PART A

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PO -CH /GH/0103

PART A

Begins: ~~12/1/83~~ 8/12/82

Ends: 19/1/83

CHANCELLOR'S MEETINGS AND POLICY CONCERNING THE G10 INDUSTRIALISED COUNTRIES

PO -CH /GH/0103

PART A

FROM: A R H BOTTRILL
DATE: 8 DECEMBER 1982

MR KERR

cc Sir K Couzens
Mr Lavelle

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.

cf *

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

Pages 4-7 only

SECRET

FROM: Sir Kenneth Couzens
DATE: 14 December 1982

For Information:

Mr Kerr
Sir Douglas Wass
Mr Carey
Mr Lavelle
Mr Bottrill
Mr Atkinson
Mr Anson

MR LITTLER

KRONBERG: G5

I attach a record of this meeting. I think no special action is called for on the IMF package: that is in hand elsewhere. On Yugoslavia, Mr Carey will take note but there is nothing basically new.

2. Action on Brazil is first in Basle, where there will have been discussion about a BIS loan. On the message which Mr McMahon gave to Sir Douglas Wass, it looks as if we are likely to be asked to guarantee $100 million. This strikes me (and Mr Carey) as a shade high, given our relative official exposure, but I am not sure about our bank exposure. If we have to give a second guarantee, we shall have both to inform Parliament and, I fear, promise to legislate. I think the Chancellor is aware of this, but a submission will obviously be necessary.

3. I am dealing separately with the question of a possible note to the Prime Minister about the G5.

KEC

K E COUZENS

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G5 MEETING
AT KRONBERG, NEAR FRANKFURT, 9 DECEMBER, 1982

H. Stoltenberg was in the chair. Others present were Regan, Volcker and Sprinkel; Delors, Lageniere and Camdessus; Poehl and Tietmeyer; Mayakawa and Watanabe (no Japanese Minister); Sir Geoffrey Howe, Richardson and Sir Kenneth Couzens.

Brazil

1. Regan obtained permission to discuss the Brazilian situation as a matter of urgency and reports about Brazil thereafter punctuated the proceedings. Regan said that they were at risk of a stop on payments within 24 hours. Volcker explained that Brazil had $80-90 billion of debts and a $14 billion current account deficit (including debt interest). They needed to borrow $2 billion a month to meet maturities and cover the deficit. However they had been able to obtain virtually no ordinary financing since late September. They had raised modest amounts with increasing trouble from the banks and they had had $1.23 billion from the United States. A letter of intent was under negotiation with the IMF.

2. Volcker said the figures changed constantly. The Brazilians were anxious to keep up payments and avoid a stop, especially as there were domestic pressures to repudiate the debts. Their plan was to negotiate a jumbo loan of a medium term kind for $3-4 billion with the banks and then to secure enough bridging money to see them through 1982 and the first quarter of 1983. During that period they hoped to see a restoration of confidence, partly from their agreement with the IMF, partly as a result of a general improvement in the banking climate as the Mexican situation was resolved.

3. However Brazil was now dependent on 1 day money borrowed in New York. They were thought to need $500 that day. It subsequently transpired that they didn't but that they might need that amount on Friday, 10 December. The sense of crisis among the banks was likely to grow.

4. He had hoped to see Mexico settled first. The Mexican situation was going better than anybody could have expected. The new President was doing all the IMF required and more. But it would still be a couple of weeks before the various aspects of Mexico's financial situation were settled, and the same was true of the Argentine.

5. Volcker said that Brazil would not be able to get by with less than $5 billion of net new money from the banks next year. That assumed a roll over of all the maturities. Volcker was uncertain whether the Brazilians would in fact be able to achieve the jumbo loan which was the key to their plan. He feared that the inter-bank money borrowed by Brazilian banks might have to go into rescheduling and added that a sizeable proportion of recent bridging finance had gone to pay off banks. Regan said he was not prepared to put more money in on his own just in order to defer a standstill by Brazil until Monday.

6. Richardson expressed dismay at the escalating figures of bridging finance. He asked whether there was any chance that even with bridging the Brazilians could get through without a standstill. He judged that they could not and Volcker confirmed that that was his view. The question therefore became one of organising an orderly standstill.

7. Poehl said that any decision about BIS help to supplement what the Americans were doing could not be taken within a day or two. The matter could be discussed in Basle on Monday, 13 December, but even then would take a few days. The BIS would also need a request by the IMF and it would be difficult to get BIS support without progress on an IMF programme for Brazil. Moreover there needed to be a consortium of banks to deal with Brazil. That did not seem yet to exist.

8. At the end of the initial discussion it was agreed that the Americans would phone Larosiere about an approach to the BIS and would tell Galveas that it was the view of the Five that Brazil should seek a standstill.

9. Volcker later reported that Larosiere was sceptical about making an approach to the BIS at this stage. There was as yet no agreement with Brazil. There were two stumbling blocks: wages policy and agricultural subsidies.

10. Regan reported that Galveas was adamantly opposed to seeking a standstill.

11. In subsequent telephone exchanges Regan put the following programme to Galveas:

i. there should be agreement that weekend on an IMF letter of intent;

ii. Brazil should seek a standstill on debt repayment;

iii. there should be a meeting with the banks next week;

iv. the Brazilians should devalue by 20-25 per cent;

v. a BIS loan would be considered.

12. The final Brazilian reaction to this was:

i. they could not sign the letter of intent with the IMF by Saturday or Sunday. It would anyway have to go before their National Monetary Council on 15 December. The most that could be hoped for was an announcement of "agreement in principle". Larosiere confirmed that that depended on a crucial meeting on Saturday;

ii. there would be no standstill. However, Brazil did have it in mind to say to the banks that there would be no repayments of principal to those banks which failed to join in the proposed new jumbo loan;

iii. they would meet the New York banks next week, but only on the question of bridging finance;

iv. there would be no large medium devaluation but they would move their crawling peg devaluation rather faster than inflation eg perhaps by 1 per cent a month;

v. on figures, Galveas said that they were due to pay $2 billion of interest $1.5 billion of principal in the last quarter of 1982. The amount from now to the end of the year was $800 million interest, $600 million principal;

vi. they wanted a loan from the BIS of up to $1.5 billion but they would not necessarily draw all of it down.

13. In a final discussion, the United States agreed to carry the Brazilians to the extent of about $500 million on Friday, 10 December. Richardson summed up the position as follows:

i. we recommended that if the Americans spent 500 million to carry the Brazilians until the weekend, that would count towards the US share of a new joint operation for Brazil;

ii. we would approach positively the idea of a BIS loan. But the IMF programme must be such as to cover repayment out of IMF drawings and disbursements should be in tranches as with Mexico;

iii. there would need to be a deal with the banks to complement the IMF loan and it would be difficult to avoid a standstill.

<u>IMF Resources Package</u>

14. Sprinkel rehearsed the contents of the paper agreed by the G5 Deputies in Washington on 11 October 1982. He said the United States was interested in a comprehensive package but after discussion with Larosiere he was content that all the components need not be in the Interim Committee. Some matters could be dealt with in the Executive Board if the G10 agreed a common position. So they were ready to keep some of the most contentious issues out of the Interim Committee.

15. He thought that the question of quota distribution as well as the size of the quota increase would have to be dealt with in the Interim Committee. The Interim Committee could discuss and endorse the changes in the GAB, but not negotiate on them. The basic decisions there were for the G10. The question of limits on enlarged access and on the CFF; of remuneration and charges; and of method of quota payment could be for the Board.

16. His check list for a decision to call the Interim Committee included the following:

i. broad agreement in the G5 and the G10;

ii. a satisfactory reception in the Board on 17 December for present ideas on the GAB;

iii. progress in the Board on distribution of quota increases;

iv. some talks with other countries.

It would be necessary to decide finally by 10 January to go for an Interim Committee meeting on 11 February.

17. The Chancellor said that it would be much better not to present a G5 take it or leave it view. There must be flexibility of posture. We should keep in play the two ranges 85-100 billion SDRs and 15-20 billion SDRs. It was probably necessary now to think of 11 February for the Interim Committee date. He agreed with what Sprinkel had said about topics to be handled in the Executive Board (including the question of the method of payment). There was then a discussion of new aspects of the package in line with the agenda circulated by the Germans. The most important point was that the Americans hinted that they might move above 85 bn SDRs if all other aspects of the package were satisfactory to them. The Japanese linked their figure of 100 billion SDRs for the new fund to the method of distribution and said they supported Method 3, Australian method.

18. On the GAB, the most important point was that Mayakawa accepted that there need not be a new facility. Japan was content to jo . the majority in building on the present GAB. Regan thought that the outcome ought to be nearer 15 billion SDRs than 20. Poehl launched strongly into the question of the distribution of quotas within the new GAB. Germany could not be at twice the level of the UK.

19. Couzens said that he hoped we could keep open the range 15-20 billion SDRs for the new GAB ceiling; and that the US would not feel too strongly bound by a figure of $20 billion. He thought that we oughtn't to have too much difficulty about agree ing a new set of quotas within the GAB though he was surprised at the strength of the German feeling about the ratio of their quota to that of the UK. On GNP and reserves grounds a ratio of 2:1 would not be all that wrong. He thought that the arrangement for lending to the Fund for non members from the GAB should be confined to the 8th Quota period. He also saw it as important that the G10 should not become involved in second guessing the IMF on individual cases. The stress should be on lending a round sum to the Fund in case of need at a stage when their existing resources were under strain ie not at the beginning of the 8th Quota period.

20. The Chancellor said that he proposed to talk to Saudi Arabia and perhaps to one or two other LDCs. Poehl was inclined to keep the present composition of the G10 but raised the question of what would happen if Saudi Arabia wished to join. It was agreed that nothing should be said (eg during M. Delors visit to Saudi Arabia) which would put into the heads of the Saudis the idea of joining the G10. But they were probably not in favour of it anyway.

21. On quota shares Mayakawa said that Japan wanted an increase in its quota and an improvement in ranking. They were economically third but now ranked fifth in G5 quotas. Stoltenberg said that the broad solution appeared to be one in which the US and the UK would go down somewhat. Germany would go up a little. And there would be a very rough equality between France and Japan.

22. Couzens explained the point about the possible reduction in drawing rights for China, India, Pakistan, Bangladesh and others which would emerge if Method 3 were applied to quota distribution

and there were little or no increase in the dollar ceiling on extended access. These countries stood to see a reduction of 20 per cent or more in their access unless either the quota redistribution were tempered or the ceiling on extended access were raised a little. The Chancellor and Poehl agreed that an increase in the Fund could hardly lead to a reduction in access and the Chancellor said it might be necessary to introduce an element of equiproportionality on top of Method 3. In the course of this discussion Sprinkel said that the United States would not necessarily stick to zero for an increase in the extended access ceiling if the general bargain were satisfactory.

23. Stoltenberg said the question of quota shares would have to go to the Board first and then there was the possibility of some agreement among the Deputies.

24. On remuneration and charges and on method of payment of quota increase, it was agreed that it would be better not to encumber the main package. These questions should be discussed in the Executive Board and for the rest, pursued by the Deputies.

25. The dates of meetings were discussed. There was a preference for 9 and 10 February for the advanced Interim Committee over 11 and 12 February. A meeting of the G10 Ministers was envisaged for about 18 January and a G5 Deputies for 17 January. It was recognised that the decision to advance the Interim Committee would have to be taken by about 10 January since one month's notice was the absolute minimum.

Mexico

26. Volcker gave an account of the progress achieved on Mexico. De la Madrid had done more than the market could have expected. He had raised petrol prices, begun to encourage foreign investment, reinstated the previous central bank Governor, taken anti-corruption measures and was reducing the 3-tier exchange market to a 2-tier market, with a view to ultimate unification. The exchange rate was being managed on a crawling peg.

27. It was hoped to build up something which could be announced with colourable conviction as a $10 billion package. Of this $10 bn, $6 billion would come from the private banks and $2 billion from various official sources, including the IMF and the United States. Larosiere was to have a discussion on the whole package in the IMF Board on 20 December. To fill the $2 billion gap by which present= prospects fell short of $10 billion, there might be some more money from US official sources and perhaps from the World Bank. However he was looking for some "extraordinary export credits" (perhaps $500-$600m of medium term credit) from other countries.

28. There was no significant reaction to this tentative bid and it was left that Regan remained in a coordinating role in relation to Mexico.

Yugoslavia

29. Camdessus gave a report. The Yugoslavs had reduced their current deficit but have suffered a capital outflow and had had to use their reserves. They were likely to run out of resources early in the new year and would probably want $½ billion by the end of January. They had so far resisted rescheduling of official debt.

30. Stoltenberg stressed that the situation was made more difficult by the weakness of the Yugoslav central government in the post-Tito period.

31. Richardson said that Larosiere calculated Yugoslavia would need $1½ billion for the whole of the year 1983. Perhaps this $1½ billion would have to be met by a combination of the use of official funds and of rescheduling. But there must be a strong IMF programme. Stoltenberg said that there was general agreement that we must not take pressure off the IMF programme.

32. The British and French representatives made it clear that they preferred rescheduling as a solution. There was some dispute with Volcker about the relative impact of rescheduling and official

assistance. Volcker made the point that if rescheduling were, as was normal, confined to repayments of principal, it would not ease the Yugoslavs current account. [In fact what really matters to the Yugoslavs is cash flow, and the fact that rescheduling might mainly ease the capital account rather than the current account is in no way critical]. Couzens pointed out that official assistance meant public expenditure in some countries whereas rescheduling did not. Rescheduling also had the advantage of distributing the burden strictly in relation to exposure; and it removed the risk that official aid would simply leak into bank repayments.

33. The one firm conclusion reached was that rehearsed by Stoltenberg: that there must be a firm IMF programme.

Kfe

14 December 1982.

H M Treasury
Whitehall
LONDON SW1

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GR 700
CONFIDENTIAL
DESKBY 150900Z
FROM UKDEL IMF/IBRD WASHINGTON 141800Z DEC 82
TO IMMEDIATE FCO
TELEGRAM NUMBER 287 OF 14 DECEMBER 1982

MY TELNO 286

Dini 'conclusions' of G10 Deputies 10 December 1982.

IMF: EXPANDED GAB

1. FOLLOWING IS TEXT OF QUOTE CONCLUSIONS UNQUOTE REFERRED TO IN PARA. 3 OF MY TELEGRAM UNDER REFERENCE.

BEGINS

AT THEIR MEETING OF DECEMBER 10, 1982 IN PARIS, THE DEPUTIES OF THE G-10 REACHED CERTAIN CONCLUSIONS IN PRINCIPLE REGARDING THE MAIN ELEMENTS OF A REVISED AND EXPANDED GAB. IT WAS THEIR VIEW THAT THE EXPANDED GAB WOULD CONTINUE TO PERFORM ITS PRESENT FUNCTIONS FOR PARTICIPANTS, BUT PROVISION WOULD BE MADE FOR THE USE OF THE GAB RESOURCES TO FINANCE PURCHASES FROM THE IMF BY NON-PARTICIPANTS IN CERTAIN CIRCUMSTANCES.

THE MAIN CONCLUSIONS WERE AS FOLLOWS:

1. 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.

2. THE SIZE OF THE GAB WOULD BE RAISED FROM THE EQUIVALENT OF ABOUT SDR 6.4 BILLION TO SDR 15-20 BILLION. THE PARTICIPANTS' CREDIT COMMITMENTS WILL BE DENOMINATED IN SDRS. ANY AGREEMENT WITH OTHER COUNTRIES ON THE PROVISION OF FINANCING TO THE IMF IN PARALLEL WITH THE GAB WOULD AUGMENT THE AMOUNTS AVAILABLE.

3. THE CREDIT COMMITMENTS 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. IT WAS AGREED THAT PARTICIPANTS' SHARES IN THE ARRANGEMENT SHOULD BE APPROPRIATELY ADJUSTED IN LIGHT OF THESE PRINCIPLES.

4. CONDITIONS AND PROCEDURES FOR ACTIVATION FOR PURCHASES FROM THE IMF BY PARTICIPANTS WOULD REMAIN UNCHANGED. THE REVISED GAB COULD BE ACTIVATED TO FINANCE PURCHASES BY OTHER MEMBERS IF THE FOLLOWING CRITERIA WERE MET:

(I) THAT THE IMF WAS FACED WITH AN INADEQUACY OF RESOURCES TO MEET APPROPRIATE REQUESTS FOR CONDITIONAL FINANCING:

(II) THAT THIS INADEQUACY OF RESOURCES AROSE FROM AN EXCEPTIONAL SITUATION ASSOCIATED WITH REQUESTS FROM COUNTRIES WITH BALANCE

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/ OF PAYMENTS

OF PAYMENTS PROBLEMS OF A CHARACTER OR OF AGGREGATE SIZE THAT COULD POSE A THREAT TO THE STABILITY OF THE INTERNATIONAL MONETARY SYSTEM.

IN CONSIDERING PROPOSALS FOR ACTIVATION OF THE GAB FOR NON-PARTICIPANTS, THE PARTICIPANTS WOULD CONSULT AMONG THEMSELVES FOR THE PURPOSE OF ASCERTAINING WHETHER THE ABOVE CRITERIA WERE MET. SUCH CONSULTATION WOULD NOT EXTEND TO THE EXAMINATION OF SPECIFIC PROGRAMS FOR USE OF FUND RESOURCES, WHICH REMAINS THE RESPONSIBILITY OF THE EXECUTIVE BOARD.

ACTIVATION OF THE GAB FOR THE BENEFIT OF NON-PARTICIPANTS WOULD NEED TO PAY DUE REGARD TO POTENTIAL CALLS ON THE ARRANGEMENTS FOR THE PURPOSE OF FINANCING PURCHASES BY PARTICIPANTS.

5. CREDIT EXTENDED TO THE IMF UNDER THE GAB WOULD EARN INTEREST AT A RATE EQUAL TO 100 PER CENT OF THE COMBINED MARKET RATE USED TO DETERMINE THE SDR INTEREST RATE. THE 1/2 PER CENT TRANSFER CHARGE NOW LEVIED WOULD BE ABOLISHED.

6. THERE WAS SOME DISCUSSION REGARDING THE RELATIONSHIP WITH OTHER POTENTIAL LENDERS WILLING TO PROVIDE RESOURCES IN PARALLEL WITH THE GAB. IT WAS ASSUMED THAT LENDING UNDER SUCH PARALLEL ARRANGEMENTS WOULD BE AVAILABLE TO FINANCE PURCHASES BY GAB PARTICIPANTS AS WELL AS NON-PARTICIPANTS, AND THAT PARALLEL LENDERS WOULD HAVE THE SAME ACCESS TO GAB RESOURCES AS PARTICIPANTS.

7. THE REVISED AND EXPANDED GAB WILL BE REVIEWED AT THE TIME OF THE NINTH GENERAL REVIEW OF QUOTAS.

8. IT WAS RECOGNIZED THAT IMPLEMENTATION OF THE ABOVE CONCLUSIONS WOULD REQUIRE AMENDMENTS OF THE GAB DECISION: IT WAS CONSIDERED DESIRABLE THAT, IN THE INTEREST OF SPEED, THE AMENDMENTS SHOULD BE KEPT TO A MINIMUM. REGARDING THE CRITERIA FOR ACTIVATION FOR THE BENEFIT OF NON-PARTICIPANTS, IT WAS LEFT OPEN WHETHER THEY SHOULD BE INCLUDED IN THE DECISION OR WHETHER THEY SHOULD BE EXPRESSED IN SOME FORM OF UNDERSTANDING AMONG PARTICIPANTS.

