Corporation's) oil stockpile bases (five in all), up 16.9% from FY 1980.

4. Japan Development Bank's loans for energy conservation and alternative energy projects are budgeted for a total of ¥357.5 billi[on], up 33.4% from FY 1980. A total of ¥116 billion will be invested in Japan Petroleum Corporation for the purpose to promote oil explorati[on] projects in Japan and abroad, up 41.5% from FY 1980. A total of ¥32.4 billion is earmarked for nuclear fusion R & D projects as compared with ¥28.8 billion in FY 1980.

Soci Security

ANNEX III

Social security expenditure will go up 7.6% over FY 1980 but various modifications to a number of schemes are to take place. A two-tier system will be introduced on the non-contributory welfare pension for people aged over 70. For an income earner's family of six including such aged people, the monthly amount one such person gets will be increased to ¥24,000 from the present ¥22,500 if his annual income is ¥6 million or below and to ¥23,000 (from the present ¥22,500) if his annual income is between ¥6 million and ¥8.76 million nothing is paid if his income is over ¥8.76 million (same as now). Child benefit will not be available in FY 1981 if the family's annual income is over ¥4.5 million (currently this threshold is ¥49.7 million).

CODE 18-77

In order to make up for inflation employees' pension (for a retired person with wife; model case) will rise to ¥144,525 from June 1981 from the present ¥136,050. The health insurace premium (% of employee's monthly income) will rise to 8.4% in March 1981 and to 8.5% in October 1981 from the present 8.0% (the premium is shared on a 50/50 basis between the employer and his employees). In compensation, the hospital expenses of employee's dependents covered under the scheme will be increased to 80% in March 1981 from the present 70%. However, patients' contribution toward the initial "diagnosis fee"and toward hotel expenses will be increased to ¥800 and ¥500 per day from the present ¥600 and ¥200 per day for each employee patient.

pwp c. Mr Halligan
~~We shall need to consider~~
X next Thurs.

10

CONFIDENTIAL

3/4 For Information: JW 3/4

Mr Barratt
Mr Hancock
Mrs Hedley-Miller
Mr Lavelle
Mr Mountfield
Mr Bottrill
Mr St Clair
Mr Hawtin
Mr Atkinson

c BF on 6/4

CHANCELLOR

G5 MEETING: 12 APRIL

I think we have reached the point where you might issue a definitive invitation and agenda for this meeting. However, it might be a little awkward to despatch it before Breda in case anything emerges there which would affect it. So I attach a draft but suggest that we wait until Monday morning before sending it. It ought then to go on a telex in the interests of speed.

2. The press know of this meeting - see Dow Jones report attached. If asked, our press office will not deny the existence of the meeting but will say it has no comment to make. There is however the possibility that press photographers will appear in or near Downing Street.

X No great matter? If it is, arrangs for admission thro' Cab. Office

KEC

K E COUZENS
2 April 1981

I agreed with Mr Halligan that the agenda cd now issue.

JW 6/4

enc

CONFIDENTIAL

TELEX

Herr Matthöfer
Bundes-Ministerium der Finanzen
Bonn
West Germany

M. Monory
French Tresor
Paris

Mr Regan
Secretary of the Treasury
US Treasury
Washington

Mr Watanabe
Ministry of Finance
Tokyo

I would now like to circulate a revised agenda for our discussions at 11 Downing Street, London on Sunday 12 April. I propose 1500 hours for the start of our meeting and look forward to our dinner together at about 1930 hours. In the light of requests received I propose the following for our agenda:-

1. IMF borrowing, including the suggested short-term loans totalling 1 billion SDR's by OECD countries; and the question of market borrowing.

2. Relations with Saudi Arabia.

3. IMF and the PLO.

4. Approach to Interim Committee meeting in Libreville, including status of questions of an SDR allocation after 1981; a food facility; and interest rate subsidy.

5. World Bank: IDA VI and bridging arrangements.

6. Energy Affiliate.

7. Monetary policy: Interest rates and exchange rates.

8. Poland

9. Any other questions on particular countries.

10. Export credits.

11. Any other Business.

I would be grateful if you would notify these arrangements to the two colleagues accompanying you.

Kind regards.

GEOFFREY HOWE

 12

9/4/81.

1/50

Mr K Couzens

2 CHANCELLOR OF THE EXCHEQUER

cc Sir Kenneth Couzens
Mr Barratt
Mr Hancock o/r
Mr Lavelle
Mr Peretz
Mr Atkinson

LENDING FROM THE UK'S RESERVES TO THE IMF

You discussed at Breda the IMF's need to borrow about SDR 1 billion from OECD central banks, in parallel with the borrowing from the Saudis - and partly as a reassurance to the latter. The general feeling was that it was very desirable that the US should participate, and that they should be pressed to do so (there will be an opportunity on Sunday) but that this should not be a condition of participation by the rest of us.

2. This subject is to come up at the BIS meeting in Basle on Monday or Tuesday next, and the purpose of this note is to seek your approval for the line it is proposed that the Governor should take.

3. The BIS has come into the picture because it suits some member countries to lend through the BIS rather than overtly. The IMF has thus been discussing amounts and terms on the BIS network, though the UK (and probably some others) prefer to lend bilaterally to the Fund, and would do so. (Why pay the BIS for unnecessary services?). But, apart from any fee the BIS charge, the terms will be similar whichever route is chosen.

4. We propose that, if the discussion makes this necessary, and others are pledging, that the Governor, on behalf of the UK, should say at the meeting next week that we agree in principle to participate in the lending programme, in respect of an amount not exceeding SDR 150 million.

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5. He need not go further. The precise terms and conditions will need to be carefully considered and settled subsequently. As with the borrowing from the Saudis, the interest rate will not be related to Euro-currency rates, but to the rates, for the appropriate periods, in the domestic markets of the countries with the 5 main currencies. The maximum period for the lending would be 2 years, but could be shorter periods, with the expectation of roll-overs making up to 2 years in all. We shall need to work out a package which contains the best combination for us of period and interest rate.

6. We would expect the terms and conditions on the loan to be sufficiently good for it to be made as a normal commercial investment of the reserves, under the terms of the Exchange Equalisation Account Act. The amount in question is very small in relation to the overall size of the foreign currency reserves.

MHM.

MRS M HEDLEY-MILLER
9 April 1981

KCC
10/4

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STEERING BRIEF

10/4/81

CHANCELLOR OF THE EXCHEQUER

cc Sir Kenneth Couzens
Mr Barratt
Mr Hancock o/r
Mr Mountfield
Mr Atkinson

PS/Governor - B/England

MEETING OF G5 MINISTERS AND GOVERNORS, LONDON, 12 APRIL 1981: STEERING BRIEF

The briefs for this meeting are attached. This covering note indicates how we have approached the briefing and how we suggest that the meeting might be handled and paced out.