9. IT WAS UNDERSTOOD THAT THE REVISION OF THE GAB ALONG THE LINES INDICATED ABOVE WAS CONTINGENT UPON REACHING SATISFACTORY AGREEMENT ON THE OTHER ISSUES RELATING TO THE EIGHTH QUOTA REVIEW.

ENDS

2. FCO PLEASE ADVANCE TO ATKINSON (TREASURY), BROWN (BANK OF ENGLAND) AND APPLEYARD (ERD).

TAYLOR

ADVANCED AS REQUESTED

MONETARY
ERD

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GRS 581
CONFIDENTIAL
DESKBY 161330Z
FM FCO 161230Z DEC 82
TO IMMEDIATE UKDEL IMF/IBRD WASHINGTON
TELEGRAM NUMBER 242 OF 16 DECEMBER

IMF - EXPANDED GAB

1. YOUR TELNOS 286 AND 287.

OBJECTIVE

2. TO GIVE LOW KEY SUPPORT TO THE G10 CONCLUSIONS. IT IS FOR THE US TO TAKE THE LEAD. IN VIEW OF THE SHORT NOTICE, WE DO NOT EXPECT A CONSIDERED RESPONSE FROM LDCS UNTIL THE JANUARY DISCUSS+ ION.

3. ON SUBSTANCE, WE ENVISAGE THAT GAB LOANS TO NON-PARTICIPANTS WILL BE CONFINED TO THE EIGHTH QUOTA REVIEW PERIOD AND WISH TO CREATE A PRESUMPTION THAT THE ARRANGEMENT WILL THEN BE DISSOLVED. WE WISH TO KEEP OPEN FIGURES AT THE TOP END OF THE SDR 15-20 BILLION RANGES.

4. THE RELATIONSHIP WITH THE SAUDIS IS DELICATE. NEITHER WE NOR OTHER LEADING MEMBERS WANT THEM TO JOIN G10. WE DO NOT CONTEMPLATE A RELATIONSHIP ANY CLOSER THAN SWISS-STYLE ASSOCIATION AND PROBABLY A RATHER LOOSER ARRANGEMENT ALTOGETHER (EG. THE PARALLELISM WHICH ALREADY EXISTS BETWEEN THE PRESENT SAMA LOAN AND THE CENTRAL BANK PLACEMENTS). DELORS (G10 CHAIRMAN) WILL BE PURSUING THIS ON HIS VISIT TO SAUDI ARABIA THIS WEEKEND. IN THE LIGHT OF YOUR TELNO YOU COULD ACKNOWLEDGE THE URGENCY AND IMPORTANCE OF ESTABLISHING THE RELATIONSHIP, BUT SHOULD NOT GO FURTHER.

POINTS?TO MAKE

5. WELCOME THE GAB REVIEW BY G10, WHICH WE HAVE LONG URGED.

6. WHILE THE GAB IS FIRMLY A SUPPLEMENT, NOT A SUBSTITUTE, FOR QUOTAS, THERE IS SOME TRADE-OF AT THE MARGIN BETWEEN THE SIZE OF FUND AND SIZE OF EXPANDED GAB. IF THE QUOTA INCREASE IN 50 PER CENT (THE MINIMUM ACCEPTABLE TO UK) THEN THE CASE FOR EXPLANDING

/THE

THE GAB TO THE TOP OF THE SDR 15-20 BN RANGE, IS STRONGER. YOU MAY DRAW ON PARAS 47-48 OF AINLEY'S COMPREHENSIVE NOTE OF FEBRUARY 1982 TO SHOW THAT GAB OF SDR 20 BN. COULD BE JUSTIFIED EVEN WITHOUT AN EXTENSION OF ITS FUNCTION.

7. THE PROPOSALS FOR ACTIVATION FOR NON-PARTICIPANTS ARE CLOSE TO THE CONCEPT OF A SECOND GAB WINDOW WHICH YOU SUGGESTED LAST MONTH. WE ENVISAGE THAT IT WOULD BE AVAILABLE ESSENTIALLY TO FINANCE THE ENLARGED ACCESS POLICY, (ALTHOUGH THE DURATION OF LOANS WOULD BE AS FOR EXISTING GAB LENDING, IE SHORTER THAN SFF/EAR RESOURCES). IT IS IMPLICIT THAT THE POLICY OF ENLARGED ACCESS IS TRANSITIONAL. WE CANNOT PREJUDGE WHEN ENLARGED ACCESS SHOULD BE PHASED OUT, BUT WE WOULD BE SURPRISED IF LOANS FROM THE SECOND WINDOW MADE MORE THAN ONE TRIP. CONCEPT OF REVOLVING ACCESS THROUGH THE SECOND WINDOW IS THEREFORE NOT APPROPRIATE.

8. QUITE APART FROM THE THIRD TRANCHE OF THE CURRENT SAMA LOAN, THE SECOND WINDOW IS NOT ENVISAGED AS THE SOLE SOURCE OF FINANCE FOR ENLARGED ACCESS. BUT THE RELATIONSHIP OF GAB LOANS FOR NON-PARTICIPANTS TO LOANS FROM OTHER POTENTIAL LENDERS WILL NEED TO BE EXAMINED CAREFULLY AND URGENTLY WITHIN THE COMING WEEKS IF THE PACKAGE IS TO BE BROUGHT TO AN EARLY CONCLUSION. THE FORMAL ASSOCIATED STATUS OF SWITZERLAND IS NOT THE ONLY CONCEIVABLE MODEL

BACKGROUND (NOT FOR USE)

9. WE FEEL DINI HAS GONE TOO FAR IN PARA 6 OF HIS STATEMENT. AGREEMENT WAS NOT REACHED ON THIS IN G10. OUR FIRST REACTION IS THAT SUCH CROSS-RELATIONSHIPS ARE UNDESIRABLE. YOU SHOULD NOT GET EMBROILED, HOWEVER, IN DISCUSSION OF THIS, OR DO MORE THAN GIVE THE IMPRESSION THAT THE QUESTION REMAINS OPEN.

10. THE QUESTION OF SHARES IN THE GAB IS FOR THE G10 TO DECIDE. YOU SHOULD BE AWARE HOWEVER, OF A 'NON-SUGGESTION' CIRCULATING AMONG LENDING MEMBERS OF THE G10 WHICH SETS OUT THE FOLLOWING, PURELY ILLUSTRATIVE, PERCENTAGE PARTICIPATIONS - US 27, GERMANY AND JAPAN 16, UK AND FRANCE 10, ITALY 8, CANADA AND NETHERLANDS 4, BELGIUM 3 AND SWEDEN 2.

PYM

MONETARY
ERD

C.

(pmp)

MINISTRY OF FINANCE
TOKYO

December 16, 1982

The Right Honourable
Sir Geoffrey Howe, QC MP
Chancellor of the Exchequer
H. M. Treasury
Parliament Street
London SW1P 3AG
England

EXCHEQUER
30 DEC 1982

Mr Lavelle
Sir K. Couzens
Mr Littler
Mr Bottrill

Dear Mr. Chancellor,

Thank you very much for your kind words of congratulations on my appointment to Minister of Finance. I feel truly honored and priviledged to be assigned again to this most demanding post in the cabinet, particularly in the current conjuncture of the Japanese economy. At present the Ministry of Finance is facing a number of problems. Reduction of the huge deficit in our budget continues to be given top priority by our new government. Other important assignments are setting the Japanese economy on the path of sustained economic growth, and stabilizing yen's exchange rate I am determined not to spare myself from every effort to resolve these problems, and I would like to ask for your advice and assistance.

!

Looking forward to seeing you in the near future,

With my warmest personal regards,

Sincerely yours,

Interesting

Noboru Takeshita

Noboru Takeshita
Minister of Finance

D15 J20

XXDB +3.

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FM UKDEL IMF/IBRD WASHINGTON 181659Z DEC 82

TO IMMEDIATE FCO

TELEGRAM NUMBER 291 OF 17 DECEMBER

Head ERD
HM Treasury
Bank of England
RC

MIPT

IMF: REVISION AND ENLARGEMENT OF THE GAB

1. VIEWS OF INDIVIDUAL DIRECTORS ON THE MAIN ISSUES ARE SET OUT BELOW.

GENERAL

2. THE G10'S CONCLUSIONS (EBS/82/232) WERE GENERALLY ENDORSED BY G10 DIRECTORS ALTHOUGH ENTHUSIASM WAS LIMITED IN SOME CASES, NOTABLY HIRAO (JAPAN). A NUMBER OF OTHER DIRECTORS, INCLUDING SENIOR (VENEZUELA) AND MUNTHALI (GUINEA), EXPRESSED GUARDED INTEREST. NIMATALLAH (SAUDI ARABIA) SAID HE HAD NOT RECEIVED INSTRUCTIONS FROM HIS AUTHORITIES AND COULD NOT THEREFORE GIVE ANY DEFINITE VIEWS. HE HOPED TO BE IN A POSITION TO DO SO BY THE TIME OF THE NEXT BOARD DISCUSSION ON 5 JANUARY. SEVERAL DIRECTORS FROM DEVELOPING COUNTRIES, NOTABLY MALHOTRA (INDIA), ZHANG (CHINA), HABIB (INDONESIA), DONOSO (CHILE) AND SALEHKOU (IRAN), HAD SERIOUS RESERVATIONS ABOUT SOME ASPECTS OF THE PROPOSALS.

SIZE (PARA 2 OF THE G10 CONCLUSIONS)

3. VIRTUALLY ALL DIRECTORS, INCLUDING MYSELF, EMPHASISED THAT AGREEMENT ON A SUBSTANTIAL QUOTA INCREASE SHOULD REMAIN THE FUND'S FIRST PRIORITY. ON THE SIZE OF THE ENLARGED GAB, GROSCHE (GERMANY) SAID THE EXACT FIGURE WOULD DEPEND, INTER ALIA, ON THE SIZE OF THE QUOTA INCREASE. IN PRESENT CIRCUMSTANCES, HIS AUTHORITIES FELT THAT A FIGURE OF SDR 20 BILLION WOULD BE MORE APPROPRIATE THAN SDR 15 BILLION. I SAID THERE WAS A STRONG CASE FOR EXPANDING THE GAB TO

A FIGURE OF SDR 20 BILLION WOULD BE MORE APPROPRIATE THAN SDR 15 BILLION. I SAID THERE WAS A STRONG CASE FOR EXPANDING THE GAB TO SDR 20 BILLION FOR THE VARIOUS REASONS IN PARA. 6 OF YOUR TELNO 242. DE MAULDE (FRANCE) WAS OPEN-MINDED ABOUT A FIGURE WITHIN THE SDR 15-20 BILLION RANGE. HIRAO (JAPAN) SAID THE DECISION WAS CONTINGENT ON THE SIZE OF THE QUOTA INCREASE. THE SUGGESTED FIGURES OF SDR 15-20 BILLION WERE QUOTE THE OUTSIDE RANGE UNQUOTE IF QUOTAS WERE TO REMAIN THE PRIMARY SOURCE OF FUND FINANCING. ERB (US) DID NOT COMMENT DIRECTLY ON THE POINT.

4. SIGURDSSON (ICELAND) SAID THAT IN VIEW OF PAST DIFFICULTIES IN ENLARGING THE GAB, IT MIGHT BE SENSIBLE TO GO FOR A LARGER RATHER THAN A SMALL EXPANSION. BUT GIVEN A CHOICE HE PREFERRED A LARGER QUOTA INCREASE (IN THE RANGE OF SDR 100-125 BILLION) AND A SMALLER INCREASE IN THE GAB RATHER THAN THE OTHER WAY ROUND. JOYCE (CANADA) THOUGHT THE GAB SHOULD BE ENLARGED TO SDR 20 BILLION BUT NOT IF THIS IMPLIED A SMALLER QUOTA INCREASE THEN WOULD OTHERWISE BE THE CASE.

5. MALHOTRA (INDIA), ZHANG (CHINA) AND OTHER LDC DIRECTORS SUSPECTED THAT THE ENLARGED GAB WAS SIMPLY A SUBSTITUTE FOR A SUBSTANTIAL QUOTA INCREASE. IN THEIR VIEW, A QUOTA INCREASE IN THE ORDER OF A DOUBLING MIGHT OBVIATE THE NEED FOR ENLARGING THE GAB.

6. IN RESPONSE, THE MD SAID ENLARGEMENT OF THE GAB WOULD MAKE IT EASIER FOR THE UNITED STATES TO GET CONGRESSIONAL APPROVAL FOR A SIZEABLE INCREASE IN THE RESOURCES AVAILABLE TO THE FUND. ERB SAID THIS WAS NOT THE MAIN CONSIDERATION FOR HIS AUTHORITIES. IN THEIR VIEW ANY TRADE-OFF BETWEEN ENLARGING THE GAB AND THE SIZE OF THE QUOTA INCREASE WAS EXTREMELY SMALL. IF AGREEMENT COULD NOT BE REACHED ON ENLARGING THE GAB, THIS WOULD NOT CHANGE THEIR VIEWS ON THE SIZE OF THE QUOTA INCREASE. IF IT WAS NOT POSSIBLE TO ENLARGE THE GAB, ALTERNATIVE BORROWING ARRANGEMENTS MIGHT HAVE TO BE EXPLORED TO ENSURE THAT RESOURCES WOULD BE AVAILABLE TO THE FUND IN PERIODS OF SYSTEMIC STRAINS.

INDIVIDUAL CREDIT LINES (PARA 3)

7. FEW DIRECTORS COMMENTED ON THIS. GROSCHE AND HIRAO SAID THE COMMITMENTS OF INDIVIDUAL PARTICIPANTS SHOULD BE DETERMINED ON THE BASIS OF NEW QUOTA SHARES AFTER THE EIGHTH REVIEW. DE MAULDE AND JOYCE SAID THE SHARES OF INDIVIDUAL PARTICIPANTS SHOULD BE BASED ON SIMPLE, OBJECTIVE CRITERIA SUCH AS GNP, RESERVES, AND/OR CALCULATED QUOTAS.

ACTIVATION CRITERIA (PARA 4)

ACTIVATION CRITERIA (PARA 4)

8. MUCH OF THE DICUSSION FOCUSSED ON THIS. SEVERAL LDC DIRECTORS, INCLUDING SALEKHOU, MALHOTRA, AND FINAISH (LIBYA) THOUGHT THE PROPOSED CRITERIA WERE CONTRARY TO THE PRINCIPLE OF UNIFORMITY AND QUESTIONED, IN PARTICULAR, THE NEED FOR A TWO-TIER DECISION-MAKING PROCESS. IN THEIR VIEW, DECISIONS ON ACTIVATING THE ENLARGED GAB SHOULD BE MADE BY THE EXECUTIVE BOARD (WHERE THE G10 ANYWAY COMMANDED A MAJORITY) AND NOT OUTSIDE THE FUND. THE PROCEDURE FOR SEPARATE CONSULTATION AMONG PARTICIPANTS HAD NOT BEEN INCORPORATED IN OTHER BORROWING ARRANGEMENTS, INCLUDING THE AGREEMENT WITH SAMA.

9. G10 DIRECTORS, INCLUDING ERB AND MYSELF, STRESSED THAT THE DECISION TO ACCEPT OR REJECT SPECIFIC FUND PROGRAMMES WOULD REMAIN THE RESPONSIBILITY OF THE EXECUTIVE BOARD. ERB SAID THAT THE PROPOSALS DID NOT INVOLVE ANY DISCRIMINATORY FEATURES. THERE WAS NO INTENTION TO GIVE ANY MEMBER PRIVILEGED ACCESS TO FUND RESOURCES NOR TO DENY ACCESS TO ANY MEMBER. THE ENLARGED GAB WOULD NOT AFFECT A MEMBER'S ABILITY TO USE FUND RESOURCES, WHICH WOULD CONTINUE TO BE DETERMINED BY THE FUND'S LENDING POLICIES, BUT WOULD STRENGTHEN THE FUND'S ABILITY TO RESPOND TO THE LEGITIMATE NEEDS OF ALL ITS MEMBERS. THE MD AGREED WITH THE INTERPRETATION. NICOLETOPOULOS (LEGAL COUNSEL) ADDED THAT THE FUND HAD DECIDED IN 1962 THAT THE ESTABLISHMENT OF THE GAB WAS CONSISTENT WITH THE UNIFORMITY PRINCIPLE. THE PRESENT PROPOSALS WOULD MAKE THE GAB LESS RESTRICTIVE AND WERE THEREFORE AN OPENING IN THE RIGHT DIRECTION EVEN THOUGH ACTIVATION FOR NON-PARTICIPANTS WOULD BE SUBJECT TO CERTAIN RESTRICTIONS.

10. SALEKHOU, HABIB, DONOSO, AND OTHER LDC DIRECTORS WERE ALSO CONCERNED THAT THE ACTIVATION CRITERIA WOULD DISCRIMINATE AGAINST SMALLER COUNTRIES. THEY SUSPECTED THAT ONLY A FEW LARGE COUNTRIES WOULD QUALIFY AND THAT THE ENLARGED GAB WAS UNLIKELY TO BE USED VERY MUCH. SALEHKOU THEREFORE ASKED WHETHER IT WOULD BE POSSIBLE TO FINANCE THE FORTHCOMING DRAWINGS BY MEXICO, ARGENTINA, AND BRAZIL FROM ORDINARY RESOURCES, AND THEN REFINANCE THESE DRAWINGS FROM THE ENLARGED GAB WHEN IT BECOME EFFECTIVE. (NICOLETOPOULOS AND THIS COULD BE DONE BY AMENDING THE GAB DECISION BUT RETROACTIVE ACTIVATION OF THIS SORT WAS NOT ENVISAGED UNDER THE PRESENT G10 PROPOSALS).

11. INRESPONSE TO THE MORE GENERAL POINT, ERB AND OTHER G10 DIRECTORS POINTED OUT THAT THE ENLARGED GAB COULD BE ACTIVATED EITHER TO FINANCE A DRAWING BY ONE COUNTRY, OR TO FINANCE DRAWINGS BY SEVERAL COUNTRIES, WHICH, TAKEN TOGETHER, STRAINED THE FUND'S LIQUIDITY AND THREATENED THE STABILITY OF THE SYSTEM. THE MD SAID THAT THIS WAS ALSO HIS UNDERSTANDING. HE ACKNOWLEDGED THAT THERE MIGHT BE CASES

ALSO THIS UNDERSTANDING. HE ACKNOWLEDGED THAT THERE MIGHT BE CASES WHERE FUND LIQUIDITY COULD BE UNDER STRAIN BUT WHERE THE DEMANDS ON THE FUND WERE NOT CONSIDERED SUCH AS TO CONSTITUTE A THREAT TO THE SYSTEM. IN SUCH CASES, THE FUND WOULD HAVE TO FINANCE THESE DEMANDS FROM ITS ORDINARY RESOURCES OR SEEK FUNDS ELSEWHERE, PERHAPS THROUGH OTHER BORROWING ARRANGEMENTS.

12. PROWSE (AUSTRALIA) ASKED WHETHER PARTICIPANTS WOULD EFFECTIVELY HAVE A PRIOR CLAIM ON THE GAB'S RESOURCES. HABERMEIER (TREASURER) EXPLAINED THAT THE G10 DEPUTIES HAD DELIBERATELY NOT INCLUDED SUBCEILINGS FOR USE BY PARTICIPANTS AND NON-PARTICIPANTS RESPECTIVELY. THERE WOULD BE CONSIDERABLE LEEWAY WITH A GAB OF SDR 20 BILLION TO FINANCE CALLS BY NON-PARTICIPANTS. DE MAULDE (FRANCE) AGREED WITH THIS INTERPRETATION AS DID SIGURDSSON WHO SAID IT WAS IMPORTANT ALSO TO SAFEGUARD THE LIQUIDITY OF THE GAB FOR CALLS BY PARTICIPANTS.

13. SIGURDSSON ALSO ASKED WHETHER IT WAS NECESSARY TO CONFINE ACTIVATION FOR NON-PARTICIPANTS TO FINANCE REQUESTS FOR QUOTE CONDITIONAL UNQUOTE FUND FINANCING. HABERMEIER AND THE MD NOTED THAT THE G10 DEPUTIES ATTACHED CONSIDERABLE IMPORTANCE TO THIS PROVISION. IT WAS ALSO LOGICAL AS RESERVE TRANCHE DRAWINGS BY NON-PARTICIPANTS WERE UNLIKELY TO STRAIN THE FUND'S LIQUIDITY, WHEREAS THOSE BY PARTICIPANTS, IN PARTICULARLY THE UNITED STATES, COULD DO SO.

14. I SUGGESTED THAT THE GAB COULD BE ACTIVATED FOR NON-PARTICIPANTS ESSENTIALLY TO FINANCE THE POLICY OF ENLARGED ACCESS WHICH WAS LIKELY TO BE CONTINUED IN SOME FORM AFTER THE EIGHTH REVIEW TOOK EFFECT. ALTHOUGH IT WAS NOT POSSIBLE TO BE SURE HOW LONG THE ENLARGED ACCESS POLICY WOULD LAST, IT SEEMED REASONABLE AT THIS STAGE TO SUPPOSE, THAT GAB LOANS TO NON-PARTINIPANTS WOULD MAKE ONLY ONE TRIP (YOUR PARA 7) NIMATALLAH AND THE MD QUESTIONED THIS. HABERMEIER SAID THE G10 DEPUTIES HAD LEFT THIS QUESTION OPEN, PREFERRING TO REVIEW THE NEW ARRANGEMENTS AT THE TIME OF THE NINTH QUOTA REVIEW. THE MD THOUGHT THERE COULD BE A NEED FOR FURTHER BORROWING FROM THE ENLARGED GAB IF THE FUND HAD LENT TO NON-PARTICIPANTS FOR MORE THAN 5 YEARS. (HE ALSO SEEMED CONCERNED THAT THE QUESTION OF ACCESS LIMITS WAS BEING BROUGHT INTO THE DISCUSSION.) ERB, DE MAULDE, JOYCE AND SIGURDSSON AGREED WITH HABERMEIER THAT THERE WAS NO EXPECTATION THAT USE OF THE GAB BY NON-PARTICIPANTS WOULD BE PHASED OUT AT THE REVIEW MENTIONED IN PARA 7 OF THE DINI SUMMARY. ERB ALSO SAID THAT THE EXPANDED GAB WAS NOT NECESSARILY RELATED TO THE ENLARGED ACCESS POLICY. THE ENLARGED GAB MIGHT CONTINUE TO BE AVAILABLE FOR NON-PARTICIPANTS IF THE

LARGED ACCESS POLICY WAS PHASED OUT.

INTEREST RATE (PARA 5)

15. THE G10 PROPOSAL WAS ENDORSED BY DE MAULDE, HIRAO, SIGURDSSON, JOYCE AND POLAK. DE MAULDE SAID THE GAB SHOULD FOLLOW THE EXAMPLE OF OTHER BORROWING ARRANGEMENTS, BUT THE HIGHER INTEREST RATE SHOULD NOT AFFECT THE FUND'S POLICY OF KEEPING CHARGES AS LOW AS POSSIBLE FOR THE USE OF ORDINARY RESOURCES. HIRAO SAID A POSSIBLE ALTERNATIVE TO THE G10 PROPOSAL WOULD BE TO BASE THE INTEREST RATE FOR GAB CREDITORS ON THE COMBINED INTEREST RATE ON 5-YEAR GOVERNMENT SECURITIES IN THE FIVE SDR CURRENCY COUNTRIES.

16. LDC DIRECTORS THOUGHT THE HIGHER INTEREST RATE FOR GAB CREDITORS IMPAIR THE CONCESSIONAL ELEMENT IN FUND LENDING. IT MIGHT BE PREFERABLE FOR THE FUND TO BORROW DIRECTLY FROM THE MARKETS. ON THIS, THE MD SAID THE FUND WOULD FIND IT DIFFICULT TO RAISE COMPARABLE SUMS ELSEWHERE. HABERMEIER SAID THE FUND WAS GETTING A FAIR DEAL: BORROWING IN THE MARKETS WOULD BE MORE EXPENSIVE.

PARALLEL ARRAMGEMENTS (PARA 6)

17. ERB SAID PARALLEL LENDERS SHOULD HAVE SIMILAR ACCESS TO GAB RESOURCES AS THE PRESENT PARTICIPANTS. PARALLEL LENDERS SHOULD ALSO BE INVOLVED IN DECISIONS TO ACTIVATE THE GAB. IN RESPONSE TO REQUESTS BY NIMATALLAH FOR GREATER PRECISION, ERB SAID THAT THIS WAS AN AREA WHICH NEEDED TO BE EXPLORED WITH POTENTIAL LENDERS. I SAID THE RELATIONSHIP BETWEEN GAB LOANS FOR NON-PARTICIPANTS AND POSSIBLE LOANS FROM OTHER POTENTIAL LENDERS SHOULD BE EXPLORED AS A MATTER OF URGENCY IN THE COMING WEEKS. THE SWISS ARRANGEMENT WAS NOT THE ONLY CONCEIVABLE MODEL. JOYCE AND LOVATO (ITALY) MADE SIMILAR POINTS. SIGURDSSON SAID THE ROLE OF OTHER POTENTIAL LENDERS IN THE DECISION-MAKING PROCESS COULD BE AN IMPORTANT DETERMINANT OF THEIR WILLINGNESS TO ENTER INTO PARALLEL ARRANGEMENTS MALHOTRA AND SALEKHOU WONDERED WHETHER THERE WAS ANY INCENTIVE FOR NON-PARTICIPANTS TO MAKE PARALLEL ARRANGEMENTS.

18. IN RESPONSE, NICOLETOPOULOS AID THERE WAS PROVISION IN THE EXISTING DECISION FOR NON-PARTICIPANTS TO JOIN THE GAB AS EQUAL PARTNERS. BUT IT WAS HIS UNDERSTANDING THAT PARALLEL LENDERS WOULD ENTER INTO SEPARATE AGREEMENTS WITH THE FUND TO LEND IN SIMILAR CIRCUMSTANCES AND ON SIMILAR TERMS TO GAB PARTICIPANTS. PARALLEL LENDERS WOULD BE ABLE TO DRAW ON THE GAB--FOR EXAMPLE, TO FINANCE A RESERVE TRANCHE PURCHASE. THE FUND WOULD ALSO BE ABLE TO FINANCE AN EARLY REPAYMENT TO A PARALLEL LENDER FROM THE GAB. POTENTIAL LENDERS WOULD BE INVOLVED IN THE DECISION-MAKING PROCESS FOR ACTIVATING THE ENLARGED GAB ALTHOUGH THE PRECISE MODALITIES HAD

ACTIVATING THE ENLARGED GAB ALTHOUGH THE PRECISE MODALITIES HAD STILL TO BE WORKED OUT. THE ASSOCIATION AGREEMENT WITH SWITZERLAND WAS ONE POSSIBLE MODEL. BUT IT CONTAINED THE SPECIAL FEATURE THAT SWITZERLAND WAS NOT A MEMBER OF THE FUND AND COULD NOT THEREFORE USE THE GAB. THE SWISS ASSOCIATION AGREEMENT WAS CUMBERSOME AND HAD ONLY BEEN ACTIVATED TWICE.

AMENDMENTS TO THE GAB DECISION (PARA 8)

19. NICOLETOPOULOS EXPLAINED THAT THE G10 PROPOSALS WOULD REQUIRE AN AMENDMENT OF THE EXISTING DECISION WHICH WOULD NEED THE ADHERENCE OF ALL THE PARTICIPANTS AND THE EXECUTIVE BOARD'S APPROVAL. AS A MINIMUM, THE DECISION WOULD HAVE TO BE AMENDED TO ALLOW ACTIVATION OF THE GAB FOR THE BENEFIT OF NON-PARTICIPANTS. THE CRITERIA FOR SUCH ACTIVATION COULD BE INCORPORATED IN THE DECISION OR IN A SEPARATE UNDERSTANDING (SIMILAR TO THE 1961 BAUMGARTNER LETTER) OR BOTH. A DEFINTION OF QUOTE PARALLEL LENDERS UNQUOTE WOULD HAVE TO BE INCLUDED IN THE DECISION. THE REFERENCES TO CREDIT LINES DENOMINATED IN NATIONAL CURRENCIES WOULD HAVE TO BE REPLACED AS THE CREDIT LINES WERE NOW TO BE DENOMINATED IN SDRS. THE PROVISIONS ON INTEREST AND CHARGES WOULD ALSO HAVE TO BE REVISED.

TIMING

20. IN RESPONSE TO QUESTIONS, NICOLETOPOULOS AND HABERMEIER SAID IT WAS NOT CLEAR WHEN THE ENLARGED GAB WOULD COME INTO EFFECT. THEY PRESUMED THAT PARTICIPANTS WOULD OBTAIN LEGISLATIVE APPROVAL FOR THE ENLARGED GAB AT THE SAME TIME AS FOR THE QUOTA INCREASE. BUT THE TWO MIGHT NOT COME INTO EFFECT SIMULTANEOUSLY AS THE EFFECTIVE DATE OF THE QUOTA INCREASE WOULD DEPEND ON FULFILMENT OF THE MINIMUM RATIFICATION REQUIREMENT.

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

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1) M Sheridan

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DESKBY 200900Z
FM UKDEL IMF/IBRD WASHINGTON 181655Z
TO IMMEDIATE F C O
TELNO 290 OF 17 DECEMBER 1982.

IMF: REVISION AND ENLARGEMENT OF THE GAB

1. FOLLOWING ARE MAIN POINTS FROM MANAGING DIRECTOR'S SUMMING-UP OF EXECUTIVE BOARD DISCUSSION ON DECEMBER 17 ON THE CONCLUSIONS REACHED BY G10 DEPUTIES (EBS/82/232). VIEWS OF INDIVIDUAL DIRECTORS ON THE MAIN ISSUES ARE SET OUT IN MIFT.

2. THE MD SAID THREE IMPORTANT PRINCIPLES HAD BEEN EMPHASISED IN THE DISCUSSION:
I. ALL DIRECTORS, WITHOUT EXCEPTION, HAD STRESSED THE FUNDAMENTAL PRINCIPLE THAT QUOTAS SHOULD REMAIN THE PRINCIPAL SOURCE OF FUND RESOURCES. ALL DIRECTORS FELT THAT AN EXTENSION OF THE GAB SHOULD NOT BE A SUBSTITUTE FOR AN ADEQUATE QUOTA INCREASE. THE IDEA THAT THERE MIGHT BE A TRADE-OFF BETWEEN AN ENLARGED GAB AND THE SIZE OF THE QUOTA INCREASE WAS NOT REALLY CONSIDERED RELEVANT. AS ERB (UNITED STATES) HAD POINTED OUT, THE US AUTHORITIES FAVOURED AN ADEQUATE QUOTA INCREASE TO MEET THE FUND'S ORDINARY REQUIREMENTS, TOGETHER WITH AN AMELIORATION OF THE PRESENT NETWORK OF BORROWED RESOURCES WHICH WOULD BE AVAILABLE TO THE FUND FOR SPECIAL CASES OF EXTREME STRAIN IN THE SYSTEM. THE PURPOSE OF ENLARGING THE GAB WAS NOT THEREFORE TO PROVIDE A SUBSTITUTE FOR THE QUOTA INCREASE NOR TO MAKE POSSIBLE A SMALLER QUOTA INCREASE. IT WOULD BE A SUPPLEMENT TO THE FUND'S ORDINARY RESOURCES IN CASES WHERE THE FUND HAD TO DEAL WITH AN IMPAIRMENT OR STRAIN IN THE SYSTEM. IN THIS REGARD, A NUMBER OF DIRECTORS REAFFIRMED THE NEED FOR A SUBSTANTIAL QUOTA INCREASE AND REPEATED THEIR VIEWS ON THE SIZE THAT INCREASE SHOULD BE.
II. DIRECTORS HAD ALSO STRESSED, STRONGLY, THE NEED TO TREAT MEMBERS IN A NON-DISCRIMINATORY WAY AND TO PRESERVE THE INTEGRITY OF THE FUND'S DECISION-MAKING PROCESS. HE UNDERLINED THE FACT THAT THE G10 PROPOSALS INVOLVED THE PROVISION OF A LENDING FACILITY WHICH WOULD BE AVAILABLE TO THE FUND AND NOT TO MEMBERS IN PARTICULAR CIRCUMSTANCES. IT WAS THUS A MEANS FOR SOLVING THE FUND'S LIQUIDITY PROBLEMS. DIRECTORS HAD GENERALLY AGREED THAT, IN ALL CIRCUMSTANCES, THE DETERMINATION OF THE NEED TO BORROW BY A PARTICULAR COUNTRY, THE EXTENT OF A MEMBER'S ACCESS TO FUND RESOURCES, AND THE ASSESSMENT OF THE QUALITY OF FUND PROGRAMMES, SHOULD BE KEPT WITHIN THE EXCLUSIVE COMPETENCE OF THE EXECUTIVE BOARD. THE IDEA, SET OUT IN PARA 4 OF THE G10 CONCLUSIONS, THAT CONSULTATIONS AMONG PARTICIPANTS ON PROPOSALS TO ACTIVATE THE GAB FOR NON-PARTICIPANTS WOULD NOT EXTEND TO THE EXAMINATION OF SPECIFIC FUND PROGRAMMES, WAS WELCOMED.
III. A NUMBER OF COMMENTS HAD BEEN MADE ON THE POSSIBILITY OF

III. A NUMBER OF COMMENTS HAD BEEN MADE ON THE POSSIBILITY OF DIFFERENCES IN THE TREATMENT OF PARTICIPANTS AND NON-PARTICIPANTS, AND BETWEEN NON-PARTICIPANTS, WHICH COULD COULD ARISE FROM THE ACTIVATION CONDITIONS IN PARA 4 OF THE G10 CONCLUSIONS. SOME DIRECTORS FELT THAT PARA 4(III) MIGHT RESTRICT ACTIVATION TO A SMALL LIST OF LARGE COUNTRIES AND EXCLUDE ACTIVATION FOR THE BENEFIT OF SMALLER COUNTRIES, PARTICULARLY AS THE DEFINITION OF STRAINS IN THE SYSTEM WAS VERY BROAD. BUT HE NOTED THAT G10 DIRECTORS AND THE STAFF HAD EXPLAINED THAT THE MD COULD BE LED TO MAKE A PROPOSAL FOR ACTIVATION IF A GROUP OF COUNTRIES OR A GROUP OF REQUESTS, EACH PERHAPS FOR A LIMITED AMOUNT, WERE TO TRIGGER, IN HIS VIEW, A LIQUIDITY PROBLEM FOR THE FUND AND REFLECT A THREAT TO THE SYSTEM. HE ALSO NOTED THE REFERENCES BY POLAK (NETHERLANDS) AND JOYCE (CANADA) TO THE FACT THAT THE ORIGINAL PURPOSE OF THE GAB, NAMELY TO ASSIST THE FUND IN FORESTALLING OR COPING WITH AN IMPAIRMENT OF THE INTERNATIONAL MONETARY SYSTEM, WAS BEING RETAINED, AND THAT THIS PURPOSE HAD BEEN INTERPRETED VERY BROADLY WHEN THE GAB HAD BEEN ACTIVATED IN THE PAST.

3. THE MANAGING DIRECTOR ALSO NOTED THAT THE FOLLOWING QUESTIONS HAD BEEN RAISED:
(A) WAS IT APPROPRIATE TO CONFINE THE ASSESSMENT OF THE ACTIVATION CRITERIA TO A LIMITED GROUP OF LENDERS ? WHAT WOULD BE THE CONSEQUENCES OF A POSSIBLE BLOCKAGE IN THAT DECISION-MAKING PROCESS, AND WOULD THIS AFFECT THE FUND'S ABILITY TO RESORT TO OTHER MEANS OF FINANCING TO MEET REQUESTS WHICH DID NOT TRIGGER THE ACTIVATION CRITERIA UNDER THE ENLARGED GAB?
(B) WHAT ARRANGEMENTS WERE CONTEMPLATED WITH PARALLEL LENDERS AS REGARDS THEIR INVOLVEMENT IN THE DECISION-MAKING PROCESS, AND WHAT MODALITIES COULD BE WORKED OUT FOR THIS?
(C) WOULD THERE BE QUANTIFIED, PREDETERMINED LIMITS TO COVER POSSIBLE FUTURE USE OF THE EXPANDED GAB BY PARTICIPANTS? (AS THE STAFF HAD EXPLAINED, THE ANSWER TO THIS QUESTION WAS NO.)
(D) WOULD THE EXTENSION OF THE GAB TO NON-PARTICIPANTS LAPSE AUTOMATICALLY IF THE ENLARGED ACCESS POLICY WAS PHASED OUT OR AT THE TIME OF THE FIRST REVIEW OF THE REVISED ARRANGEMENTS? (AS THE STAFF, ERB (US) AND SOME OTHER G10 DIRECTORS HAD EXPLAINED, THE ANSWER TO THIS QUESTION WAS ALSO NO: THIS WAS COVERED BY PARA 7 OF THE DINI DOCUMENT).

4. THE MD ADDED THAT HE HAD DELIBERATELY PUT MORE EMPHASIS ON THE QUESTIONS RAISED RATHER THAN ON THE POSITIVE REACTIONS TO THE PROPOSALS BY G10 DIRECTORS AS WELL AS BY OTHER DIRECTORS REPRESENTING NON-PARTICIPANTS. THESE OTHER DIRECTORS HAD VIEWED THE PROPOSALS AS AN IMPORTANT POTENTIAL ADDITION TO FUND RESOURCES ON THE UNDERSTANDING THAT THE ENLARGED GAB WOULD NOT CIRCUMVENT THE BASIC PRINCIPLES HE HAD OUTLINED.

FUTURE WORK.
5. IT WAS NOW UP TO THE BOARD TO DO FURTHER WORK ON THE PRINCIPLES PRESENTED BY THE G10 WITHOUT WAITING FOR THE NEXT MEETINGS OF G10 DEPUTIES OR MINISTERS. THE STAFF WOULD PREPARE A PAPER, FOR BOARD DISCUSSION ON JANUARY 5, ON THE LEGAL AND TECHNICAL ASPECTS OF THE G10'S CONCLUSIONS. THE PAPER WOULD ATTEMPT TO CLARIFY THE QUESTIONS RAISED AND EXAMINE ALTERNATIVE MODALITIES. HE HOPED THE BOARD WOULD BE ABLE TO REPORT SERIOUS PROGRESS TO NATIONAL AUTHORITIES

WOULD BE ABLE TO REPORT SERIOUS PROGRESS TO NATIONAL AUTHORITIES IN THE COMING WEEKS, PARTICULARLY IF THERE WAS TO BE AN EARLY SESSION OF THE INTERIM COMMITTEE.