Time and Place

2. The participants will arrive via the Cabinet Office entrance and be shown to No.11, with the aim of beginning the meetings at 3 pm. The discussions will be held in No.12. The dinner will be held in your state Dining Room.

Participants

3. A list of participants, so far as is at present known, is attached at Annex A. I will give plenty of copies of this list, and of the agenda, to Mr Wiggins, so that they can be made available at the meeting to each participant. As I think you know, M. Monory and Mr Watanabe will have "whisperers"; in both cases these are in fact quite senior people.

4. You will no doubt wish at an early stage to express regrets about Herr Matthoefer's illness and absence.

5. You will have met Mr Regan and Mr Sprinkel at luncheon. You will then I think know all the participants except for the Japanese (and M. Monory's whisperer).

General

6. The topics are by now all familiar to you, and many were discussed at Breda. They are all current and interesting. But the main achievement of the meeting will perhaps be less to arrive at a set of decisions than to achieve understanding of each other's positions. It offers a timely opportunity to make the acquaintance of the new US Treasury Secretary, and to have informal exchanges with him. This is important since, on several issues, the United States are tending towards a harder line than some Europeans. And there is the recurrent thread of disquiet about the interest rate/exchange rate issues, with a tendency to want to blame the Americans for the present high level of interest rates in Europe. A good talk in the surroundings of No.11 should stand everyone in good stead for more formal occasions later. But I suppose there must be some possibility that you will have to stop the temperature from rising, on one or two items.

Briefing

7. The briefs do not go into great detail on substance : as I have said, the subjects are familiar to you. We have tried to help with the handling of each item, indicating some introductory remarks, a lead speaker where appropriate,* an indication of national positions, and a possible summing up.

Agenda

8. The agenda is attached as Annex B. It reflects the wishes of the countries concerned. It falls into four categories :

IMF/IBRD matters
Interest rates/exchange rates etc.
Country questions - Poland in particular
Export Credits.

* We have told the US Embassy of the items on which you would be likely to turn Mr Regan first.

Spacing out the Discussion

9. The order of this agenda will have to be modified a bit. The Japanese Finance Minister (and his whisperer) will leave during dinner : but it is important to have the export credits discussion while he is still present.

10. The interest rate complex on the other hand looks suitable for discussion round the dinner table, and thus to be the final item, though it would be best for it to have been begun earlier round the conference table.

11. The Japanese Minister's plan seems to give you a good excuse for suggesting at the outset an arrangement of the time available as follows :

a. a fairly brisk discussion on the Fund/Bank topics, items 1-6 on the agenda, with the aim of finishing by say 4.30. This timing should not, and is not intended to,imply any skimping : it should be ample.

b. displacing item 7, interest rates. This could begin at say 6 pm to 6.15 pm, to take up something like half an hour or so before drinks, and to be resumed at dinner.

c. therefore fitting in export credits; Poland; other countries if necessary; and "any other business" between 4.30 pm and the move to the interest rate issues.

In suggesting serious discussion over dinner you might indicate that you would allow say two courses to proceed amid more frivolous conversation.

MHM.

MRS M HEDLEY-MILLER
10 April 1981

Annex A

ANX A

G5 MEETING. No 11 DOWNING STREET, LONDON. 12 APRIL 1981

PARTICIPANTS

France	M. Rene Monory, Minister of the Economy
	M. Renaud de la Geniere, Governor, Bank of France
	M. Jean-Yves Haberer, Directeur, Tresor
	M. Rigaud (who will interpret for M. Monory) Chef du Cabinet of M. Monory
Federal Republic of Germany	Herr Karl-Otto Poehl, President, Bundesbank
	Herr Horst Schulmann, State Secretary for Monetary Affairs, Finance Ministry
Japan	Mr Michio Watanabe, Minister of Finance
	Mr Takehiro Sagami, Vice-Minister of Finance
	Mr Harvo Maekawa, Governor, Bank of Japan
	Mr Hirotake Fujino (who will interpret for Mr Watanabe) Assistant Vice-Minister of Finance
United Kingdom	Sir Geoffrey Howe, Chancellor of the Exchequer
	Sir Kenneth Couzens, 2nd Permanent Secretary, Overseas Finance Sector, HM Treasury
	Mr Gordon Richardson, Governor, Bank of England
United States	Mr Donald Regan, Secretary to the Treasury
	Mr Beryl Sprinkel, Under Secretary for Monetary Affairs, US Treasury
	Mr Paul Volcker, Chairman of the Federal Reserve Board

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Annex B

ANX B

G5 MEETING. 11 DOWNING STREET, LONDON. 12 APRIL 1981

AGENDA

1. IMF borrowing, including the suggested short-term loans totalling 1 billion SDR's by OECD countries; and the question of market borrowing.

2. Relations with Saudi Arabia.

3. IMF and the PLO.

4. Approach to Interim Committee meeting in Libreville, including status of questions of an SDR allocation after 1981; a food facility; and interest rate subsidy.

5. World Bank : IDA VI and bridging arrangements.

6. Energy Affiliate.

7. Monetary policy : Interest rates and exchange rates.

8. Poland

9. Any other questions on particular countries.

10. Export credits.

11. Any other Business.

ITEM 1

G5 MINISTERIAL MEETING: 12 April

ITEM 1: IMF BORROWING

Chairman's Introduction

1. Fund's latest estimate of need for new borrowings in 1981 is up to SDR 10 bn. (includes possibly India at SDR 4 bn). So far Larosiere has obtained SDR 4 bn from Saudi Arabia (with a further SDR 4 bn in 1982 and possibly a further repeat in 1983). He is looking to G 10 Central Banks, either directly or through BIS, for a relatively short-term revolving $1 bn. Beyond that we understand he is looking to other OPEC countries (Emirates, Kuwait, Venezuela?), and possibly also to market borrowing, "if this were indespensable". (Last Interim Committee Communique).

2. Main issues

(a) Are G10 Central Banks going to lend? Will welcome in particular results of US consideration of the legal obstacles they have hither to seen.

(b) If so, bilaterally or through the BIS? And on what terms?

(c) What future do we see for market borrowing?

Position of Others

3. Japan, Germany and France (as well as UK) have signalled their willingness to participate in the G10 whip-round probably on a fairly equal basis, say 100 to 150 m SDR's each. The Japanese might go further. The Germans prefer to lend indirectly through the BIS (because of their weak external position), the Japanese marginally prefer it, the French could lend through either channel.

4. Only the US has stalled. They have said they have no legal authority to lend direct to the IMF and the BIS route would look like tricking Congress. The US did agree, however, at the G5 Deputies meeting to reconsider their position by today.