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

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FROM UKDEL IMF/IBRD WASHINGTON 292245Z DEC 82.
TO IMMEDIATE F C O
TELEGRAM NUMBER 310 OF 29 DECEMBER.

IMF: GENERAL ARRANGEMENTS TO BORROW-STAFF COMMENTARY ON PROPOSED CHANGES.

MY TWO IMMEDIATELY PRECEDING TELEGRAMS.

1. FOLLOWING ARE MAIN POINTS FROM THE STAFF'S COMMENTARY ON THE PROPOSED AMENDMENTS TO THE 1962 GAB DECISION (SM/82/239):

PREAMBLE

2. STAFF HAVE DELETED THE SPECIFIC REFERENCES TO THE CONDITIONS WHICH PREVAILED AT THE TIME OF THE GAB WAS INITIALLY ADOPTED. GIVEN THE TIME DIMENSION OF THE GAB, THE STAFF DO NOT THINK IT APPROPRIATE TO FORMULATE AN ALTERNATIVE DESCRIPTION OF THE TYPE OF CONDITIONS WHICH MIGHT GIVE RISE TO USE OF THE GAB IN FUTURE. THEY THINK THE EXISTING BROAD DESCRIPTION SHOULD BE SUFFICIENT AND NOTE IT WOULD APPLY TO ALL USES OF GAB RESOURCES TO FINANCE TRANSACTIONS WITH MEMBERS.

PARA. 1 (XI) - DEFINITION OF PARALLEL CREDITOR

3. STAFF ASSUME THAT THERE WOULD BE APPROPRIATE CONSULTATION WITH PARTICIPANTS BEFORE THE FUND WOULD DECLARE THAT A MEMBER WAS BEING GIVEN PARALLEL CREDITOR STATUS. THEY ADD THAT IN ORDER TO QUALIFY FOR PARALLEL CREDITOR STATUS, THE TERMS AND CONDITIONS ON WHICH LOANS COULD BE MADE AVAILABLE TO THE FUND WOULD NEED TO BE COMPARABLE TO THOSE FOR LOANS FROM GAB PARTICIPANTS. THEY NOTE THAT IT WOULD ALSO SEEM REASONABLE THAT THE AMOUNT OF CREDIT ARRANGEMENT WITH A PARALLEL CREDITOR SHOULD BE DETERMINED ON THE BASIS OF PRINCIPLES SIMILAR TO THOSE USED IN DETERMINING THE AMOUNTS OF PARTICIPANTS' CREDIT ARRANGEMENTS.

4. THE SECOND SENTENCE OF THE NEW PARA. 1(XI) WHICH IS IN SQUARE BRACKETS, WOULD MAKE IT POSSIBLE FOR THE FUND TO EXTEND PARALLEL CREDITOR STATUS TO SWITZERLAND OR THE SWISS NATIONAL BANK IF DESIRED. IT WOULD EXTEND TO THEM THE POTENTIAL APPLICATION OF THE PRINCIPLE THAT THE GAB COULD BE USED TO FINANCE EARLY ENCASHMENTS OF LOAN CLAIMS BY PARALLEL CREDITORS.

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/PARA 9

PARA. 9 - INTEREST RATE

5. THE AMENDMENTS HERE CLOSELY REFLECT THE RELEVANT CONCLUSIONS OF THE G10 DEPUTIES. THE REVISED PROVISIONS ASSUME THAT THE RULES FOR DETERMINING THE SDR INTEREST RATE WILL CONTINUE TO INCLUDE THE CONCEPT OF A COMBINED MARKET RATE. IN THE UNLIKELY EVENT OF A CHANGE, THE STAFF NOTE THAT IT WOULD BE NECESSARY TO AGREE ON A MUTUALLY ACCEPTABLE ALTERNATIVE METHOD FOR DETERMINING INTEREST ON GAB LOANS WITH PARTICIPANTS.

PARA. 10 - USE OF BORROWED CURRENCY

6. THE REVISED TEXT REFLECTS THE PROPOSAL THAT GAB LOANS MAY BE USED TO FINANCE PURCHASES BY NONPARTICIPANTS UNDER EXTENDED ARRANGEMENTS. THE STAFF NOTE THAT IF IT WERE THOUGHT DESIRABLE TO PERMIT THE GAB TO BE ACTIVATED FOR EXTENDED ARRANGEMENTS REQUESTED BY PARTICIPANTS, APPROPRIATE AMENDMENTS COULD BE MADE TO PARAS. 6 AND 7 OF THE EXISTING DECISION.

PARA. 19 - PERIOD OF RENEWAL

7. THE PROPOSED ADDITION OF PARA. 19 (D) IS DESIGNED TO SERVE TWO PURPOSES. FIRST, THE STAFF NOTE THAT THE GAB WAS LAST RENEWED FOR 5 YEARS UP TO OCTOBER 1985 BUT FEEL THAT IT WOULD BE APPROPRIATE, IF THE REVISED GAB COMES INTO EFFECT AT AN EARLIER DATE AS IS NOW ENVISAGED, TO COMMENCE A FULL NEW PERIOD ON THE EFFECTIVE DATE OF THE REVISION. SECOND, THEY SUGGEST THAT THE PERIOD SHOULD END 12 MONTHS AFTER THE DATE THE BOARD OF GOVERNORS ADOPTS A RESOLUTION COMPLETING THE NINTH QUOTA REVIEW. AS A DECISION FOR RENEWAL MUST BE TAKEN AT LEAST 12 MONTHS BEFORE THE END OF THE PERIOD, THE NEXT REVIEW OF THE GAB WOULD THUS TAKE PLACE AT THE SAME TIME AS THE COMPLETION OF THE DISCUSSIONS ON THE NINTH REVIEW, IN LINE WITH G10 CONCLUSIONS.

PARA. 21 - USE OF CREDIT ARRANGEMENTS FOR NONPARTICIPANTS

8. UNDER THE NEW PARA. 21(A), THE FUND WOULD BE ABLE, IN THE CASE OF PARALLEL CREDITORS, TO USE THE RESOURCES OF THE GAB FOR THE SAME PURPOSES AND UNDER THE SAME CONDITIONS AS FOR PARTICIPANTS. THE STAFF ASSUME THAT, FOR THEIR PART, PARALLEL CREDITORS WOULD AGREE THAT THE FUND COULD USE THEIR CREDIT LINE IN THE SAME CIRCUMSTANCES AND FOR THE SAME PURPOSES AS IN THE CASE OF PARTICIPANTS' CREDIT ARRANGEMENTS, INCLUDING THE REFINANCING OF AN EARLY ENCASHMENT.

9. THE REST OF PARA. 21 CONSISTS OF TWO ALTERNATIVES DEALING WITH THE ACTIVATION OF THE GAB FOR ALL OTHER NONPARTICIPANTS. UNDER ALTERNATIVE I, THE GENERAL AUTHORISATION IN PARA 21(B) FOR THE FUND TO USE THE GAB TO FINANCE CONDITIONAL DRAWINGS BY NONPARTICIPANTS WOULD BE SUPPLEMENTED BY A MORE SPECIFIC DESCRIPTION OF THE CIRCUMSTANCES IN WHICH THE GAB COULD BE

/ACTIVATED

ACTIVATED FOR NONPARTICIPANTS. THE STAFF NOTE THAT THIS FORMULATION WOULD EMPHASISE THE EXCEPTIONAL SITUATION IN WHICH SUCH ACTIVATION COULD TAKE PLACE. VERSION A FOLLOWS VERY CLOSELY THE LANGUAGE IN THE CONCLUSIONS OF THE G10 DEPUTIES. VERSION B EXPRESSES THE SAME PRINCIPLE BUT IS DESIGNED TO CLARIFY TWO POINTS. FIRST, THE INADEQUACY OF FUND RESOURCES THAT IS A NECESSARY PRECONDITION FOR ACTIVATION WOULD BE DETERMINED WITH REFERENCE TO THE RESOURCES ''READILY AVAILABLE'' TO THE FUND. THE STAFF POINT OUT THAT THE FUND NEED NOT HAVE EXHAUSTED ALL OTHER MEANS OF ACQUIRING RESOURCES, INCLUDING BORROWING FROM OTHER SOURCES OR MOBILISING ALL ITS OTHER ASSETS, BEFORE IT CAN ACTIVATE THE GAB. SECOND, VERSION B WOULD MAKE IT EXPLICIT THAT THE MANAGING DIRECTOR COULD TAKE ACCOUNT OF BOTH ACTUAL AND EXPECTED REQUESTS FOR CONDITIONAL FINANCING.

10. ALTERNATIVE I ALSO INCLUDES, UNDER BOTH VERSIONS A AND B, A SPECIFIC REFERENCE TO THE CONSIDERATION MENTIONED IN THE G10 CONCLUSIONS THAT, WHEN CONSIDERING ACTIVATION OF THE GAB FOR PURCHASES BY NONPARTICIPANTS, DUE REGARD SHOULD BE GIVEN TO POTENTIAL CALLS TO FINANCE PURCHASES BY PARTICIPANTS. STAFF NOTE THAT THIS PRINCIPLE WOULD ALSO APPLY TO POTENTIAL CALLS TO FINANCE PURCHASES BY PARALLEL CREDITORS.

11. ALTERNATIVE II REFLECTS A DIFFERENT APPROACH UNDER WHICH THE DESCRIPTION OF THE SPECIAL CIRCUMSTANCES IN WHICH THE GAB COULD BE USED TO FINANCE PURCHASES BY NON PARTICIPANTS WOULD NOT BE SPELLED OUT IN THE REVISED GAB DECISION BUT WOULD BE INCORPORATED IN APPROPRIATE SUPPLEMENTARY UNDERSTANDINGS AMONG THE PARTICIPANTS, EITHER IN THE FORM OF AN AGREED DECLARATION BY THE G10 OR IN AN EXCHANGE OF LETTERS. THE STAFF NOTE THAT IF THIS ROUTE WERE FOLLOWED, THE MANAGING DIRECTOR WOULD NOT HAVE A LEGAL OBLIGATION TO ENSURE THAT THE SPECIAL CIRCUMSTANCES WERE MET BEFORE INITIATING THE ACTIVATION PROCEDURE. BUT THEY STRESS THAT IT IS VERY UNLIKELY THAT THE MD WOULD INITIATE THE ACTIVATION PROCEDURE IF HIS PRIOR CONSULTATIONS INDICATED THAT HIS PROPOSAL WOULD NOT BE ACCEPTED BY THE PARTICIPANTS. THE STAFF ALSO POINT OUT THAT REFERENCE TO THE CONSIDERATIONS IN SUPPLEMENTARY UNDERSTANDINGS AMONG PARTICIPANTS WOULD, OF COURSE, MEAN THAT THEY WOULD HAVE TO BE TAKEN INTO ACCOUNT BY THE PARTICIPANTS WHEN THEY CONSIDERED WHETHER TO ACCEPT A PROPOSAL OF THE MD.

OTHER POINTS

12. ON TIMING. THE STAFF NOTE THAT THE PROPOSED AMENDMENTS WOULD REQUIRE THE CONCURRENCE OF ALL PARTICIPANTS. THEY ASSUME THAT PARTICIPANTS WILL GET THE NECESSARY LEGISLATIVE AUTHORISATION FOR THE AMENDMENTS AT THE SAME TIME AS FOR THE INCREASE IN THE AMOUNTS OF THEIR CREDIT ARRANGEMENTS. THEY THEREFORE ENVISAGE THAT THE AMENDMENTS, TOGETHER WITH A REVISED ANNEX SHOWING THE INCREASED AMOUNTS OF THE CREDIT ARRANGEMENTS,

WOULD BE INCORPORATED IN A BOARD DECISION WHICH WOULD BECOME EFFECTIVE ONLY WHEN THE FUND HAD RECEIVED FORMAL NOTICE FROM ALL THE PARTICIPANTS OF THEIR ACCEPTANCE OF THE REVISED TERMS, INCLUDING THE INCREASED AMOUNT OF THEIR RESPECTIVE CREDIT ARRANGEMENTS.

13. THE STAFF ALSO SUGGEST THAT IT SHOULD BE MADE CLEAR, IN AN AGREED UNDERSTANDING AMONG PARTICIPANTS, THAT CONSULTATIONS AMONG PARTICIPANTS ON A PROPOSAL FOR FINANCING PURCHASES BY A NONPARTICIPANT WOULD NOT DEAL WITH THE CONSISTENCY OF A REQUEST WITH THE APPLICABLE POLICIES OF THE FUND, NOR THE ADEQUACY OF THE PROGRAMME ON WHICH THE REQUEST WAS BASED, SINCE THESE QUESTIONS ARE THE RESPONSIBILITY OF THE FUND.

14. IN THE INTERESTS OF SPEED, THE STAFF HAVE DELIBERATELY KEPT THE AMENDMENTS TO A MINIMUM. THEY NOTE THAT THE REVISED TEXT DOES NOT INCLUDE TWO POSSIBLE AMENDMENTS WHICH WERE MENTIONED IN THE DISCUSSIONS OF THE G10 DEPUTIES, NAMELY TO RAISE THE MINIMUM AMOUNT OF A NEW PARTICIPANT'S CREDIT ARRANGEMENT, AND TO REQUIRE THE FUND TO REPAY INDEBTEDNESS ATTRIBUTABLE TO A RESERVE TRANCHE PURCHASE BY ANOTHER PARTICIPANT IF AND WHEN THE FUND'S HOLDINGS RESULTING FROM THAT PURCHASE WERE CORRESPONDINGLY REDUCED LESS THAT 5 YEARS AFTER THE BORROWING BY THE FUND.

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

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TO IMMEDIATE FCO
TELEGRAM NUMBER 309 OF 29 DECEMBER

IMF: GENERAL ARRANGEMENTS TO BORROW--PROPOSED AMENDMENTS TO 1962 DECISION

MIPT

1. FOLLOWING ARE THE AMENDMENTS PROPOSED BY THE STAFF IN SM/82/239 TO THE JANUARY 1962 GAB DECISION (SELECTIVE DECISIONS, 9TH ISSUE, PAGES 105-115):

PREAMBLE - IN THE FIRST SENTENCE DELETE ''IN THE NEW CONDITIONS OF WIDESPREAD CONVERTIBILITY, INCLUDING GREATER FREEDOM FOR SHORT-TERM CAPITAL MOVEMENTS'' AND, LATER ON, DELETE ''IN THE AFORESAID CONDITIONS''.

PARA 1(VI), PARA 2, PARA 3(B) - DELETE ''UNITS OF ITS CURRENCY'' AND SUBSTITUTE ''SPECIAL DRAWING RIGHTS''.

PARA 1 (XI) - ADD THE FOLLOWING DEFINITION:

'' ''PARALLEL CREDITOR'' MEANS A MEMBER OR THE OFFICIAL INSTITUTION OF A MEMBER THAT IS NOT A PARTICIPANT AND HAS ENTERED INTO AN AGREEMENT TO PROVIDE CREDIT TO THE FUND WHICH DECLARES THAT THE MEMBER OR INSTITUTION SHALL HAVE THE STATUS OF A PARALLEL CREDITOR FOR THE PURPOSES OF THIS DECISION. SQUARE BRACKETS BEGIN A PARALLEL CREDITOR MAY ALSO BE A NONMEMBER OR THE CENTRAL BANK OF A NONMEMBER THAT HAS ENTERED INTO A CREDIT AGREEMENT CONTAINING A SIMILAR DECLARATION. SQUARE BRACKETS END''

PARA 9 - DELETE ''AND CHARGES'' FROM THE TITLE.

REPLACE PARAS 9(A) AND 9(B) WITH THE FOLLOWING:
''(A) THE FUND SHALL PAY INTEREST ON ITS INDEBTEDNESS AT A RATE EQUAL TO THE COMBINED MARKET INTEREST RATE COMPUTED BY THE FUND FROM TIME TO TIME FOR THE PURPOSE OF DETERMINING THE RATE AT WHICH IT PAYS INTEREST ON HOLDINGS OF SPECIAL DRAWING RIGHTS.

(B) INTEREST SHALL ACCRUE DAILY AND SHALL BE PAID ON THE DATES THAT THE FUND PAYS INTEREST ON HOLDINGS OF SPECIAL DRAWING RIGHTS.''

IN PARA 9(C) DELETE ''AND CHARGES'' AND SUBSTITUTE ''DUE TO A PARTICIPANT''

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/PARA 10

PARA 10 - AFTER ''STAND-BY'' INSERT ''AND EXTENDED''

PARA 11 - IN PARA 11(H) DELETE ''BUT NOT BEYOND THE AMOUNT OF THE CREDIT ARRANGEMENT''.

IN PARA 11(I) DELETE ''AND CHARGES''.

PARA 19 - ADD A NEW SUB-PARAGRAPH (D) AS FOLLOWS:

''(D) NOTWITHSTANDING PARAGRAPH 19(B), A NEW PERIOD SHALL BEGIN ON THE EFFECTIVE DATE OF DECISION NO. , ADOPTED , 1983, AND SHALL END TWELVE MONTHS AFTER THE DATE THE NINTH GENERAL REVIEW OF QUOTAS IS COMPLETED.''

PARA 21 - ADD THE FOLLOWING NEW PARAGRPAH ENTITLED ''USE OF CREDIT ARRANGEMENTS FOR NONPARTICIPANTS:''

''(A) THE FUND MAY MAKE CALLS IN ACCORDANCE WITH PARAGRAPHS 6 AND 7 FOR EXCHANGE TRANSACTIONS WITH A MEMBER THAT IS A PARALLEL CREDITOR OR WHOSE INSTITUTION IS A PARALLEL CREDITOR, AS IF THE MEMBER WERE A PARTICIPANT. THE FUND MAY ALSO MAKE REQUESTS UNDER PARAGRAPH 11(E) IN CONNECTION WITH AN EARLY REPAYMENT OF THE CLAIM OF A PARALLEL CREDITOR UNDER ITS CREDIT AGREEMENT WITH THE FUND DUE TO A BALANCE OF PAYMENTS NEED, IN THE SAME MANNER AS FOR PARTICIPANTS. ALL THE FOREGOING PROVISIONS OF THIS DECISION RELATING TO CALLS AND REQUESTS WITH RESPECT TO EARLY REPAYMENT SHALL APPLY TO CALLS AND REQUESTS UNDER THIS PARAGRAPH 21(A).

ALTERNATIVE I

(B) THE FUND MAY MAKE CALLS IN ACCORDANCE WITH PARAGRAPHS 6 AND 7 FOR EXCHANGE TRANSACTIONS IN THE CONDITIONAL TRANCHES OR UNDER STAND-BY OR EXTENDED ARRANGEMENTS REQUESTED BY OTHER MEMBERS THAT ARE NOT PARTICIPANTS. ALL THE PROVISIONS OF THIS DECISION RELATING TO CALLS SHALL APPLY, EXCEPT AS OTHERWISE PROVIDED IN PARAGRAPH 21(C).

(C) THE MANAGING DIRECTOR MAY INITIATE THE PROCEDURE FOR MAKING CALLS UNDER PARAGRAPH 7 IN CONNECTION WITH REQUESTS REFERRED TO IN PARAGRAPH 21(B) IF, AFTER CONSULTATION, HE CONSIDERS

VERSION A

THAT (I) THE FUND FACES AN INADEQUACY OF RESOURCES TO MEET REQUESTS FOR CONDITIONAL FINANCING, AND (II) THE INADEQUACY IS THE RESULT OF AN EXCEPTIONAL SITUATION ASSOCIATED WITH REQUESTS FOR SUCH FINANCING BY MEMBERS WITH BALANCE OF PAYMENTS PROBLEMS OF A CHARACTER OR AGGREGATE SIZE THAT COULD POSE A THREAT TO THE STABILITY OF THE INTERNATIONAL MONETARY SYSTEM.

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/VERSION B

VERSION B

THAT THE FUND FACES AN INADEQUACY OF RESOURCES READILY AVAILABLE TO MEET ACTUAL AND EXPECTED REQUESTS FOR CONDITIONAL FINANCING THAT REFLECT THE EXISTENCE OF AN EXCEPTIONAL SITUATION ASSOCIATED WITH BALANCE OF PAYMENTS PROBLEMS OF MEMBERS OF A CHARACTER OR AGGREGATE SIZE THAT COULD THREATEN THE STABILITY OF THE INTERNATIONAL MONETARY SYSTEM.

IN MAKING A PROPOSAL FOR CALLS PURSUANT TO PARAGRAPH 21(B) AND (C), THE MANAGING DIRECTOR SHALL PAY DUE REGARD TO POTENTIAL CALLS PURSUANT TO OTHER PROVISIONS OF THIS DECISION.

ALTERNATIVE II

(B) THE FUND MAY MAKE CALLS IN ACCORDANCE WITH PARAGRAPHS 6 AND 7 FOR EXCHANGE TRANSACTIONS IN THE CONDITIONAL TRANCHES OR UNDER STAND-BY OR EXTENDED ARRANGEMENTS REQUESTED BY OTHER MEMBERS THAT ARE NOT PARTICIPANTS. ALL THE PROVISIONS OF THIS DECISION RELATING TO CALLS SHALL APPLY TO CALLS MADE UNDER THIS PARAGRAPH 21(B).''

2. THE SALIENT POINTS FROM THE STAFF'S COMMENTARY ON THE ALTERNATIVE PROPOSALS IN THIS NEW PARAGRAPH ARE SET OUT IN MIFT.

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

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TO IMMEDIATE F C O

TELEGRAM NUMBER 312 OF 30 DECEMBER

M I P T

IMF: GENERAL ARRANGEMENTS TO BORROW

1. FOLLOWING IS TEXT OF NICOLETOPOULOS'S PAPER.

BEGINS

FORMS OF ASSOCIATION WITH THE GAB

THIS MEMORANDUM OUTLINES VARIOUS WAYS IN WHICH A MEMBER OF THE FUND (OR ITS CENTRAL BANK) WHICH IS NOT A G-10 MEMBER, BUT WHICH IS WILLING TO PROVIDE SUPPLEMENTARY RESOURCES TO THE FUND ON GAB TERMS, COULD BE ASSOCIATED WITH THE GAB.

I. DIRECT PARTICIPATION

PARAGRAPH 3 OF THE GAB DECISION PERMITS A MEMBER, OR AN OFFICIAL INSTITUTION OF A MEMBER, TO BE ACCEPTED AS A PARTICIPANT, IF (I) QUOTE THE FUND SHALL SO AGREE AND NO PARTICIPANT OBJECT UNQUOTE, AND (II) THE PROSPECTIVE PARTICIPANT UNDERTAKES A CREDIT COMMITMENT OF AT LEAST SDR 100 MILLION. THE TERMS AND CONDITIONS GOVERNING PARTICIPATION ARE SET OUT IN THE DECISION ITSELF. THERE WOULD BE NO NEED FOR A SEPARATE AGREEMENT BETWEEN THE MEMBER AND THE FUND OR FOR AN AMENDMENT OF THE GAB DECISION, ALTHOUGH IT WOULD BE APPROPRIATE TO DELETE THE REFERENCE TO QUOTE THE MAIN INDUSTRIAL COUNTRIES UNQUOTE IN THE PREAMBLE TO THE DECISION.

PARTICIPATION IN THE GAB ALSO IMPLIES PARTICIPATION IN THE CONSULTATIVE AND DECISION-MAKING ARRANGEMENTS SET FORTH IN THE 1961 LETTER BETWEEN THE MINISTER OF FINANCE OF FRANCE AND HIS COUNTERPARTS IN THE OTHER NINE PARTICIPATING COUNTRIES. THE UNDERSTANDINGS IN THIS LETTER REGARDING THE PROCEDURE BY WHICH THE ORIGINAL PARTICIPANTS WOULD REACH DECISIONS ON PROPOSALS TO ACTIVATE THE GAB SERVED AS THE BASIS FOR THE ESTABLISHMENT OF THE G-10, AS A FORUM IN WHICH THE MAIN INDUSTRIAL COUNTRIES COULD DISCUSS AND COORDINATE THEIR APPROACH TO IMPORTANT ISSUES AFFECTING THE FUND AND THE INTERNATIONAL MONETARY SYSTEM. ACCEPTANCE OF A NEW PARTICIPANT INTO THE GAB NEED NOT INVOLVE A CHANGE IN THE COMPOSITION OF THE G-10, AS SUCH. BY APPROPRIATE MODIFICATIONS IN THE ARRANGEMENTS SET OUT IN THE 1961 LETTER, CONSULTATIONS AMONG GAB PARTICIPANTS COULD BE LIMITED TO ACTIVATION PROPOSALS AND OTHER MATTERS ARISING UNDER THE GAB. THE EXISTING MEMBERS OF THE G-10 COULD CONTINUE TO MEET AND DISCUSS OTHER ISSUES, NOT AS GAB PARTICIPANTS BUT AS THE MAIN INDUSTRIAL COUNTRIES.

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II. ASSOCIATION ON THE SWISS MODEL

A SECOND POSSIBLE FORM OF ASSOCIATION COULD BE ALONG THE LINES ADOPTED FOR SWITZERLAND, SUITABLY MODIFIED TO FIT THE CASE OF A MEMBER. THE MAIN FEATURES OF THE 1964 ASSOCIATION AGREEMENT WITH SWITZERLAND, THE EFFECTIVENESS OF WHICH HAS BEEN EXTENDED TO JULY 15, 1985, ARE AS FOLLOWS:

(A) LIKE THE CREDIT COMMITMENTS OF PARTICIPANTS UNDER THE GAB, THE SWISS COMMITMENT OF THE EQUIVALENT OF SF 865 MILLION IS A REVOLVING CREDIT, WHICH CAN BE USED ONLY IN CONNECTION WITH USE OF THE FUND'S RESOURCES BY GAB PARTICIPANTS.

(B) THE CREDIT COMMITMENT UNDER THE ASSOCIATION AGREEMENT MAY BE ACTIVATED BY A PROPOSAL OF THE MANAGING DIRECTOR. WHENEVER THE MANAGING DIRECTOR PROPOSES ACTIVATION OF THE GAB FOR THE BENEFIT OF A PARTICIPANT HE MAY, AFTER CONSULTATION WITH THE SWISS AUTHORITIES, ALSO PROPOSE THAT SWITZERLAND MAKE RESOURCES AVAILABLE FOR THE SAME PARTICIPANT. IF THE MANAGING DIRECTOR'S PROPOSAL UNDER THE GAB IS DULY ACCEPTED BY PARTICIPANTS AND APPROVED BY THE EXECUTIVE BOARD, SWITZERLAND IS OBLIGED TO CARRY OUT HIS PROPOSAL UNDER THE ASSOCIATION AGREEMENT, UNLESS THE SWISS AUTHORITIES CITE BALANCE OF PAYMENTS GROUNDS.

(C) ONE MAJOR DIFFERENCE FROM THE CREDIT COMMITMENTS UNDER THE GAB IS THAT THE ASSOCIATION AGREEMENT CONTEMPLATES THAT SWITZERLAND WILL LEND DIRECTLY TO THE GAB PARTICIPANT NEEDING ASSISTANCE, IN ACCORDANCE WITH AN QUOTE IMPLEMENTING AGREEMENT UNQUOTE BETWEEN ITSELF AND THE PARTICIPANT. THE REPAYMENT TERMS ARE TO CORRESPOND AS FAR AS PRACTICABLE TO THOSE OF GAB LOANS. THE FUND ACCEPTS NO RESPONSIBILITY OR LIABILITY REGARDING THE PERFORMANCE BY THE BORROWER OF ITS OBLIGATIONS UNDER AN IMPLEMENTING AGREEMENT.

(D) ON THE BASIS OF THE ASSOCIATION AGREEMENT, REPRESENTATIVES OF SWITZERLAND (OFFICIALS OF THE SWISS NATIONAL BANK) HAVE BEEN ATTENDING G-10 MEETINGS AS OBSERVERS. THEY TAKE PART IN THE DISCUSSIONS. HOWEVER, THEY DO NOT PARTICIPATE IN THE PROCESS PRESCRIBED IN THE 1961 LETTER FOR REACHING DECISIONS ON PROPOSALS OF THE MANAGING DIRECTOR TO ACTIVATE THE GAB, EVEN THOUGH WHEN THE GAB IS ACTIVATED SWITZERLAND IS BOUND TO CARRY OUT A PARALLEL PROPOSAL MADE BY THE MANAGING DIRECTOR UNDER THE ASSOCIATION AGREEMENT.

THE TECHNIQUE UNDER WHICH SWITZERLAND MAKES LOANS DIRECTLY TO A GAB PARTICIPANT, IN CONJUNCTION WITH THE USE OF THE FUND'S RESOURCES FINANCED BY GAB LOANS, HAS PROVED TO BE CUMBERSOME. BECAUSE OF THIS THE ASSOCIATION AGREEMENT HAS BEEN INVOKED ONLY TWICE, IN THE EARLIER YEARS OF ITS EFFECTIVENESS. IN CONNECTION WITH TWO MORE RECENT ACTIVATIONS OF THE GAB THE FUND HAS ENTERED INTO BILATERAL BORROWING AGREEMENTS WITH THE SWISS NATIONAL BANK UNDER WHICH THAT BANK HAS UNDERTAKEN TO LEND THE FUND UP TO A STATED AMOUNT FOR THE SPECIFIC PURPOSE OF FINANCING PURCHASES UNDER A STAND-BY ARRANGEMENT WITH A GAB PARTICIPANT, IN CONJUNCTION WITH AN ACTIVATION OF THE GAB. THE TERMS AND CONDITIONS OF THE LOANS WERE COMPARABLE TO THOSE OF GAB LOANS. THE CREDIT COMMITMENTS UNDER THESE AGREEMENTS WERE NOT OF A REVOLVING CHARACTER. /III.

WITH SIMILAR PROPOSALS TO PARTICIPANTS AND ANY OTHER PARALLEL CREDITORS, ALTHOUGH THE MANAGING DIRECTOR WOULD NOT BE OBLIGED TO INCLUDE A PARALLEL CREDITOR IN EACH CASE. THE BALANCE OF PAYMENTS AND RESERVE POSITION OF INDIVIDUAL GAB PARTICIPANTS IS TAKEN INTO ACCOUNT IN DETERMINING THE PARTICIPANTS TO WHICH PROPOSALS WILL BE MADE, AND IT IS ASSUMED THAT SIMILAR ACCOUNT WOULD BE TAKEN OF THE BALANCE OF PAYMENTS AND RESERVE POSITION OF A PARALLEL CREDITOR.

(4) THE PRECISE MODALITIES OF CONSULTATION NEED TO BE EXAMINED AND DISCUSSED WITH THE DIFFERENT PARTIES INVOLVED BEFORE ANY FIRM CONCLUSIONS ARE REACHED AS TO WHAT IS MOST APPROPRIATE. THERE IS ALSO THE RELATED QUESTION OF THE NATURE OF THE CREDITOR'S OBLIGATION TO RESPOND TO PROPOSALS FOR CALLS UNDER ITS CREDIT LINE. THE ASSOCIATION AGREEMENT WITH SWITZERLAND PROVIDES THAT SWITZERLAND WILL ACCEPT A PROPOSAL FOR CALLS IN THOSE CASES WHERE GAB PARTICIPANTS HAVE ACCEPTED AND THE EXECUTIVE BOARD HAS APPROVED ACTIVATION OF THE GAB. THE SWISS AUTHORITIES ATTEND MEETINGS OF THE GAB PARTICIPANTS AS AN OBSERVER, BUT THEY HAVE NO VOTE IN THE DECISION-MAKING PROCESS. IT IS THUS EVIDENT THAT THE ARRANGEMENTS COULD TAKE DIFFERENT FORMS. FOR EXAMPLE:

(I) THE PARALLEL CREDITOR WOULD BE INDIVIDUALLY CONSULTED BY THE MANAGING DIRECTOR BEFORE HE MAKES A PROPOSAL UNDER THE PARALLEL CREDIT ARRANGEMENT BUT THE CREDITOR WOULD BE FREE TO ACCEPT OR REJECT THE MANAGING DIRECTOR'S PROPOSAL. UNDER THIS APPROACH THERE WOULD BE NO PARTICIPATION OF THE PARALLEL CREDITOR IN THE CONSULTATIONS AMONG THE GAB PARTICIPANTS.

(II) A PARALLEL CREDITOR WOULD COMMIT ITSELF TO MAKE AVAILABLE THE AMOUNT SPECIFIED IN THE MANAGING DIRECTOR'S PROPOSAL, IF THE CORRESPONDING PROPOSAL UNDER THE GAB WAS ACCEPTED BY THE GAB PARTICIPANTS. UNDER THIS APPROACH, THE PARALLEL CREDITOR WOULD BE CONSULTED BY THE MANAGING DIRECTOR AS UNDER (I) BUT, IN ADDITION, THE PARALLEL CREDITOR WOULD BE INCLUDED IN THE CONSULTATIONS ASSOCIATED WITH THE ACTIVATION OF THE GAB. THE PARTICIPANTS COULD AGREE THAT THE CREDITOR WOULD BE INVITED TO TAKE PART AS AN OBSERVER, IF IT SO WISHED, IN MEETINGS OF PARTICIPANTS TO CONSIDER SUCH ACTIVATION. PROVISION FOR THIS COULD BE INCLUDED IN SOME FORM OF UNDERSTANDING SUPPLEMENTING THE 1961 LETTER.

(III) THE PARTICIPATION REFERRED TO IN (II) COULD POSSIBLY BE EXTENDED SO THAT THE PARALLEL CREDITOR WOULD BE ABLE TAKE PART IN THE DECISION-MAKING PROCESS AS IF IT WERE A PARTICIPANT. THIS WOULD REQUIRE AN AMENDMENT TO THE 1961 LETTER. LIKE THE INVOLVEMENT IN THE CONSULTATIVE PROCESS REFERRED TO IN (II), THE PARTICIPATION IN THE DECISION-MAKING PROCESS WOULD NEED TO BE AGREED AMONG THE PARTICIPANTS.

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

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III. PARALLEL CREDIT AGREEMENTS

ONE FEATURE OF THE SWISS ASSOCIATION WITH THE GAB IS THAT, AS A NONMEMBER, SWITZERLAND HAS NOT BEEN ACCORDED RECIPROCAL ACCESS TO THE RESOURCES OF THE GAB. THE G-10 DEPUTIES HAVE PROPOSED THAT A MEMBER MAKING A PARALLEL CREDIT ARRANGEMENT WITH THE FUND SHOULD BE ENTITLED TO HAVE ACCESS TO THESE RESOURCES ON THE SAME TERMS AS GAB PARTICIPANTS THEMSELVES. IT IS POSSIBLE TO DEVELOP A FORM OF PARALLEL ARRANGEMENT APPROPRIATE FOR A MEMBER, BY COMBINING THIS FEATURE WITH FEATURES ADAPTED FROM THE ARRANGEMENTS MADE WITH SWITZERLAND. PRINCIPAL ASPECTS OF SUCH A PARALLEL ARRANGEMENT WERE OUTLINED BRIEFLY IN SM/82/239, DECEMBER 28, 1982, AND ARE DISCUSSED IN MORE DETAIL BELOW:

(1) THE QUOTE PARALLEL CREDITOR UNQUOTE WOULD ENTER INTO A BILATERAL AGREEMENT WITH THE FUND, IN THE FORM OF A LINE OF CREDIT UNDER WHICH THE FUND WOULD BE ABLE TO BORROW IN THE SAME CIRCUMSTANCES AS UNDER THE GAB, AND ON COMPARABLE TERMS. THUS, THE AGREEMENT WOULD REMAIN IN EFFECT FOR THE FULL CURRENT PERIOD OF THE GAB AND WOULD BE RENEWABLE FOR FURTHER PERIODS IN THE SAME MANNER AS GAB CREDIT ARRANGEMENTS. RENEWAL WOULD NOT BE OBLIGATORY, BUT THE MEMBER WOULD CEASE TO HAVE THE STATUS OF A PARALLEL CREDITOR IF IT WERE TO TERMINATE THE AGREEMENT. THE CREDIT LINE WOULD HAVE A REVOLVING CHARACTER SIMILAR TO GAB ARRANGEMENTS. THE AMOUNT OF THE CREDIT LINE WOULD BE AVAILABLE FOR USE IN CONNECTION WITH PURCHASES BY ANY MEMBER OF THE FUND, INCLUDING BOTH GAB PARTICIPANTS AND NONPARTICIPANTS, IN RESPECT OF WHICH THE FUND COULD BORROW UNDER THE GAB. THE CREDIT LINE COULD ALSO BE DRAWN UPON TO REFINANCE LOAN CLAIMS OF PARTICIPANTS AND OTHER PARALLEL CREDITORS THAT ARE ENCASHED PRIOR TO MATURITY ON BALANCE OF PAYMENTS GROUNDS. AS FOR THE TERMS OF THE PARALLEL LOANS THEMSELVES, IT DOES NOT SEEM ESSENTIAL THAT THESE SHOULD BE IDENTICAL TO THOSE OF GAB LOANS: RATHER, COMPARABILITY COULD BE DETERMINED ON THE BASIS OF THE FINANCIAL, LEGAL AND OTHER PROVISIONS OF THE PARALLEL CREDIT AGREEMENT, TAKEN AS A WHOLE.

(2) THE ABOVE OUTLINE OF CONDITIONS FOR USE OF THE PARALLEL CREDIT LINE ASSUMES THAT THE GAB DECISION WILL BE AMENDED TO PERMIT THE USE OF GAB RESOURCES TO FINANCE PURCHASES BY THE PARALLEL CREDITOR, AND TO REFINANCE EARLY ENCASHMENT OF THE CREDITOR'S LOAN CLAIMS ON BALANCE OF PAYMENTS GROUNDS, ON SIMILAR TERMS TO THOSE APPLICABLE TO PURCHASES AND EARLY ENCASHMENT OF CLAIMS BY PARTICIPANTS. A POSSIBLE AMENDMENT TO THIS EFFECT IS PRESENTED IN SM/82/239.