5. French and German will want to lean hard on the US, but won't make US participation a pre-condition.

6. On market borrowing, the Japanese and French are still formally opposed. The Germans are also hostile to it, except as a last resort. The ostensible reason is that market borrowing cuts across the co-operative nature of the Fund and would force it to compete for funds with the World Bank. We wonder whether these three, currently deficit, countries are also worried about the fund competing with their own borrowing programmes. But all three are receptive to the point that access to the market would reduce the future bargaining leverage of the Saudis. The US are strongly in favour of market borrowing.

UK VIEW

7. Like the others, we are anxious that the US should participate in the Central Bank placements. A figure of 250 m SDR's was mentioned at the G5 Deputies meeting. Given that the lending would be short term and at market rates, a US refusal to participate would look very bad and might lead to others backing out. If the US cannot lend bilaterally straight away and will not use the BIS "Back Door", could they commit themselves to helping Congressional clearance to participate at a later stage this year?

8. We ourselves prefer to participate bilaterally, rather than through the BIS. The latter would be a more expensive route for the Fund. The loan would need to be justified in the UK as a genuine deployment of reserves rather then financial support for the Fund, so the terms will be very important.

9. On market borrowing, there may be no escape this year if the Fund's need for 10 bn SDR's this year materialises. The Fund will almost certainly have to tap the market. Moreover the Saudi loan is only firm for 2 years: thereafter there will be an interval until the Fund's quota-based resources are next increased in 1985, during which market borrowing may be needed. We do not feel to argue for large recource to the market at present. But important to clear away all obstacles to rapid market borrowing if ever required. One major barrier is the sheer unfamiliarity of the Fund to the markets. Hence we favour a limited (say, not exceeding $500m) toe-in-the-water approach to the market this year.

Objective for Summing Up

10. To record the willingness of all (except the US?) to participate in the Central Bank placements, not letting the US off too lightly, if they continue to resist. To leave it to individual members to decide on direct lending or via the BIS.

11. To keep the option of market borrowing open, and to clear away preliminary obstacles, stop short of a decision in favour of an experimental $500 m issue if that is clearly against the sense of the meeting. But at least we should retain the prospect of market borrowing as a bargaining counter with the Saudis, if appropriate, to record resistance to any political concessions to other potential OPEC lenders whom Larosiere is approaching.

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ITEM 2 : RELATIONS WITH SAUDI ARABIA

ITEM 2

Handling

1. The Germans suggested this item for inclusion in the Agenda and could be asked to take the lead.

Introductory Remarks

2. We showed some disarray in the G5 over the Saudi quota. Perhaps that should be put behind us. We have to recognise the Saudi's had bargaining strength, and there was a widespread view outside the G5 that the number 6 position was warranted. But this ranking implies that they also have responsibilities for the Fund and the System, and obligations for the future. They are no longer simply providers of money. What form should this wider involvement take? How can G5 help to bring about the transition in the Saudi role within the Fund.

Views of Others

3. Not known. This issue was not discussed by the G5 Deputies.

UK Line

4. We agree that the Saudis need to be more closely involved in the important decisions on managing the Fund, and that G5 relationships with them, both bilaterally and collectively, should be strengthened. But it would be wrong to try to structure this new relationship too formally: we do not see them participating in G5, G10 or in the General Arrangements to Borrow, for example. Their interests and ours do not sufficiently coincide. They do not have the same problems of domestic economic management or international reserve currency role as G5.

5. Better instead to build on the perspectives we do share with the Saudis, eg collective discussion on the long-term financing of the Fund and the appropriate balance between quota-based and borrowed resources in the longer term. We could encourage Larosiere to invite the Saudi Executive Director at the Fund on occasions when he finds it appropriate to consult or brief the G5 Directors separately. He did this for the first time last week when he broke the news of Poland's interest in joining the Fund. He was quite right to do this.

6. Should we arrange a Ministerial luncheon at the time of the Annual Meetings (or at Libreville, though the timetable there is very compressed)? Which of us might take such an initiative? Is there anything to be done among the Central Banks?

Objectives for Summing-Up

7. To get agreement that encouragement to the Saudis to play an active and responsible role ought to be actively promoted. Should make some concrete arrangements in this direction, but nothing too institutionalised.

ITEM 3 : IMF/IBRD AND THE PLO

Introductory Remarks

1. These can simply be an invitation to Mr Regan to speak. /G5 Deputies meeting agreed that Mr Regan would set out the US position and current state of play/.

Views of Others

2. The French and Japanese have said they would not again be able to support the US on a straight proposal to keep the PLO out from the Annual Meetings. The German view is not known, but is likely to be close to our own. Japanese are very soft on the PLO, presumably because they are sensitive about their dependence on oil from the Gulf.

ITEM 3

Background and UK View

3. Last year the PLO was invited to attend the Annual Meetings by the Chairman for the time being of the Governing Board (a Tanzanian). The invitation was overturned by a US-inspired resolution which narrowly obtained the necessary quorum, freezing attendance to those observers who had attended in the year before until such time as the Boards of Governors had agreed what the procedure on inviting observers should be in the future. Recommendations on procedure are to be submitted by the Executive Boards to the Governors in mid-June. In the meantime there is growing recognition that the question of PLO attendance next year will have to be settled at a political level.

4. We feel that although the PLO, as a political body, is unsuited to be an observer alongside international economic entities, nevertheless, if the Arabs press for their attendance, neither the US (nor therefore anyone else) is likely to drum up enough support to keep them out. Important to minimise the future wrangling, which has tended to elevate the role of the Chairman of the Boards of Governors above that set out in the Articles.

5. But it is for the US to get alongside the Saudis and work something out.

<u>Possible Summing-Up</u> (Depends very much however on what Mr Regan says)

6. Generally agreed that the attendance of the PLO in September is a matter which must now depend premarily on what transpires between the US and leading Arab states (esp Saudi Arabia). Important that it should be resolved sooner rather than later, if possible by Gabon but certainly by the time the Chairman (a Uruguayan this year) is expected to send out invitations (July?). It cannot really wait for the outcome of the Israeli elections in June, which may affect US attitudes to the PLO.

7. Perhaps it may be possible to find a compromise which did not accord the PLO exactly the same status as established observers.

8. In the review of the procedure for inviting observers, we should resist any tendency towards elevating the role of the Chairman of the Board of Governors at the expense of the Executive Boards or the Boards of Governors.

ITEM 4 : (a) Approach to Interim Committee Meeting in Libreville
(b) SDR Allocation after 1981
(c) The Cereals Facility
(d) The Interest Rate Subsidy

Handling and Introductory Remarks

1. Suggest that it may be convenient to discuss all 4 items above rather than in turn. Chancellor could begin saying that he looks forward to hearing other views. The UK can go along with something on cereals facility, but is very hesitant about the SDR allocation. However, in general we feel that the industrialised countries need not be on the defensive at Libreville: the Fund has made several important decisions in recent months.