(3) THE PARALLEL CREDIT AGREEMENT WOULD CONTAIN A PROCEDURE FOR ITS ACTIVATION SIMILAR TO THAT APPLICABLE TO GAB CREDIT ARRANGEMENTS, I.E., THE MANAGING DIRECTOR, AFTER CONSULTATION WITH THE PARALLEL CREDITOR, WOULD SUBMIT A PROPOSAL FOR CALLS IN RESPECT OF A REQUEST BY A MEMBER SEEKING TO USE THE FUND'S RESOURCES. THE PROPOSAL WOULD BE MADE IN CONJUNCTION

/WITH

December 30, 1982

Forms of Association with the GAB

This memorandum outlines various ways in which a member of the Fund (or its central bank) which is not a G-10 member, but which is willing to provide supplementary resources to the Fund on GAB terms, could be associated with the GAB.

I. Direct Participation

Paragraph 3 of the GAB Decision permits a member, or an official institution of a member, to be accepted as a participant, if (i) "the Fund shall so agree and no participant object", and (ii) the prospective participant undertakes a credit commitment of at least SDR 100 million. The terms and conditions governing participation are set out in the Decision itself. There would be no need for a separate agreement between the member and the Fund or for an amendment of the GAB Decision, although it would be appropriate to delete the reference to "the main industrial countries" in the Preamble to the Decision.

Participation in the GAB also implies participation in the consultative and decision-making arrangements set forth in the 1961 Letter between the Minister of Finance of France and his counterparts in the other nine participating countries. The understandings in this Letter regarding the procedure by which the original participants would reach decisions on proposals to activate the GAB served as the basis for the establishment of the G-10, as a forum in which the main industrial countries could discuss and coordinate their approach to important issues affecting the Fund and the international monetary system. Acceptance of a new participant into the GAB need not involve a change in the composition of the G-10, as such. By appropriate modifications in the arrangements set out in the 1961 Letter, consultations among GAB participants could be limited to activation proposals and other matters arising under the GAB. The existing members of the G-10 could continue to meet and discuss other issues, not as GAB participants but as the main industrial countries.

II. Association on the Swiss Model

A second possible form of association could be along the lines adopted for Switzerland, suitably modified to fit the case of a member. The main features of the 1964 Association Agreement with Switzerland, the effectiveness of which has been extended to July 15, 1985, are as follows:

(a) Like the credit commitments of participants under the GAB, the Swiss commitment of the equivalent of SF 865 million is a revolving credit, which can be used only in connection with use of the Fund's resources by GAB participants.

(b) The credit commitment under the Association Agreement may be activated by a proposal of the Managing Director. Whenever the Managing Director proposes activation of the GAB for the benefit of a participant he may, after consultation with the Swiss authorities, also propose that Switzerland make resources available for the same participant. If the Managing Director's proposal under the GAB is duly accepted by participants and approved by the Executive Board, Switzerland is obliged to carry out his proposal under the Association Agreement, unless the Swiss authorities cite balance of payments grounds.

(c) One major difference from the credit commitments under the GAB is that the Association Agreement contemplates that Switzerland will lend directly to the GAB participant needing assistance, in accordance with an "implementing agreement" between itself and the participant. The repayment terms are to correspond as far as practicable to those of GAB loans. The Fund accepts no responsibility or liability regarding the performance by the borrower of its obligations under an implementing agreement.

(d) On the basis of the Association Agreement, representatives of Switzerland (officials of the Swiss National Bank) have been attending G-10 meetings as observers. They take part in the discussionns. However, they do not participate in the process prescribed in the 1961 Letter for reaching decisions on proposals of the Managing Director to activate the GAB, even though when the GAB is activated Switzerland is bound to carry out a parallel proposal made by the Managing Director under the Association Agreement.

The technique under which Switzerland makes loans directly to a GAB participant, in conjunction with the use of the Fund's resources financed by GAB loans, has proved to be cumbersome. Because of this the Association Agreement has been invoked only twice, in the earlier years of its effectiveness. In connection with two more recent activations of the GAB the Fund has entered into bilateral borrowing agreements with the Swiss National Bank under which that Bank has undertaken to lend the Fund up to a stated amount for the specific purpose of financing purchases under a stand-by arrangement with a GAB participant, in conjunction with an activation of the GAB. The terms and conditions of the loans were comparable to those of GAB loans. The credit commitments under these agreements were not of a revolving character.

III. Parallel Credit Agreements

One feature of the Swiss Association with the GAB is that, as a nonmember, Switzerland has not been accorded reciprocal access to the resources of the GAB. The G-10 Deputies have proposed that a member making a parallel credit arrangement with the Fund should be entitled to have access to these resources on the same terms as GAB participants themselves. It is possible to develop a form of parallel arrangement appropriate for a member, by combining this feature with features adapted from the arrangements made with Switzerland. Principal aspects of such a parallel arrangement were outlined briefly in SM/82/239, December 28, 1982, and are discussed in more detail below:

(1) The "parallel creditor" would enter into a bilateral agreement with the Fund, in the form of a line of credit under which the Fund would be able to borrow in the same circumstances as under the GAB, and on comparable terms. Thus, the agreement would remain in effect for the full current period of the GAB and would be renewable for further periods in the same manner as GAB credit arrangements. Renewal would not be obligatory, but the member would cease to have the status of a parallel creditor if it were to terminate the agreement. The credit line would have a revolving character similar to GAB arrangements. The amount of the credit line would be available for use in connection with purchases by any member of the Fund, including both GAB participants and nonparticipants, in respect of which the Fund could borrow under the GAB. The credit line could also be drawn upon to refinance loan claims of participants and other parallel creditors that are encashed prior to maturity on balance of payments grounds. As for the terms of the parallel loans themselves, it does not seem essential that these should be identical to those of GAB loans; rather, comparability could be determined on the basis of the financial, legal and other provisions of the parallel credit agreement, taken as a whole.

(2) The above outline of conditions for use of the parallel credit line assumes that the GAB Decision will be amended to permit the use of GAB resources to finance purchases by the parallel creditor, and to refinance early encashment of the creditor's loan claims on balance of payments grounds, on similar terms to those applicable to purchases and early encashment of claims by participants. A possible amendment to this effect is presented in SM/82/239.

(3) The parallel credit agreement would contain a procedure for its activation similar to that applicable to GAB credit arrangements, i.e., the Managing Director, after consultation with the parallel creditor, would submit a proposal for calls in respect of a request by a member seeking to use the Fund's resources. The proposal would be made in conjunction with similar proposals to participants and any other parallel creditors, although the Managing Director would not be obliged to include a parallel creditor in each case.

The balance of payments and reserve position of individual GAB participants is taken into account in determining the participants to which proposals will be made, and it is assumed that similar account would be taken of the balance of payments and reserve position of a parallel creditor.

(4) The precise modalities of consultation need to be examined and discussed with the different parties involved before any firm conclusions are reached as to what is most appropriate. There is also the related question of the nature of the creditor's obligation to respond to proposals for calls under its credit line. The Association Agreement with Switzerland provides that Switzerland will accept a proposal for calls in those cases where GAB participants have accepted and the Executive Board has approved activation of the GAB. The Swiss authorities attend meetings of the GAB participants as an observer, but they have no vote in the decision-making process. It is thus evident that the arrangements could take different forms. For example:

(i) The parallel creditor would be individually consulted by the Managing Director before he makes a proposal under the parallel credit arrangement but the creditor would be free to accept or reject the Managing Director's proposal. Under this approach there would be no participation of the parallel creditor in the consultations among the GAB participants.

(ii) A parallel creditor would commit itself to make available the amount specified in the Managing Director's proposal, if the corresponding proposal under the GAB was accepted by the GAB participants. Under this approach, the parallel creditor would be consulted by the Managing Director as under (i) but, in addition, the parallel creditor would be included in the consultations associated with the activation of the GAB. The participants could agree that the creditor would be invited to take part as an observer, if it so wished, in meetings of participants to consider such activation. Provision for this could be included in some form of understanding supplementing the 1961 Letter.

(iii) The participation referred to in (ii) could possibly be extended so that the parallel creditor would be able take part in the decision-making process as if it were a participant. This would require an amendment to the 1961 Letter. Like the involvement in the consultative process referred to in (ii), the participation in the decision-making process would need to be agreed among the participants.

31/12

FROM: SIR KENNETH COUZENS
DATE: 31 December 1982

MR LITTLER

cc Mr Lavelle
Mr Bottrill ✓ 105/3
Mr Peretz
Mr Atkinson
Mr Anson

UK QUOTA IN NEW GAB

At the G5 meeting near Frankfurt on 8/9 December Pöhl raised the question of the German share in a revised GAB and, rather gratuitously, complained about the low UK share. The shares in the present GAB fixed in 1962 have been altered dramatically by exchange rate movements so that the German share is now 23.5% compared with a US share of 29.9% and a UK share of 9%. Just as dramatically, the French share has fallen to 5.7% and the Italian to 3.5%.

2. Obviously it is reasonable that the new GAB shares should reflect relative economic weight more and rate of depreciation less. At Frankfurt Pöhl showed me a table which Volcker had invented on the back of an envelope, and which ran as follows:-

US	25
Germany	15
Japan	15
UK	10
France	10.

Pöhl appeared to find this acceptable.

3. At the G10 deputies meeting in Paris on 10 December I prepared the attached "Non-Suggestion" and Dini circulated it. In order to get the numbers to add to 100 (excluding Switzerland) I had to move off the simple 5X module, which anyway seemed to me a shade easy on

the United States (Volcker's suggestion!). One could of course try to bring Switzerland in to ease the numbers, but they are <u>not</u> a member of the GAB so it is strictly a contradiction in terms to speak of them taking an X% quota of the GAB. Alternatively one could say that if the new GAB ceiling were 20bn SDR's Switzerland would look after 1bn of that and the GAB would then be scaled on 19bn.

4. A week or so after the 10 December Dini telephoned me about new GAB shares. The Germans (ie the Bundesbank) wanted to stay at 15 and were pressing that the UK be set at 12. They used the size of our IMF quota as their main argument for this. I said 10 really was more than enough for us in comparison to either 16 or 15 for Germany and 10 for France. The hapless Dini muttered that he would have to try to persuade the US and Canada to take say 1 more each in order to give the Germans and Japanese 15.

5. I should add that I know 4, 3, 2 are acceptable respectively to Holland, Belgium and Sweden. I believe 10 is acceptable to France.

6. For ease of reference I attach the various tables on this subject circulated before and at the G10 Deputies meeting.

7. I still think that 10% is quite enough for the UK. My "Non-Suggestion" is fairly close to the shares produced by looking at a 50/50 weighting of relative GDP and relative non-gold reserves. Arguably those are the most relevant factors for GAB shares. I do not think that IMF quotas (present or calculated) are terribly relevant in this sharing of liabilities (mostly for cooperative purposes) between a limited group of industrial countries. But again my Non Suggestion was not very far from calculated IMF quotas for the Ten either.

8. My impression is that on the relative German/UK shares it is Pöhl and the Bundesbank who are making difficulty, not Bonn. I think Tietmeyer would settle on my basis. At all events, this may come up at the Ministerial G10. It would be better however if Dini had settled it out of court before then.

. It is perhaps worth noting that if somebody suggests treating the Swiss as equivalent to 5% and making the shares of the Ten add to 95 in order to get back to the Volcker pattern of US 25, Germany/Japan 15, France/UK 10, that would be equivalent to 10.5% for us, 15.8% for Germany and 25.8% for the US on a 100 scale. That would be messy but perhaps not wholly unacceptable. It would be much better however if Dini could push others around (eg the soft Canadians) without bothering us further. One possibility the Germans may fear, and possibly we should fear a little too, is a situation in which one or two of the majors (eg the US, France, Italy) had to be exempted from a call on balance of payments grounds and some of the weight was then transferred to Germany/UK. It is not too difficult to imagine a situation in which France and/or Italy have to go to the Fund at a time when the US is in large current account deficit in 1983 or 1984. A share of 10 in a GAB of 20bn SDR's could mean for us a requirement to lend up to 2bn SDR's or what is now something like 2¼bn dollars.

KEC

K E COUZENS

Non-Suggestion on Distribution of Quotas in a New CAB

NOTE: This assumes that Switzerland is still outside the CAB and operating with the IMF in parallel.

	Percentage of total
U.S.	27
Cermany	16
Japan	16
U.K.	10
France	10
Italy	8
Canada	4
Netherlands	4
Belgium	3
Sweden	2
	100

GAB SHARES UNDER AMERIC' ILLUSTRATIVE CALCULATIONS (1)

(in per cent)

	New GAB commitment on the basis of GDP and non-gold reserves	New GAB commitment on the basis of calculated quotas
United States	26.5	28.2
Germany	19.7	15.0
Japan	16.1	12.2
United Kingdom	8.4	9.5
France	9.7	10.2
Italy	8.4 ✓	6.7
Canada	2.9	5.1
Netherlands	4.0	5.6
Belgium	2.3	5.0
Sweden	2.0	2.5
Total	100.0	100.0

(1) cfr. telex from Mr. Sprinkel and Governor Wallich of Dec. 2, 1982

ALTERNATIVE GAB SHARES

(In per cent)

	GDP 1977-81	Non-gold reserves 1977-81	Calculated quotas
United States	40.6	7.5	28.2
Germany	11.7	29.5	15.0
Japan	16.5	16.5	12.2
United Kingdom	6.8	12.1	9.5
France	9.1	10.9	10.2
Italy	5.3	9.9	6.7
Canada	4.0	2.3	5.1
Netherlands	2.5	5.2	5.6
Belgium	1.7	3.6	5.0
Sweden	1.8	2.5	2.5
TOTAL	100.0	100.0	100.0

Table 1

ALTERNATIVE GAB SHARES (1)

(in per cent)

	GAB commitments		GDP		Non-gold reserves		Total reserves (gold at market price)		Foreign trade	
	original	present	1977-1981	1981	1977-1981	1981	1977-1981	1981	1977-1981	1981
United States	33.3	29.9	40.6	42.7	7.5	10.5	27.1	29.2	22.0	24.3
Germany	16.7	23.5	11.7	10.2	29.5	26.7	20.5	19.0	16.9	16.3
Japan	4.2	18.5	16.5	16.6	16.5	15.4	8.6	8.0	12.2	14.1
United Kingdom	16.7	9.0	6.8	7.4	12.1	9.9	6.4	5.5	8.6	4.9
France	9.2	5.7	9.1	8.4	10.9	14.6	12.0	13.3	10.8	10.9
Italy	9.2	3.5	5.3	5.2	9.9	10.6	10.2	10.3	7.7	7.9
Canada	3.3	2.7	4.0	4.2	2.3	1.4	2.8	2.5	6.3	6.8
Netherlands	3.3	3.9	2.5	2.1	5.2	5.4	6.2	6.2	6.7	6.5
Belgium	2.5	2.3	1.7	1.5	3.6	3.4	4.7	4.6	6.0	5.6
Sweden	1.6	1.0	1.8	1.7	2.5	2.1	1.5	1.4	2.8	2.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(1) For original data see Appendix 1.

ALTERNATIVE GAB SHARES INCLUDING SWITZERLAND (1)
(in per cent)

	GDP		Non-gold reserves		Total reserves (gold at market price)		Foreign trade	
	1977-81	1981	1977-81	1981	1977-81	1981	1977-81	1981
United States	40.0	42.1	6.9	9.9	24.5	26.5	21.4	23.6
Germany	11.5	10.0	27.3	25.1	18.5	17.3	16.4	15.8
Japan	16.2	16.4	15.2	14.5	7.7	7.3	11.9	13.7
United Kingdom	6.8	7.3	11.2	9.3	5.8	5.0	8.3	4.8
France	8.9	8.3	10.1	13.7	10.9	12.0	10.5	10.6
Italy	5.2	5.1	9.2	9.9	9.2	9.3	7.5	7.7
Canada	4.0	4.2	2.1	1.3	2.6	2.3	6.1	6.6
Netherlands	2.4	2.1	4.9	5.1	5.6	5.6	6.5	6.3
Belgium	1.7	1.5	3.4	3.2	4.2	4.1	5.8	5.5
Sweden	1.8	1.6	2.3	2.0	1.4	1.2	2.8	2.7
Switzerland	1.5	1.4	7.4	6.0	9.6	9.4	2.8	2.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(1) For original data, see Appendix I.

Table 2

GAB shares under different combinations of GDP and non-gold reserves shares

(in per cent)

GAB share = α GDP share + $(1 - \alpha)$ non-gold reserves share

	1977-1981					1981				
α =	.2	.4	.5	.6	.8	.2	.4	.5	.6	.8
United States	14.1	20.7	24.0	27.4	34.0	16.9	23.4	26.6	29.8	36.3
Germany	25.9	22.4	20.6	18.8	15.2	23.4	20.1	18.4	16.8	13.5
Japan	16.5	16.5	16.5	16.5	16.5	15.7	15.9	16.0	16.1	16.4
United Kingdom	11.1	10.0	9.4	8.9	7.9	9.4	8.9	8.6	8.4	7.9
France	10.5	10.2	10.0	9.8	9.5	13.4	12.1	11.5	10.9	9.6
Italy	9.0	8.1	7.6	7.1	6.2	9.5	8.5	7.9	7.4	6.3
Canada	2.6	3.0	3.2	3.3	3.7	2.0	2.5	2.8	3.4	3.7
Netherlands	4.7	4.1	3.8	3.6	3.0	4.7	4.1	3.8	3.0	2.7
Belgium	3.2	2.8	2.7	2.5	2.1	3.0	2.6	2.5	2.3	1.9
Sweden	2.4	2.2	2.2	2.1	1.9	2.0	1.9	1.9	1.9	1.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table 3

GAB shares under different combinations of GDP and total reserves shares (in per cent)

GAB share = αGDP share + $(1-\alpha)$ total reserves share

	1977-1981					1981				
α=	.2	.4	.5	.6	.8	.2	.4	.5	.6	.8
United States	29.8	32.5	33.9	35.2	37.9	31.9	34.5	36.0	37.3	40.0
Germany	18.7	17.0	16.1	15.2	13.5	17.2	15.5	14.6	13.7	12.0
Japan	10.2	11.8	12.6	13.3	14.9	9.7	11.4	12.3	13.2	14.9
United Kingdom	6.5	6.6	6.6	6.6	6.7	5.9	6.3	6.4	6.7	7.0
France	11.4	10.8	10.5	10.3	9.7	12.3	11.3	10.8	10.3	9.4
Italy	9.2	8.2	7.7	7.3	6.3	9.3	8.3	7.7	7.3	6.2
Canada	3.0	3.3	3.4	3.5	3.8	2.8	3.2	3.4	3.5	3.9
Netherlands	5.5	4.7	4.4	4.0	3.2	5.4	4.6	4.2	3.7	2.9
Belgium	4.1	3.5	3.2	2.9	2.3	4.0	3.4	3.0	2.7	2.1
Sweden	1.6	1.6	1.6	1.7	1.7	1.5	1.5	1.6	1.6	1.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table 4

GAB SHARES INCLUDING SWITZERLAND

(Combination of GDP and Reserves)

	GAB share = .5 (GDP share) + + .5 (non-gold reserves)		GAB share = .5 (GDP share) + + .5 (total reserves)	
	1977-1981	1981	1977-1981	1981
United States	23.5	26.0	32.3	34.3
Germany	19.4	17.6	15.0	13.6
Japan	15.7	15.4	12.0	11.8
United Kingdom	9.0	8.3	6.3	6.2
France	9.5	11.0	9.9	10.2
Italy	7.2	7.5	7.2	7.2
Canada	3.1	2.7	3.3	3.2
Netherlands	3.7	3.6	4.0	3.9
Belgium	2.5	2.4	2.9	2.8
Sweden	2.0	1.8	1.6	1.4
Switzerland	4.4	3.7	5.5	5.4
Total	100.0	100.0	100.0	100.0

DATA USED FOR TABLES 1 - 4

	GDP (billion dollars) (1)		Non-gold reserves (million SDR) (2)		Total reserves (3) (gold at market price) (million SDR)		Foreign trade (4) (exports+imports) (billion dollars)	
	1977-1981	1981	1977-1981	1981	1977-1981	1981	1977-1981	1981
United States	2,376.0	2,888.5	8,724.9	15,772.0	82,139.0	118.801.0	400.1	507.1
Germany	684.4	687.1	34,502.0	40,186.0	61,997.0	77,316.0	307.2	340.0
Japan	962.1	1,126.9	19,309.0	23,218.0	25,899.0	32,670.0	221.8	294.4
United Kingdom	400.3	503.7	14,093.0	14,900.0	19,471.0	22,324.0	155.8	102.0
France	530.8	569.9	12,776.0	21,887.0	36,418.0	53,817.0	196.5	227.4
Italy	309.7	350.2	11,640.0	15,919.0	30,901.0	41,927.0	139.9	166.4
Canada	236.0	285.9	2,644.0	2,115.8	8,493.6	10,099.0	113.8	142.6
Netherlands	143.2	140.5	6,136.5	8,092.7	18,830.0	25,234.0	122.6	135.9
Belgium	101.2	99.3	4,229.6	5,139.6	14,102.0	18,473.0	108.7	117.7
Sweden	103.1	112.5	2,887.9	3,200.2	4,551.6	5,567.7	51.9	57.2
Total	5,846.8	6,764.5	116,942.9	150,430.3	302,802.2	406,228.7	1,818.3	2,090.7
Switzerland	87.4	94.5	9,323.8	9,608.7	32,233.0	42,096.0	52.5	57.7
Total including Switzerland	5,934.2	6,859.0	126,266.7	160,039.0	335,035.2	448,324.7	1,870.8	2,148.4

(1) Source: IMF, IFS, Country page line 99b, converted in US dollar at the annual average exchange rate.

(2) Source: IMF, IFS, Total reserves minus gold, period average based on monthly data.

(3) Source: IMF, IFS, Gold is valued at the yearly average SDR price.

(4) Source: IMF, IFS.

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TO IMMEDIATE UKDEL IMF/IBRD WASHINGTON
TELEGRAM NUMBER 1 OF 4 JANUARY
IMF: GAB

1. YOUR TELNO 001.

OBJECTIVES

1. WE HAVE NOW EXAMINED NICOLETOPOULOS' PAPER MORE FULLY. ON CONSULTATION WE STRONGLY PREFER THE RELATIVELY LOOSE ARRANGEMENTS AT PARA 4(I) OF YOUR TELNO 312. THIS ACCORDS BETTER WITH THE WISH OF THE G5 AND G10 THAT SAUDI ARABIA SHOULD NOT BE INTEGRATED INTO G10 COUNSELS. IT IS NOT OF COURSE FOR THE UK TO MAKE THIS POINT BLUNTLY AT THIS STAGE PARTICULARLY IN VIEW OF THE CHANCELLOR'S FORTHCOMING VISIT.

3. IT IS IMPORTANT THAT THIS OBJECTIVE IS NOT UNDERMINED BY CONCERNING UPON PARALLEL LENDERS A FINANCIAL RELATIONSHIP WITH THE GAB VIRTUALLY INDISTINGUISHABLE FROM THAT OF A G10 PARTICIPANT, SO THAT IT BECOMES POLITICALLY MORE AWKWARD TO EXCLUDE THEM FROM G10 COUNSELS. THIS POINT IS REINFORCED BY POSSIBILITY OF ADDITIONS AT A LATER STAGE OF FULL MEMBERS (AUSTRALIA) OR PARALLEL LENDERS (KUWAIT). IN ANY EVENT THE SAUDIS THEMSELVES MIGHT PREFER GREATER FLEXIBILITY AND AVOIDANCE OF TOO CLOSE AN IDENTIFICATION WITH G10.

4. IN THIS CONTEXT WE ARE CONCERNED AND WORRIED AT THE DIRECTION AND PACE AT WHICH THE DISCUSSION ON PARALLEL LENDING IS MOVING. OUR UNDERSTANDING WAS THAT PARALLEL LOANS WOULD BE A PREARRANGED LINE OF FINANCE THAT WOULD BE CALLED UPON, IN PARALLEL WITH LOANS FROM THE GAB, TO FINANCE CONDITIONAL LENDING WHEN THE SECOND WINDOW WAS ACTIVATED. THE TREATMENT OF RECIPROCAL ACCESS IN DINI'S STATEMENT WAS UNFORTUNATE, BUT THE STAFF'S INTERPRETATION SEEMS TO GO FURTHER STILL IN IMPLYING THAT THERE IS RECIPROCAL ACCESS EVEN WHEN THE SECOND WINDOW IS NOT ACTIVATED.

5. IN GENERAL WE FEEL THAT THE STAFF ARE PREEMPTING G10 DISCUSSIO

ON A NUMBER OF ISSUES WHICH WERE NOT DISCUSSED AT ALL (EG FUTURE RELATIONSHIP WITH SWITZERLAND OR ONLY INADEQUATELY (EG RECIPROCAL ACCESS) IN THAT FORUM. WE SHARE YOUR VIEW THAT THE G10 FORUM IS THE RIGHT PLACE TO RESOLVE THESE ISSUES. WE ARE ACCORDINGLY ANXIOUS TO AVOID FURTHER CRYSTALLISATION OF EXECUTIVE BOARD VIEWS, PARTICULARLY IN ADVANCE OF THE CHANCELLOR'S OWN DISCUSSIONS WITH THE SAUDIS, EVEN IF THIS MEANS A RATHER HIGHER PROFILE THAN WE WOULD OTHERWISE WISH. WE NOTE FROM YOUR TELNO 305, PARA 3 THAT THE SAUDIS THEMSELVES MIGHT BE CONTENT TO LEAVE GAB DETAILS TO ONE SIDE FOR THE TIME BEING. IF PRACTICABLE, IT WOULD BE HELPFUL TO ELICIT ANY FURTHER VIEWS THAT NIMATALLAH HAS ON POINTS OF CONTENT/ TIMING, PERHAPS OUTSIDE THE MEETING.

6. ON SPECIFIC ISSUES

A. WE WANT THE SWISS RELATIONSHIP WITH THE GAB TO BE UNAFFECTED BY THE DISCUSSION (PARA 3 OF MY TELNO 356).

B. WE ARE NOW CONTENT WITH THE WORDING ON THE MARKET RATE, AND AGREE THAT PARA 9 OF MY TELNO 356 NEED NOT BE PRESSED.

C. ON RECIPROCAL ACCESS, GRATEFUL IF YOU COULD DETERMINE FROM NICOLETOPOULOS WHETHER SFF/EAR LOAN CLAIM ENCASHMENT IS ELIGIBLE FOR GAB FINANCING AT PRESENT. IF SO, WE WOULD WELCOME THE VIEW OF US AND GERMAN DIRECTORS ON WHETHER EXTENSION OF THIS TO SAUDI SFF/EAR LOAN CLAIMS IS LIKELY TO BE ACCEPTABLE TO THEM. IN ANY EVENT YOU SHOULD GET OUR RESERVATIONS ON THE RECORD AND RESIST ANY SUMMING UP WHICH MIGHT PREEMPT FURTHER G10 DISCUSSION ON THIS POINT. (IN OUR VIEW ENCASHMENT OF SAUDI SFF/EAR LOAN CLAIMS SHOULD REMAIN AN OBLIGATION UPON FUND MEMBERSHIP AS A WHOLE, POSSIBLY TO BE MET INITIALLY BY MARKET BORROWING.

POINTS TO MAKE.

7. G10 DISCUSSION SO FAR HAS LOOKED AT BARE ESSENTIALS. EXECUTIVE BOARD SHOULD NOT PREEMPT THEIR FURTHER DISCUSSION ON THE DETAIL OF THEIR PROPOSALS. THERE IS NO PARTICULAR NEED FOR HASTE IN FINALISING REVISED DOCUMENTATION.

8. IN PARTICULAR G10 HAS NOT DISCUSSED THEIR FUTURE RELATIONSHIP WITH SWITZERLAND. PASSAGE IN SQUARE BRACKETS SHOULD BE DELETED IN PARA 1 (XI) THE POSSIBILITY OF RETAINING A CATEGORY OF ASSOCIATE

MEMBERSHIP QUITE DISTINCT FROM PARALLEL LENDER MAY HAVE BOTH POLITICAL AND OPERATIONAL ATTRACTION.

9. POSSIBILITY ALSO SHOULD BE RETAINED OF QUITE WIDE VARIATIONS IN THE FORM OF PARALLEL LENDING. A STEREOTYPE MODEL AGREEMENT SHOULD BE AVOIDED.

10. ONE AREA IN WHICH G10 VIEWS HAVE YET TO BE DEFINED IS THE RELATIONSHIP WITH PARALLEL LENDERS. A KEY AIM OF THE GAB REVISION IS TO LEAVE THE TRADITIONAL GAB MECHANISM BASICALLY AS IT IS, BUT TO GRAFT ON TO IT ARRANGEMENTS TO ALLOW ITS RESOURCES TO BE LENT OUT, IN PARALLEL WITH LOANS FROM OTHER SURPLUS MEMBERS, TO FINANCE CONDITIONAL DRAWINGS BY NON-PARTICIPANTS. ONE POSSIBLE WAY OF IMPLEMENTING THIS APPROACH WOULD BE IF THE MANAGING DIRECTOR CONFINED CALLS ON PARALLEL LENDERS TO THE CIRCUMSTANCES SET OUT IN PARAGRAPH 21C.

IF THE PURCHASES OF G10 MEMBERS NEED GAB FINANCING IN CIRCUMSTANCES WHICH FALL SHORT OF THOSE SET OUT IN PARAGRAPH 2LC, THE CALLS WOULD BE CONFINED TO PARTICIPANTS (AND SWITZERLAND). SIMILARLY ANY PURCHASES MADE BY PARALLEL LENDERS IN THESE CIRCUMSTANCES WOULD NOT BE REFINANCED FROM THE GAB.

11. ONCE THE CIRCUMSTANCES SET OUT IN PARAGRAPH 21C ARE DEEMED PRESENT, THERE SHOULD BE RECIPROCAL ACCESS BETWEEN GAB PARTICIPANT AND PARALLEL LENDERS, CERTAINLY TO FINANCE CONDITIONAL DRAWINGS AND TO REFINANCE ENCASHMENT OF GAB LOAN CLAIMS THROUGH THE SECOND WINDOW AND PARALLEL LOAN CLAIMS (WHERE THERE IS SOME MUTUALITY OF OBLIGATION). IT IS NOT ENTIRELY CLEAR THAT RECIPROCAL ACCESS FOR THE FINANCING OF OTHER PURCHASES (IE CFF, BSF, RESERVE TRANCHE) FLOWS LOGICALLY FROM THE CONCEPT OF PARALLEL LENDING DISCUSSED IN THE G10, NOR IS IT CLEAR THAT RECIPROCAL ACCESS FOR THE ENCASHMENT OF OTHER LOAN CLAIMS WAS INTENDED OR IS DESIRABLE. IF GAB PARTICIPANTS HAVE TO PROVIDE COVER NOT ONLY FOR THEIR OWN REQUIREMENTS TO DRAW UPON THE GAB BUT ALSO TAKE ACCOUNT OF POTENTIAL ENCASHMENT OF SFF/EAR LOAN CLAIMS OF PARALLEL LENDERS, THE SUMS AVAILABLE TO LEND AT THE SECOND WINDOW WOULD BE FURTHER REDUCED, POSSIBLY SUBSTANTIALLY SO.

PYM

MONETARY

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TO IMMEDIATE F C O
TELEGRAM NUMBER 6 OF 4 JANUARY

YOUR TELNO 1 OF JANUARY 4

I M F: GENERAL ARRANGEMENTS TO BORROW

1. I HAVE PUT THE POINT IN YOUR PARA. 6C TO NICOLETOPOULOS. HIS REPLY WAS AS FOLLOWS:
QUOTE G A B RESOURCES CAN BE USED TO FINANCE (UNDERLINE NEXT WORD) ALL PURCHASES BY PARTICIPANTS BUT (UNDERLINE NEXT WORD) ONLY REPAYMENT OF CLAIMS RESULTING FROM OUTSTANDING LOANS BY THEM UNDER THE GAB (IF THE FUND'S HOLDINGS OF CURRENCIES NEEDED FOR THIS PURPOSE ARE NOT ADEQUATE) UNQUOTE.

2. F C O PLEASE ADVANCE TO ATKINSON (TREASURY), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (E R D).

ADVANCED AS REQUESTED

ANSON

MONETARY
ERD

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DESKBY 060900Z
FM UKDEL IMF/IBRD WASHINGTON 052356Z JAN 83
TO IMMEDIATE F C O
TELEGRAM NUMBER 7 OF 5 JANUARY

I M F: REVISION AND ENLARGEMENT OF THE GAB

1. FOLLOWING ARE THE MAIN POINTS COVERED WHEN THE EXECUTIVE BOARD TODAY RETURNED TO ITS DISCUSSION OF THIS SUBJECT (THE FIRST DISCUSSION WAS REPORTED IN MY TELNOS 290 AND 291 OF 17 DECEMBER). MOST OF THE DISCUSSION FELL INTO ONE OF TWO AREAS - DETAILED REVISION OF THE GAB DECISION, TAKING AS A BASIS THE STAFF'S (NICOLETOPOULOS) PROPOSALS IN SM/82/239: AND MORE FUNDAMENTAL QUESTIONS RAISED BY LDC DIRECTORS. THERE WAS ALSO SOME LESS FOCUSSED DISCUSSION OF THE IMPLICATIONS FOR, AND STATUS OF, PARALLEL LENDERS.

2. AT THE START THE MANAGING DIRECTOR WELCOMED THE PROCEDURE UNDER WHICH THE BOARD WAS BEING GIVEN AN OPPORTUNITY TO REACT TO THE G10 OUTLINE. THE PRESENT DISCUSSION SHOULD HELP THE G10 TO CRYSTALISE VIEWS AT THEIR NEXT MEETING.

REVISION OF GAB DECISION

3. G10 DIRECTORS GENERALLY FOUND THE STAFF'S PROPOSALS A USEFUL STARTING POINT. SOME LDC DIRECTORS SAID THAT THEY COULD NOT ADDRESS DETAILED POINTS BEFORE RECEIVING ANSWERS TO MORE BASIC QUESTIONS (PARAGRAPHS 15 TO 19 BELOW).

THE INTEREST RATE

4. ALL G5 DIRECTORS SAID THAT THEY WOULD PREFER TO STAY WITH THE QUARTERLY CYCLE OF INTEREST PAYMENTS IN THE EXISTING GAB. MOST OTHER G10 DIRECTORS AGREED. LASKE (GERMANY) WANTED IT TO BE STATED THAT INTEREST SHOULD BE BASED ON THE FORMULA FOR THE SDR RATE AS IT STANDS AT PRESENT. A NEW FORMULA WOULD THEN REQUIRE CONSENT OF THE PARTICIPANTS. OTHER G5 DIRECTORS AND SCHNEIDER (FOR HIS BELGIAN AUTHORITIES) AGREED. LASKE ALSO WANTED THE FLOOR OF 4 PERCENT TO BE RETAINED. I SYMPATHISED, ALTHOUGH QUESTIONING THE PRACTICAL EFFECT. DE MAULDE (FRANCE) WAS DOUBTFUL: OTHERS DID NOT EXPRESS A VIEW.

UNIFORMITY OF ACCESS

5. ERB (U.S.) SAID THAT STRESS SHOULD BE GIVEN TO THE STAFF'S REFERENCE TO THIS PRINCIPLE (SECOND HALF OF LAST FULL PARAGRAPH ON PAGE 4). G 10 DIRECTORS GENERALLY AGREED.

REVIEW DATE

6. G5 DIRECTORS PREFERRED THAT THE NORMAL 5 YEAR CYCLE FOR GAB REVIEW SHOULD BE RETAINED: THERE SHOULD BE LESS OF A LINKAGE TO THE NEXT QUOTA REVIEW. I THOUGHT IT WOULD BE HELPFUL IF THE NEED FOR CONTINUATION OF THE SECOND WINDOW WAS SPECIFICALLY ADDRESSED IN THE REVIEW. LASKE AGREED. NICOLETOPAULOS THOUGHT THIS WAS NOT THE PREPONDERANCE OF VIEW IN THE G10, BUT WE REPEATED THE POINT LATER.

DEFINITION OF CONDITIONAL FINANCING

7. ERB WANTED TO CLEARER ON THE MEANING OF CONDITIONAL FINANCING: IT SHOULD EXCLUDE FIRST CREDIT TRANCHE DRAWINGS UNLESS ACCOMPANIED BY UPPER TRANCHE DRAWINGS. LASKE SUPPORTED HIM BUT POLAK (NETHERLANDS ETC) THOUGHT THAT FIRST CREDIT TRANCHE DRAWINGS AND THOSE IN THE UPPER HALF OF THE CFF COULD NOW BE REGARDED AS CONDITIONAL.

PARALLEL LENDERS

8. G5 DIRECTORS, ESPECIALLY ERB, LASKE AND MYSELF, SAID THAT PARALLEL LENDING WOULD NEED FURTHER DISCUSSION WITHIN THE G10 AND BETWEEN THE G10, THE FUND AND POTENTIAL LENDERS. IT WOULD BE IMPORTANT TO CLARIFY THE RIGHTS AND OBLIGATIONS OF PARALLEL LENDERS, PROBABLY WITHIN THE DECISION PROPER. CONFERMENT BY THE FUND OF PARALLEL CREDITOR STATUS (DECISION PARAGRAPH 1(XI)) WOULD NEED TO BE MADE SUBJECT TO CONSENT BY GAB PARTICIPANTS (SEE PARA 20 BELOW). I SPOKE TO YOUR TELNO 1.
WE SHOULD RETAIN THE POSSIBILITY OF QUITE WIDE VARIATIONS IN PARALLEL CREDIT ARRANGEMENTS, INCLUDING THE POSSIBILITY THAT THEY WOULD BE CALLED UPON ONLY IN THE CIRCUMSTANCES OF PARAGRAPH 21(C). THE FORM OF RECIPROCAL ACCESS WOULD DEPEND ON THE NATURE OF THE OBLIGATION ACCEPTED. NICOLETOPOULOS SAID THAT HE WOULD NOT WANT TO WRITE INTO THE DECISION THAT PARALLEL CREDIT ARRANGEMENTS COULD ONLY BE ACTIVATED IN THE CASE OF PARAGRAPH 21(C). HE THOUGHT MY SUGGESTION WAS ALSO INCONSISTENT WITH THE SECOND SENTENCE OF PARA 6 OF DINI'S SUMMARY. I SAID THAT THE FIRST SENTENCE WAS LESS CLEAR. THE FORM OF RELATIONSHIP COULD ONLY BE FURTHER CONSIDERED IN THE LIGHT OF REACTIONS FROM THE BOARD AND POTENTIAL PARALLEL LENDERS. BUT I AGREED THAT IT WOULD NEED TO BE FURTHER CONSIDERED IN G10.