Item 4

2. It would then be appropriate to ask Mr Regan to speak on the general approach and on the specific issues: we are all anxious to hear from him at first hand. /On SDR allocations, the G5 Deputies concluded that if the US were prepared to take the lead in saying no to any allocation, the rest of G5 would support them. On the Cereals Facility, the US have yet to express a willingness to go along with any sort of facility. Both these issues require an 85 per cent majority, so US support is essential/.

3. Undoubtedly M Monory, as Chairman of the Interim Committee, would welcome a specific invitation to comment on how he sees the Interim Committee going and what he feels it might achieve.

Views of Others

4. M Monory, both as Interim Committee Chairman and in his own capacity is acutely sensitive to LDC pressures and has been dove-ish on all three of the issues on the agenda (which feature prominently in the G24 list of demands). He is particularly committed to the SDR/Aid Link (which however, is not for discussion at Gabon), but according to hearsay a straightforward SDR allocation has been ruled out by M Barre as potentially inflationary. France, almost alone among the industrialised countries has supported a separate cereals facility, (which is likely to be more generous to LDC's than a cereals "window" integrated within the Fund's existing Compensatory Financing Facility). And the French have also

committed themselves to $10 million bridging loan for the IMF's Interest Subsidy Account.

5. The US general attitude towards the Gabon meeting is not known. The new Administration has not yet appointed its Fund Executive Director, , but its general stance in private has been hard. Thus the Americans seem to be firmly against the SDR Allocation (no case for it on liquidity grounds, would tend to postpone adjustment by LDC's), non-committal on the cereals facility, and unwilling from the outset to make bridging finance available to the Interest Subsidy Account.

6. The Germans initially thought further SDR allocations were politically inevitable, but should be modest - no more than SDR 4 billion a year. Now, like the Japanese, they agree the role of the SDR ought to be fundamentally reviewed first, with no further allocations for the time being. The Germans accept an integrated cereals and compensatory facility "without enthusiasm". They have also said they will not contribute to the Interest Subsidy Account: the Japanese too, are not contributing this year and will only contribute in later years if other major countries do.

UK View

7. General Approach. The industrialised countries should not be defensive. We should take full credit for the general expansion of the Fund's facilities, noting the willingness of many LDC's (eg Morocco, Pakistan, Bangladesh, Sierra Leone) to draw on the Fund. We must be careful not to be too lenient on conditionality though this should be reasonable and sensitive: it would be self defeating for the Fund to agree programmes which contain inadequate adjustment. Many of the G24 demands have now been met in substance.

8. SDR Allocation. The UK would certainly agree with what we believe is the German and Japanese view that more fundamental thinking needs to be done on the role of the SDR floating rate system. Perhaps for example, new SDR's should be tied to a properly controlled substitution process. We could agree with the US line that there should be no SDR Allocations in the period after 1981, but emphasise that all G5 members need to stick to this line if adopted, and Larosiere should be told categorically in advance of Gabon. Otherwise we can expect continued LDC rumblings and we

don't want any undignified retreats.

9. Cereals Facility. As Germans, (paragraph 6).

10. Interest Subsidy. Like the US, we have said throughout that for budgetary reasons we cannot contribute this year or over the next two years.

Objectives for Summing-Up

11. To get agreement that the general tone of the Libreville meeting should be to look back on what had been achieved, to concentrate Fund efforts on implementing the new expanded lending policies and to discourage ideas of revolutionary or even brave new initiatives. But we will no doubt have to work hard to carry the LDC's with us.

12. To reaffirm that if the US is prepared to take the lead in saying no to any allocation, the rest of G5 would support them To emphasise the importance of sticking to this resolve.

13. To agree that we should consider further how to encourage the Fund to set in hand a fundamental re-consideration of the role of the SDR, including the scope for substitution.

14. We should aim to reach agreement on the cereals facility by the time of the Interim Committee.

15. The inability of many countries to subscribe to the Interest Subsidy Account will be unpopular to the LDC's. G5 countries should perhpas point to the efforts they are making to control the underlying factors that give rise to high interest rates. This ties in with the discussion under item 7.

ITEM 5 - WORLD BANK - IDA 6 BRIDGING ARRANGEMENTS AND OTHER TOPICS

Handling

You should ask Mr Regan to speak first on this item, to be followed by Herr Schulmann and M. Monory. The point is that we are all anxious to know about the prospect in Washington.

Background

2. Implementation of the IDA 6 Agreement has been delayed, first because the Carter Administration could not obtain Congressional approval and later while the Reagan Administration made up its mind. The Administration has decided to fulfil its obligations in total, but is proposing a rearrangement of the timing in depositing the promissory notes so as to delay expenditure. It remains to be seen how far and how quickly Congressional authority can be obtained, and even if the proposals for the immediate financial year are accepted, there could be difficulties later.

ITEM 5

3. The other countries were asked last year to provide bridging so that IDA could continue to commit funds, and many including the Germans and Japanese have deposited promissory notes equivalent to their first tranche (of three). The UK and the French have deposited 50% of their first tranche. These are commitment authorities only, expenditure occurs much later.

4. Decisions are required soon on:

(a) whether there should be further bridging beyond the first tranche;

(b) whether the British and French should pay the second half of their first tranche.

Views of Other Countries

5. The Germans are forthright that they will offer no more bridging beyond their first tranche. This is probably agreed among all the countries present.

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6. As far as the second half of the first tranche is concerned, the French are unlikely to pay it over. If the point comes up, you could ask M. Monory about French intentions. We ourselves have not yet taken a decision. However Ministers are likely to be recommended to pay the second half, provided that other contributions totalling $1 billion from at least four other countries are promised. This formula is intended primarily to catch the three Arab countries, Saudi Arabia, Kuwait, United Arab Emirates, who have not paid anything, plus Sweden or France. Belgium and Italy, the other main non-contributors so far have Parliamentary and other difficulties, and there is little point in pressing them. Since expenditure is almost certainly not affected, there is little point in the UK standing back even if the French decide to do so.

UK Interest

7. On the general question there are no particular points for us to push. We can allow others, if they wish, to lecture the Americans about their general failure on IDA 6 so far.

8. We can agree too to a united front against further bridging beyond the first tranche.

9. As far as the second half of our own first tranche is concerned, we ~~will~~ shall probably be ~~proposing~~ considering a formula aimed at catching the three OPEC contributions.

Outcome

10. The G5 might agree to look at the situation again, once the American Congress has decided on the Administration's proposals.

Other Points

11. Although not on the agenda, someone may mention the Dutch initiative on the World Bank's general capital increase. They are proposing that the Development Committee should urge member countries to take up at least part of their shares as soon as subscriptions open in October 1981, and to press for an early decision on the unit of value/maintenance of value problem. The intention is to allow the World Bank to expand its borrowing and lending as soon as possible.

12. At the moment progress is stalled on the technical unit of value/ maintenance of value problem but some solution will probably be achievable as a deadline approaches.

13. There is no need to object to the Dutch initiative. However, besides the UOV/MOV problem, the Americans need Congressional authority, and there could well be delays in the other countries as well. We ourselves have not yet decided how many shares to take up.

ITEM 6 - ENERGY AFFILIATE

Handling

This can be opened up to general discussion, with no introductory explanation

2. Following up a reference in the Venice Summit communique, the World Bank is pursuing proposals to establish an energy affiliate. The affiliate would have a separate capital structure from the World Bank, with contributions drawn both from OECD and OPEC, and its sponsors hope that it would be able to borrow surplus funds from OPEC for energy exploration and development in LDCs. Since it would be able to borrow and lend more than its capital, an energy affiliate might be a convenient way of getting round the restrictive 1:1 capital: lending ratio of the IBRD, but it is not clear that establishing an energy affiliate would actually be easier to achieve than amending the IBRD's Articles. Both require formal international agreement and ratification. The idea is stalled because the Americans have said that they cannot support an energy affiliate at the moment. Nevertheless the World Bank and others may seek to set it up even without American participation. An energy affiliate without American participation, if possible at all, would not attract itself to capital markets and would almost certainly not get the gearing up of borrowing which is one of its main justifications.

ITEM 6

Other Countries' Views

3. It is not clear whether the Americans have ruled out the energy affiliate altogether or whether they simply want a delay because of the possible public expenditure involved. Establishing an energy affiliate might, at some future date, prove a useful way of heading off other demands.

4. The French are very keen on the energy affiliate, and have been pressing the case (so far without much success) for an organisation well separated from the World Bank, probably with its headquarters in Paris.

5. The Germans and Japanese probably share our own views to a large extent.

UK Interest

6. There is no attraction in an energy affiliate unless it can mobilise OPEC funds which would not otherwise be available. Whether it would in practice be able to do this must be doubtful, and probably out of the question without full American participation.

7. The World Bank's own energy programme is being expanded, and there is no point in duplicating international organisations. The energy affiliate, if it is established, should be solely a financial mechanism, sharing staff and project appraisal facilities with the World Bank.

8. We should ensure that the World Bank's lending for energy is directed solely at investments which would not otherwise be taken up. There is no point in displacing private flows or taking over risks from oil companies.

9. No additional soft funds can be provided for energy other than what is made available to IDA.

10. If an Energy Affiliate were to be set up, the UK could probably not stay out for this might mean that British exporters would be excluded from competing for contracts.

Outcome

11. It will be for the Americans to defend their decision against the demands which are bound to be made at the Development Committee and at the Bank/Fund Annual Meeting for an Energy Affiliate to be established quickly to help deal with the adjustment problems of LDCs.

12. It seems doubtful whether the other countries can or should do anything as long as the Americans decline to participate.

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ITEM 7. MONETARY POLICY. INTEREST AND EXCHANGE RATES

Introductory Remarks

Important matter, currently of great concern. Anxiety in Europe about the level of interest rates, particularly in low inflation countries where interest rates are being kept high to sustain exchange rates, for fear of worsening inflation and to finance external deficits. Central Bank Governors have had opportunities for discussion with US representatives. Invaluable opportunity now for joint discussion with US Treasury Secretary. Invite views. (If hesitation, suggest a European should speak first, and try to get the Germans).

Country Positions

Item 7

Germany. Considerable anguish over the dilemma: high interest rates help DM but inhibit investment. Schmidt, SPD and German Finance Ministry inclined to complain most about high interest rates and want to encourage private investment as way out of recession. Bundesbank and Lambsdorff put counter inflation objective higher and more inclined to accept US interest rates.

France. At Breda Monory said interest rate levels were "suicidal". (Though French have negative real rates).

Both. May hanker after "disarmament". May also argue that the volatility of US interest rates is a worse evil than the level - ie US methods dubious: though Schmidt and Monory are clearly on level as well as volatility. Monory, against background of

French direct credit controls, argues that interest rate levels are not only way to control money. But there is no clear agreement on what the US should do, except perhaps to rely more on fiscal policy.

Japan. Managing to stand aside. Recent reductions in discount rate, as part of measures to push a rather sluggish economy (by Japanese standards) towards the planned 5.3% growth this year. Yen has not weakened unduly as a result: objective probably not to depreciate Yen.

U.S. May say object of policy is to bring down interest rates, as it is to bring down inflation. Recent trend of US rates has been down. Will insist also they understand the point about making tax and expenditure cuts in parallel.

UK Position

UK rates now below US rates and marginally below German rates. Not now in firing line.

UK Budget showed our determination to keep up fight against inflation while switching the burden from monetary to fiscal policy. Faced costs of achieving reduction in interest rates to help private investment.

Can't criticise US for fighting inflation. Hope, in their interests as well as ours, that they will not leave too much of the burden to be borne by monetary policy. Hope their fiscal deficit will stay moderate but understand can't reduce interest rates artificially while battle against inflation not yet won. Would not be sustainable. Also hope they will be able to avoid volatility.

Possible Points for Summing Up

Can assure US of support in fight against inflation. World's chief reserve currency must be firm and stable.

Hope however that they will not leave too much weight on monetary policy, for example as result of widening of fiscal deficit. Less chance of success if rely too heavily on interest rates, and risk of more currency instability, damaging others.

[If necessary, to meet Europeans: ought to discuss together and keep under review the prospects for interest rates and warn one another about developments which might put them up.]

ITEM 8. POLAND

Background

The main creditor countries have been meeting in Paris this week to hammer out the terms of an inter-governmental agreement on the rephasing of Polish debts. The intention is that the proposed arrangements should be approved by individual governments, so that the multilateral agreement covering the broad terms of the relief can be signed by the end of this month. Meanwhile the banks are working in parallel towards a similar debt relief operation.

Handling

2. There may thus be questions arising from the Paris talks to be considered. M. Haberer, the French Chairman of the creditors' group, will be present. If he so indicates, you will no doubt have to give him an opportunity to speak.

3. But as far as possible we advise you to steer discussion away from these immediate issues, and to avoid any conclusions on the scale or distribution of assistance to Poland (except of course that the Soviet bloc must do their share).

4. If possible therefore your introductory remarks could be to the effect that the agreement was in capable hands, and that there might be greater value in considering some of the more general and longer term questions arising from the Polish financial crisis. For example, the apparent withdrawal of the Russian"umbrella" over the creditworthiness of its Eastern bloc satellites has far-reaching implications. Western banks are heavily exposed in other Eastern bloc countries besides Poland and their willingness to lend in future is likely to be much reduced. There will be more pressure on Western countries to provide export credit on favourable terms. And there will be moves by the satellites (already evident from Poland but Hungary is another early candidate) to join the IMF, which could in due course impose a considerable strain on Fund resources.

Item 8

Other Interests

5. There has been some tension between the Americans and French over the degree of conditionality required of the Poles in the debt relief agreement. (We sympathise with the American desire for a tough approach but doubt whether it is realistic to expect more in the agreement now being drawn up). The French, and possibly the Germans, may press for more burden sharing on new credit.

UK Interest

6. We do not accept the concept of burden sharing and do not want the discussion to turn into a pledging session on new credit for Poland. The multilateral negotiations are concerned with debt relief: new credit is a separate issue, for individual governments. Our aim must be to minimise new ECGD exposure on Poland (Ministers have set a limit of £40 million on new credit for this year, most of which will be required to finance the UK share of EC food aid packages.)

Summing Up

7. On immediate issues, the conclusion might be that, so long as the Russians hold off, the aim should be to achieve early agreement on a debt relief package, and to encourage the private banks to do likewise. G5 might wish to return to the wider issues of Eastern bloc indebtedness at a future meeting.

(1) CONDITIONALITY

AEF3 Division
9 April 1981

ITEM 9 : TURKEY (Only if raised by others)

Handling

Depends who raises. No introductory remarks necessary : merely invite reactions.

Points to Make

2. (If pressed) Whilst the UK welcomes the encouraging progress made by the military government in getting to grips with the country's economic problems, the case for aid on purely developmental grounds remains weak. Nonetheless we recognise the overriding political importance of helping Turkey.

3. (If pressed) Given the difficult economic situation, overseas aid cannot be immune from the pressures affecting other forms of public expenditure. Will think further, but rather difficult.

Background

4. There will be an OECD pledging session sometime in the next few weeks, probably on 7 May. Our pledge has not yet been decided. £15 million soft loan - the same in cash terms as last year _ has (so far) been contemplated.

Other Countries

5. Germany and the USA are likely to make substantial pledges and to press their colleagues to be generous. France and Japan are likely to be less enthusiastic, but their pledges may well be larger than ours.

Summing Up

6. Must depend on the course of the discussion.

ITEM 9

ITEM 9 (OTHER COUNTRIES) 40

BRIEF ON BRAZIL (Only if raised by others)

Opening Lead in

Brazil has a very heavy burden of foreign debt (around $54 billion) and financing requirements of around $20 billion in both 1981 and 1982, for which it looks mainly to the commercial banks. If Brazil were unable to continue to raise and service loans, this would have serious consequences for the international money market and for governments which have provided guaranteed credit. Particularly following Poland, it would badly shake international confidence. But Brazil appears to be coping successfully so far this year and seems unlikely to seek IMF assistance in 1981.

2. The Germans have by far the highest amount of Government guaranteed export credit at risk in Brazil and might be invited to give their assessment of the outlook.

Other Interests

3. Around 60% of Brazil's debts are financial credits raised on the Euro-currency markets. Two-thirds of these are owed to US banks - UK exposure is much less. In addition most Western governments have significant commitments on guaranteed export credit - West Germany, followed by France, Japan, UK and USA have most at stake.

UK Interest

4. ECGD exposure is over £900 million. Within limits, ECGD is still providing cover for new projects but we are watching the situation closely.

Objective for summing up

5. Brazil is going through a difficult stage which will last for some years, though the country has huge natural resources (except oil) and long term prospects are good. A formal approach to the IMF in due course (informal discussions have already taken place) is to be encouraged as it will help to retain banking confidence. But this would not be enough to solve Brazil's problems and corrective measures will need to be pursued.

AEF3 Division
9 April 1981

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ITEM 10

BRIEF ON EXPORT CREDITS

Opening Lead in (No introductory remarks, save invitation to US to speak)

This item has been tabled by the Americans, and Secretary Regan should be invited to speak first. He can be expected to press the case for a substantial reduction in export credit subsidies, and early agreement on revised arrangements to bring Consensus interest rates more in line with market levels.

Other Interests

2. The French are regarded by the Americans as the villains of the piece. They have taken a negative line on proposals for change in the Consensus, and have blocked EC agreement on any system of automatic interest rate adjustment. They may well try to lie low.

3. Recently, the Japanese have emerged as a new obstacle to progress. They want to be allowed to provide finance at sub-Consensus rates (reflecting their low domestic market rates), even though the bulk of their export finance is provided through a state institution (Japanese ExIm Bank) and thus involves official support of the interest rate in the normally accepted sense under the Consensus.

4. The Germans support the US desire for progress, and would like to see a flexible approach to the problem of the low interest rate currencies. Until recently they have been in this category themselves, and they support an eventual solution under which different market-related rates would be set for each currency.

Item 10

UK Interest

5. We remain keen to see Consensus rates raised, and thus reduce our subsidy bill (£500 million in 1980-81, and still heavy in spite of recent reductions in UK rates). But we are bound to be concerned about our competitive position, and cautious about changes which might accord Japan specially favourable treatment. We do not subscribe to French worries about the effect of increases on the LDCs: preferential treatment for them would blur the distinction between

commercial credit and aid. The French should also be discouraged from trying to link agreement on the Consensus with US interest rate disarmament: this would be the tail wagging the dog with a vengeance.

Summing up

6. We suggest your aim might be to get agreement on the following points:-

i. preservation of the Consensus is very important. Agreement will require all concerned to show flexibility. But sacrifices are worth making to avoid a credit war which could start an outbreak of protectionism.

ii. progress should be made towards a more realistic structure of Consensus interest rates. G5 might be suitable forum for encouraging this.

iii. the problem of low interest rate currencies will need to be studied and resolved; meanwhile all participants should continue to adhere to the Consensus until new arrangements are negotiated.

AEF3 Division
9 April 1981

G5 Dinner. Proposed seating plan. (given to GHF)

Shulman Kadsawa Chancellor Poehl Watanabe Fujino
(Interpreter)

Volcker Pierse

Haberer

Couzens Sprinkel

de la Genière Regan Governor Monory Rigaud Sagami
(Interpreter)

Names in full on sheet below.

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G5 MEETING. No 11 DOWNING STREET, LONDON. 12 APRIL 1981

PARTICIPANTS

France	M. Rene Monory, Minister of the Economy
	M. Renaud de la Geniere, Governor, Bank of France
	M. Jean-Yves Haberer, Directeur, Tresor
	M. Rigaud (who will interpret for M. Monory) Chef du Cabinet of M. Monory
Federal Republic of Germany	Herr Karl-Otto Poehl, President, Bundesbank
	Herr Horst Schulmann, State Secretary for Monetary Affairs, Finance Ministry
	Herr Eckard Pieske, Department for Monetary Affairs, Finance Ministry
Japan	Mr Michio Watanabe, Minister of Finance
	Mr Takehiro Sagami, Vice-Minister of Finance
	Mr Haruo Maekawa, Governor, Bank of Japan
	Mr Hirotake Fujino (who will interpret for Mr Watanabe) Assistant Vice-Minister of Finance
United Kingdom	Sir Geoffrey Howe, Chancellor of the Exchequer
	Sir Kenneth Couzens, 2nd Permanent Secretary, Overseas Finance Sector, HM Treasury
	Mr Gordon Richardson, Governor, Bank of England
United States	Mr Donald Regan, Secretary to the Treasury
	Mr Beryl Sprinkel, Under Secretary for Monetary Affairs, US Treasury
	Mr Paul Volcker, Chairman of the Federal Reserve Board

LIST OF PARTICIPANTS OVERLEAF 45

10/4/81.

G5 MEETING. 11 DOWNING STREET, LONDON. 12 APRIL 1981

AGENDA

1. IMF borrowing, including the suggested short-term loans totalling 1 billion SDR's by OECD countries; and the question of market borrowing.

2. Relations with Saudi Arabia.

3. IMF and the PLO.

4. Approach to Interim Committee meeting in Libreville, including status of questions of an SDR allocation after 1981; a food facility; and interest rate subsidy.

5. World Bank : IDA VI and bridging arrangements.

6. Energy Affiliate.

7. Monetary policy : Interest rates and exchange rates.

8. Poland

9. Any other questions on particular countries.

10. Export credits.

11. Any other Business.

CHANCELLOR

G5

It has been the practice at some recent G5 meetings for the Chairman of the last meeting of the Deputies to report at the beginning of each item on the degree of agreement reached on it at the Deputies' meeting. I believe this can be done in one or two sentences. If you wish me to do this on Sunday I will do so.

KEC

K E COUZENS
10 April 1981

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With the compliments of

Resident Clerk

FOREIGN AND COMMONWEALTH OFFICE
LONDON, SW1A 2AH

10/4

ADVANCE COPIES   POLAND ECONOMIC ASSISTANCE 27

48

6 PS
3 PS/LPS
PS/MR BLAKER
PS/PUS
MR BULLARD
LORD BRIDGES
MR FERGUSSON
MR EVANS
HD/EESD
HD/ECD (E)
HD/WED
HD/ESID
HD/ERD
HD/NEWS D

RESIDENT CLERK

MR ~~MOUNTFIELD~~ COUZENS   TREASURY
MR COTTERILL   E C G D
MR WENBAN-SMITH   CABINET OFFICE
MR POWNALL   CRE4 DOT

IMMEDIATE

GRS 650
CONFIDENTIAL
FM PARIS 101652Z APR 81
TO IMMEDIATE FCO
TELEGRAM NUMBER 273 OF 10 APRIL 1981
AND TO ROUTINE WASHINGTON BONN VIENNA WARSAW MOSCOW UKREP BRUSSELS
AND SAVING TO OTTWAW BRUSSELS COPENHAGEN HELSINKI ROME TOKYO
OSLO THE HAGUE STOCKHOLM BERNE

IMMEDIATE

POLISH DEBT
FROM MOUNTFIELD

1. A MEETING OF THE FIFTEEN WESTERN CREDITOR COUNTRIES FINISHED HERE TONIGHT WITH VIRTUALLY COMPLETE ACCEPTANCE OF A DRAFT AGREEMENT ON A DEBT SETTLEMENT OPERATION. THIS WILL NOW BE REFERRED BACK TO CAPITALS FOR APPROVAL. THERE WILL BE ANOTHER MEETING HERE ON 27 APRIL TO CONCLUDE THE DEAL.

2. ITS MAIN FEATURES ARE:

(A) AGREEMENT TO RESCHEDULE OR REFINANCE 80% OF PRINCIPAL AND INTEREST OF GOVERNMENT OR GOVERNMENT - GUARANTEED DEBT FALLING DUE FOR PAYMENT BETWEEN 1 MAY 1981 AND 31 DECEMBER 1981, TOGETHER WITH ARREARS DURING APRIL 1981

(B) A GRACE PERIOD OF FOUR YEARS FOLLOWED BY REPAYMENT SPREAD OVER ANOTHER FOUR YEARS.

(C) INTEREST RATES LEFT TO BILATERAL NEGOTIATION BUT TO BE RELATED TO MARKET RATES.

(D) NO MORE FAVOURABLE TERMS TO BE EXTENDED TO ANY OTHER CREDITORS. (EG EASTERN BLOC COUNTRIES AND BANKS).

(E) A POLISH ECONOIC RECOVERY PLAN, NOT UNLIKE AN IMF LETTER OF INTENT, IS ANNEXED TO THE AGREEMENT AND LINKED FIRMLY TO IT. THIS CONTAINS BALANCE OF PAYMENTS AND FINANCING TARGETS FOR 1981 AND PROJECTIONS FOR LATER YEARS, AS WELL AS SUPPORTING DATA AND PROJECTIONS ABOUT THE DOMESTIC POLISH ECONOMY.

(F) A JOINT COMMISSION, OPEN TO ALL PARTICIPATING CREDITOR COUNTRIES, WILL MEET IN PARIS SEPTEMBER/OCTOBER TO REVIEW PROGRESS AGAINST THIS PLAN AND CONSIDER AN EXTENSION OF THE AGREEMENT OT COVER THE FIRST SIX MONTHS OF 1982. THIS OPERATION COULD THEN BE REPEATED UNTIL THE END OF 1983. MOST CREDITORS ACCEPT THAT IN PRACTICE IT WILL HAVE TO GO ON MUCH LONGER. THO US TEAM WASINABLE TO ACCEPT ANY FIRM COMMITMENT BEYOND DECEMBER 1981 OR ANY AUTOMATIC PROVISION FOR RENEWAL, AND WILL NEED FRESH INSTRUCTIONS. BUT THIS COMPROMISE SHOULD MEET THEIR NEEDS.

(G) A BREAK CLAUSE GIVING THE CREDITORS THE UNILATERAL RIGHT TO WITHDRAW. THIS IS RECOGNISED TO MEAN THAT WE WILL CANCEL THE AGREEMENT IF THE USSR INTERVENES OR A POLISH REGIME RESORTS TO FORCE.

(H) COUNTRIES PARTICIPATING IN THE BRIDGING OPERATIONS DURING THE FIRST PART OF 1981 WILL PROBABLY BE ALLOWED TO COUNT THEIR ASSISTANCE TOWARDS THEIR SHARE OF THE RESCHEDULING OPERATION. UK, FRANCE, AND FRG ALL WANT THIS. US IS HOLDING OUT FOR TACTICAL REASONS. BUT NO FORMULA TO DEAL WITH IT HAS BEEN WORKED OUT, AND FINAL RESOLUTION OF THIS PROBLEM IS LEFT TO THE MEETING ON 27 APRIL.

(I) BUT THEBIG FRENCH AND GERMAN LOANS OF 1980 AND EARLIER WILL PROBABLY BE RESCHEDULED AND WILL NOT COUNT TOWARDS THEIR CONTRIBUTION BECAUSE THESE WERE UNDERTAKEN AT THEIR OWN RISK BEFORE A MULTILATERAL OPERATION WAS IN PROSPECT. THE AMERICANS INSIST ON THIS AND MAY ABANDON OPPOSITION TO POINT (H) IF THEY CAN SECURE THIS.

(J) THE AGREEMENT WILL BE IMPLEMENTED BY A SERIES OF BILATERAL DEALS TO BE COMPLETED BY END JUNE 1981.

3. POLAND ASKED US TO INCLUDE A COMMITMENT TO OPEN UP MARKETS FOR THEIR EXPORTS, ON THE GROUND THAT THIS WOULD HELP THEM TO REPAY OUTSTANDING DEBT. WE SAID THAT THIS WAS LARGELY A MATTER OF COMMUNITY COMPETENCE TO BE PURSUED BILATERALLY IN THE EXISTING MIXED TRADE COMMISSIONS AND IN BRUSSELS.

4. AS EXPECTED, THE QUESTION OF NEW CREDIT WAS RAISED. UK AND US, WITH SOME SUPPORT FROM OTHERS, ARGUED THAT THIS WAS A SEPARATE ISSUE FROM DEBT AND THAT WE COULD MAKE NO COMMITMENTS. HABERER, IN HIS CAPACITY AS CHAIRMAN HAS SENT A STRONG FORMAL APPEAL TO CREDITORS TO BE GENEROUS WITH NEW CREDITS. FRANCE MAY RAISE THIS ISSUE SEPARATELY WITH MAJOR CREDITORS POSSIBLY AT MEETINGS OVER THIS WEEKEND. FRANCE INTENDS TO CALL A FURTHER MEETING OF POTENTIAL DONORS SHORTLY. MINISTERS WILL HAVE TO SETTLE THE UK LINE FIRST.

5. POLAND DID NOT REFER DIRECTLY TO THE POSSIBILITY OF JOINING THE IMF. BUT IN SEPARATE DISCUSSIONS THE US TEAM TOLD THE CREDITORS THAT WHEN JAGIELSKI WAS IN WASHINGTON HE INDICATED THAT THE USSR HAD QUOTE GIVEN THE YELLOW LIGHT IF NOT THE GREEN LIGHT UNQUOTE TO THE APPLICATION. HABERER SAID THE FRENCH HAD THE SAME IMPRESSION. KARCZ CONFIRMED THIS OVER LUNCH.

6. AN ANODYNE PRESS COMMUNIQUE WAS AGREED. TEXT IN MIFT.

FCO PLEASE ADVANCE TO COUZENS (TREASURY) ON SATURDAY.

FCO PLEASE PASS SAVING TO OTTAWA BRUSSELS COPENHAGEN HELSINKI ROME TOKYO OSLO THE HAGUE STOCKHOLM BERNE

HIBBERT.

[ADVANCED AS REQUESTED]

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IMMEDIATE

SENT/RECD AT 1Ø18Ø5Z JG/HK

ADVANCE COPIES   POLAND ECONOMIC ASSISTANCE 27

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6	PS	MR ~~MOUNTFIELD~~ COUZENS	TREASURY
3	PS/LPS	MR COTTERILL	E C G D
	PS/MR BLAKER	MR WENBAN-SMITH	CABINET OFFICE
	PS/PUS	MR POWNALL	CRE4 DOT
	MR BULLARD		
	LORD BRIDGES		
	MR FERGUSSON		
	MR EVANS		
	HD/EESD		
	HD/ECD (E)		
	HD/WED		
	HD/ESID		
	HD/ERD		
	HD/NEWS D		
	RESIDENT CLERK		

IMMEDIATE

RR MOSCOW

RR UKREP BRUSSELS

IMMEDIATE

GRS 130
UNCLASSIFIED
FM PARIS 101646Z APR 81
TO IMMEDIATE FCO
TELEGRAM NUMBER 274 OF 10 APRIL 1981
INFO ROUTINE WASHINGTON, BONN, VIENNA, WARSAW, MOSCOW, UKREP BRUSSELS,
INFO SAVING OTTAWA, BRUSSELS, COPENHAGEN, HELSINKI, ROME, TOKYO, OSLO, THE HAGUE, STOCKHOLM, BERNE.

MIPT: POLISH DEBT
FOLLOWING IS TEXT OF PRESS RELEASE.

REPRESENTATIVES OF GOVERNMENTS OF 15 CREDITOR COUNTRIES (AUSTRIA, BELGIUM, CANADA, DENMARK, FINLAND, FRANCE, THE FEDERAL REPUBLIC OF GERMANY, ITALY, JAPAN, THE NETHERLANDS, NORWAY, THE UNITED
*KINGDOM, ~~SG?? ??? ?? NOR?~~ THE UNITED STATES
OF AMERICA, SWEDEN AND SWITZERLAND) MET IN PARIS ON 9TH AND 10TH OF APRIL WITH THE PARTICIPATION OF A POLISH DELEGATION IN ORDER TO

PURSUE THE EXAMINATION OF THE PROBLEM OF POLAND'S EXTERNAL PAYMENTS AND OF MAINTAINING A HIGH LEVEL OF MUTUAL TRADE.

SUFFICIENT PROGRESS WAS MADE DURING THE MEETING TO CONFIRM THE 27TH OF APRIL AS THE DATE FOR THE PROPOSED CONCLUDING MEETING.

THE REPRESENTATIVES OF CREDITOR COUNTRIES WELCOMED THE CONFIRMATION FROM THE POLISH SIDE THAT A SIMILAR PROCESS HAS BEEN INITIATED BETWEEN POLAND AND COMMERCIAL BANKS WITH REGARD TO NON GUARANTEED CREDITORS.

FCO PLEASE PASS SAVING ADDRESSEES.

HIBBERT

IMMEDIATE

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PARA 1 LINE 4 SHOULD READMMM.......

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KINGDOM, THE UNITED STATES, ...

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