ASSOCIATE MEMBERSHIP

9. REFERRING TO SWITZERLAND, I SAID THAT THERE WAS OBVIOUSLY A FUNDAMENTAL DISTINCTION BETWEEN MEMBERS AND NON-MEMBERS AND THAT THE POSSIBILITY OF RETAINING ASSOCIATE MEMBERSHIP AS A DISTINCT CATEGORY SHOULD BE KEPT OPEN AT THIS STAGE. JOYCE (CANADA ETC) CONCURRED. SCHNEIDER ASKED WHETHER IF THE STATUS OF ASSOCIATE GAB MEMBER WERE MERGED WITH THAT OF PARALLEL CREDITOR THIS WOULD MEAN THAT PARALLEL LENDERS WOULD HAVE THE SAME STATUS AS SWITZERLAND.

NICOLETOPOULOS, IN A LATER REPLY, SAID HE DID NOT KNOW WHETHER THE SWISS WANTED PARALLEL LENDER STATUS: PARTICIPANTS MIGHT WISH TO CONSIDER THE POINT. PARALLEL CREDITOR STATUS WAS SOMETHING NEW TO THE GAB AND ENTIRELY DIFFERENT. WHETHER SWITZERLAND HAD PARALLEL CREDITOR STATUS WOULD AFFECT WHETHER THAT COUNTRY COULD BE BROUGHT INTO THE REFINANCING OF A CREDIT WITHDRAWAL BY A PARALLLEL LENDER.

MINIMUM COMMITMENT

10. SEVERAL DIRECTORS ASKED WHETHER THE OPPORTUNITY SHOULD BE TAKEN TO INCREASE THE SIZE OF THE MINIMUM GAB COMMITMENT. NICOLETOPOULOS SAID THAT IT WOULD BE AN EASY CHANGE TO MAKE BUT THE G10 SO FAR HAD NOT PROPOSED IT. IT WAS SOMETHING THEY MIGHT CONSIDER.

EARLY REPAYMENT

11. SEVERAL G10 DIRECTORS (PRINCIPALLY LASKE, HIRAO (JAPAN), JOYCE)) WANTED TO HAVE IT SPECIFIED THAT THE FUND SHOULD MAKE EARLY REPAYMENT TO THE GAB IF A PARTICIPANT, HAVING DRAWN ITS RESERVE TRANCHE, WENT ON TO RECONSTITUTE IT, WHETHER BY A REPURCHASE OR BY A FUND USE OF THE RELEVANT CURRENCY. NICOLETOPOULOS FELT THAT THIS COULD BE BEST DEALT WITH THROUGH AN AD HOC ATTRIBUTION BY THE EXECUTIVE BOARD AT THE TIME OF AN EARLY REPAYMENT BUT FAILED TO CONVINCE LASKE.

ACTIVATION CRITERIA

12. ALMOST ALL THOSE WHO SPOKE ON THE DETAILED ACTIVATION CRITERIA (PARAGRAPH 21) EXPRESSED A PREFERENCE FOR ALTERNATIVE I OVER ALTERNATIVE II AND, WITHIN IT, FOR VERSION B OVER VERSION A. IT WAS GENERALLY AGREED THAT THE NEW PROVISIONS REGARDING ACTIVATION FOR THE BENEFIT OF NON-PARTICIPANTS WERE TOO IMPORTANT TO BE LEFT TO A SEPARATE LETTER OF MEMORANDUM OF UNDERSTANDING. IN MOST CASES, VERSION B WAS PREFERRED BECAUSE IT BROUGHT IN ''EXPECTED REQUESTS'' AND/OR BECAUSE IT SPECIFIED ''READILY AVAILABLE'' RESOURCES. ERB, HOWEVER WHILE ACCEPTING THE FIRST POINT, QUERIED THE DESIRABILITY OF INCLUDING THE LATTER TERM AND WOULD RATHER TAKE IT OUT. IN HIS VIEW THE QUESTION WHETHER THE FUND HAD AVAILABLE RESOURCES WAS BEST LEFT OPEN, AS IN VERSION A. THE QUESTION OF WHETHER RESOURCES WERE EXHAUSTED WOULD BE ONE FOR THE FUND. IT WAS IMPORTANT NOT TO PRECLUDE THAT THE FUND MIGHT DECIDE TO GO TO THE MARKET OR SEEK FURTHER BILATERAL OFFICIAL BORROWING.

13. THE STAFF (HABERMEIER) EXPLAINED THAT READILY AVAILABLE RESOURCES MEANT ORDINARY RESOURCES AND EXISTING LINES OF CREDIT BUT NOT GOLD OR FURTHER BORROWING. THE TERM HAD BEEN INCLUDED IN B BECAUSE THE STAFF HAD FELT THAT ''INADEQUACY'' WAS A STRONG WORD. THERE MUST NOT BE A LEGAL PRESUMPTION THAT THE FUND'S LIQUID ASSETS AND WORKING BALANCES BE DISPOSED OF BEFORE RESORT TO THE EXPANDED GAB. ERB AGREED BUT NEVERTHELESS FELT A WAS BETTER ON THIS POINT, AND COULD SUPPORT IT IF IT WERE UNDERSTOOD THAT REQUESTS INCLUDED EXPECTED REQUESTS.

14. LDC DIRECTORS (DONOSO (CHILE)) ASKED WHETHER AN ACTUAL REQUEST WAS NEEDED IN ORDER TO INITIATE THE PROCEDURE. THE MANAGING DIRECTOR SAID THAT UNDER VERSION B THE FIRST SET OF CONSULTATIONS WITH PARTICIPANTS COULD TAKE PLACE MERELY AFTER NEEDY MEMBERS HAD APPROACHED THE FUND. (VERSION A WAS LESS EXPLICIT.) BUT FORMAL ACTIVATION WOULD ONLY BE POSSIBLE WHEN AN ACTUAL REQUEST MATERIALISED. NICOLETOPOULOS ADDED THAT THE FUNCTION OF PARAGRAPH 21(C) WAS TO SPELL OUT THE CONDITIONS FOR ACTIVIATION OF THE SECOND WINDOW. THE ACTUAL PROCEDURE OF ACTIVATION WAS GOVERNED BY PARAGRAPHS 6 AND 7 WHICH MADE EXPLICIT THE DISTINCTION BETWEEN THE SUCCESSIVE STAGES OF CONSULTATION AND ACTUAL DRAWING. KAFKA (BRAZIL) ARGUED THAT IT SHOULD BE STATED EXPLICITLY THAT THE CONSULTATION IN PARAGRAPH 21(C), LINE 3, MUST INCLUDE CONSULTATION WITH THE EXECUTIVE BOARD.

/BASIC

BASIC QUESTIONS

15. LDC DIRECTORS, LED BY KAFKA AND, MOST EXTENSIVELY, MALHOTRA (INDIA), EXPRESSED STRONG CONCERN THAT THE BASIC QUESTIONS THEY HAD RAISED IN THE PREVIOUS DISCUSSION, AND WHICH THE MANAGING DIRECTOR HAD HIGHLIGHTED IN HIS SUMMING UP, HAD NOT YET RECEIVED A RESPONSE. THIS MADE THE TASK OF COMMENTING ON THE REVISIONS DIFFICULT. THE HUB OF THE MATTER WAS THE IDEA OF SETTING UP ANOTHER FORUM TO MAKE DECISIONS WHICH WERE PROPERLY THE PROVINCE OF THE FUND ITSELF. WHY COULD NOT THE SAUDI SYSTEM BE FOLLOWED IN WHICH POTENTIAL LENDERS GAVE A FIRM INITIAL COMMITMENT AND LEFT JUDGMENTS ABOUT CALLS TO THE EXECUTIVE BOARD, IN WHICH THE G10 HAD AFTER ALL A HEAVY VOTING POWER. A SEPARATE G10 VETO WAS NOT NEEDED BECAUSE THERE WERE ALREADY ENOUGH SAFEGUARDS. THE BOARD HAD SET CEILINGS ON BORROWING AND WAS BEST PLACED TO JUDGE WHETHER THERE WAS A THREAT TO THE STABILITY OF THE SYSTEM.
THIS WAS A MATTER OF PRICIPLE, NOT TO BE SACRIFICED TO CONVENIENCE. THE BOARD SHOULD NOT STAND BEFORE THE JUDGEMENT OF THE G10. CONSULTATION BETWEEN THE MD AND THE G10 WAS, OF COURSE, ACCEPTABLE.

16. SIMILAR SENTIMENTS WERE EXPRESSED BY OTHER LDC DIRECTORS (VENEZUELA, CHINA, GUINEA, INDONESIA, IRAN, ETC).

17. ERB GAVE A TRENCHANT REPLY. GAB PARTICIPANTS HAD LONG AGO SET UP A QUITE LEGITIMATE FINANCING ARRANGEMENT TO HELP THE FUND AND THEMSELVES, AND THEY WERE NOW CONSIDERING EXTENDING THIS FOR THE BENEFIT OF NON-PARTICIPANTS. THE BOARD HAD TO DECIDE WHETHER TO USE THE EXTENDED GAB. IT WAS, IN HIS VIEW, A PITY IF THEY CHOSE NOT TO DO SO.
THE PROPOSED EXTENSION DID NOT PRECLUDE OTHER OTPIONS.
THE SAUDI AGREEMENT WAS NOT OPEN-ENDED. THERE WERE CONDITIONS: IT APPLIED ONLY TO ENLARGED ACCESS AND THE SAUDI LOANS WERE TEMPORARY, WHEREAS HE SAW THE EXTENDED GAB AS A LONG-TERM PROSPECT.

18. THE MD SAID THAT IT WAS QUITE NORMAL FOR LENDERS AND BORROWERS TO BE IN CONTACT WHEN A LINE OF CREDIT WAS ACTIVATED. IT WAS NATURAL THAT THE G10 SHOULD WISH TO RESERVE SOME POWER OF DECISION OVER DRAWINGS. THE KEY THING WAS THAT THE G10 HAD ABNEGATED DECISION-MAKING RESPONSIBILITY ON INDIVIDUAL REQUESTS. THEY HAD BEEN ABSOLUTELY CLEAR ON THIS. THE QUESTION NOW WAS WHETHER THE FUND WANTED TO ACCEPT THE OPENING UP OF THIS NEW POOL OF RESOURCES. KAFKA SAID THAT HE COULD NOT DISAGREE WITH ERB BUT IF THERE WERE GENUINELY A WISH TO PURSUE OTHER OPTIONS PERHAPS IT WOULD BE AN APPROPRIATE MOMENT TO GIVE THE MD SIMULTANEOUS AUTHORITY TO INITIATE BORROWING IN THE PRIVATE MARKET. MALHOTRA SAID THAT THERE WAS NO EFFECTIVE ALTERNATIVE EXCEPT GOING TO THE MARKET.

19. THE LDC DIRECTORS ALSO RAISED AGAIN THEIR BASIC CONCERNS THAT THE NEW ARRANGEMENT WOULD BE DISCRIMINATORY AND THAT THE DISTINCTION BETWEEN PARTICIPANTS AND PARALLEL LENDERS WAS INVIDIOUS. DISCRIMINATION AROSE BECAUSE FUND MEMBERS WHO WERE NOT PARTICIPANTS OR PARALLEL CREDITORS WOULD BE ABLE TO DRAW OUT

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ONLY ON CONDITIONAL TERMS (KAFKA). SHOULD IT BE POSSIBLE FOR POTENTIAL LENDERS WILLING TO LEND ON THE SAME TERMS TO BE DENIED PARALLEL STATUS BY PARTICIPANTS? G10 DIRECTORS RESPONDED THAT ACCESS TO FUND RESOURCES WOULD REMAIN AVAILABLE TO ALL MEMBERS ON UNIFORM TERMS AND WOULD NOT DEPEND ON THE AVAILABILITY OF GAB FINANCING.

PARALLEL CREDIT

20. MANY DIRECTORS RAISED THE QUESTION OF THE IMPLICATIONS OF GAB EXTENSION FOR OTHER POTENTIAL LENDERS. THERE WAS CONSIDERABLE DISCUSSION OF THE STATUS OF PARALLEL CREDITORS AND THE NATURE OF THE LINKS BETWEEN PARALLEL LENDING AND LENDING THROUGH THE EXPANDED GAB. IT WAS CLEAR FROM NICOLETOPOULOS'S RESPONSE THAT THE STAFF ATTACH IMPORTANCE TO THE NOTION THAT ALTHOUGH THE TERMS AND CONDITIONS OF PARALLEL CREDIT ARRANGEMENTS COULD DIFFER, THEY WOULD BE FAIRLY SIMILAR TO THOSE UNDER THE GAB SECOND WINDOW, AND THAT THERE WOULD BE CONSIDERABLE RECIPROCITY OF RIGHTS AND OBLIGATIONS BETWEEN GAB PARTICIPANTS AND PARALLEL CREDITORS. IN PARTICULAR, ACTIVATION OF PARALLEL LENDING OF CREDIT SHOULD BE CLOSELY LINKED WITH GAB ACTIVATION. IF SO, HE THOUGHT PARALLEL LENDERS WOULD HAVE TO BE INVOLVED IN THE DECISION-MAKING PROCESS. THE KIND OF REPROCITY REFERRED TO IN PARA. 6 OF THE DINI OUTLINE WOULD BE AN ATTRACTIVE INDUCEMENT TO PARALLEL CREDITORS. HE ALSO DID NOT FAVOUR GIVING PARTICIPANTS AN OUTRIGHT VETO OVER ADMISSION OF PARALLEL CREDITORS, ALTHOUGH THERE COULD BE CONSULTATION. NICOLETOPOULOS NEVERTHELESS STRESSED THAT THESE WERE MATTERS FOR NEGOTIATION AND COULD NOT BE PREEMPTED AT THIS STAGE.

CONCLUSION

21. THE MD DID NOT ATTEMPT A FULL SUMMING UP. HE SAID THE BALL WAS NOW IN THE G10 COURT. THE STAFF WOULD ALSO DO SOME REDRAFTING TO MEET THE POINTS RAISED. IN PARA 21, DIRECTORS HAD CLEARLY PREFERRED ALTERNATIVE I AND HE THOUGHT THIS WAS RIGHT. WITHIN THIS, VERSION B HAD BEEN GENERALLY PREFERRED, EXCEPT THAT ''READILY AVAILABLE'' SHOULD EITHER BE REDRAFTED, OR ELSE OMITTED WITH SOME EXPLANATION IN THE COMMENTARY THAT ''INADEQUACY'' DID NOT IMPLY THAT RESOURCES MUST BE EXHAUSTED FIRST. ON KAFKA'S POINT ABOUT MARKET BORROWING, HE SAID THAT IF THE GAB DID NOT PROVE AS USABLE AS ENVISACED, AND THE FUND NEEDED TO REPLENISH ITS RESOURCES, WE WOULD HAVE TO CONTEMPLATE ALL POSSIBILITIES OF SUPPLEMENTARY BORROWING. MARKET BORROWING WAS ONE POSSIBILITY WHICH THE STAFF HAD BEEN ACTIVELY CONSIDERING. WE HAD NOT YET HAD TO RESORT TO IT BECAUSE IT HAD NOT BEEN NECESSARY AND THE BOARD AND THE INTERIM COMMITTEE HAD INSISTED THAT THE POSSIBILITIES OF OFFICIAL BORROWING SHOULD BE EXHAUSTED FIRST. BUT IF THAT ROUTE WAS BLOCKED AND THERE WAS STILL SOME UNUSED AUTHORITY WITHIN THE BORROWING GUIDELINES, HE WOULD MAKE PRECISE OPERATIONAL PROPOSALS TO ENABLE

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THE FUND'S FINANCIAL OPERATIONS TO CONTINUE WITHIN THE CONTEXT OF FUND LENDING POLICIES. ON WHETHER THIS SHOULD BE SOMEHOW LINKED TO THE GAB DECISION, HE WOULD BE VERY HAPPY TO DO SO SINCE IT MIGHT HAVE BEEN WISE TO HAVE GONE TO THE MARKET EARLIER. BUT ALTHOUGH THE STAFF WERE VERY OPEN TO THE IDEA OF MARKET BORROWING, IT WAS NOT YET THE MOMENT. THE TIMING SHOULD BE GUIDED BY PRACTICAL CONSIDERATIONS OF THE FUND'S LIQUIDITY POSITION.

22. THERE HAS BEEN NO OPPORTUNITY FOR ANY FURTHER TALK WITH NIMATALLAH BEFORE HIS DEPARTURE TODAY.

23. FCO PLEASE ADVANCE TO LITTLER, LAVELLE (TREASURY), GILCHRIST (BANK OF ENGLAND) AND APPLEYARD (ERD).

(ADVANCED AS REQUESTED)

ANSON

MONETARY
ERD

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UNITED KINGDOM TREASURY AND SUPPLY DELEGATION
BRITISH EMBASSY
WASHINGTON, D.C. 20008

Mr Littler

For G10 Deputies' meeting.

GAB 14/1.

January 6, 1983

R.G. Lavelle Esq
HM Treasury
London, England

Dear Roger,

IMF: GENERAL ARRANGEMENTS TO BORROW

We sent a long telegram last night (telno 7 of January 5) reporting the discussion yesterday of the draft GAB agreement prepared by the Staff. I hope this will have been helpful to you in preparation for your journey to Riyadh as well as in briefing for the meetings of G10 Deputies and Ministers later this month. It may, however, be worthwhile to let you have some more general reflections on this discussion and the previous Board discussion on December 17.

2. We have been considerably hampered by the fact that the conclusions transmitted by Dini to the Managing Director of the G10 meeting on December 10 did not fully conform to the understanding of the outcome taken away by the UK participants in that meeting. This is always the risk when the Chairman prepares a summary of conclusions on his own authority, but I think it is essential that agreed conclusions are reached at the meetings later this month.

3. The two main areas of difficulty were the extent to which the revision of the GAB should be regarded as temporary or permanent; and the access by potential parallel lenders to GAB resources. On the latter point, it was very helpful that we had the opportunity of a further exchange of telegrams over the New Year holiday before yesterday's meeting. The line suggested in your telno 1 of January 4 was one which was just sustainable without provoking open disagreement by other G10 Directors in the Board. At a G5 Directors meeting before that telegram arrived, I had asked Erb whether he felt that para. 6 of Dini's summary had represented a genuine consensus among the G10 Deputies. He said that he himself had thought that it fairly represented the conclusion of the Deputies' meeting, but he acknowledged that others could perhaps have come away thinking differently. After I received your telegram, I spoke to Erb and Laske again, and traded my support for some of their other technical points for an understanding that they would not get into an argument with me on this one. As you will see from para. 8 of my telno 7, I was opposed by Nicoletopoulos, who seems to have cast himself as the guardian of Dini's conclusions

/as though they were

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1/73/12

as though they were holy writ, but I was able eventually to leave the matter on the basis that it would need further consideration in the G10. However, unless you have been able to make further progress on this point in Riyadh, the fact remains that the Saudi and other potential parallel lenders will have drawn the impression from Dini's conclusions and the Staff paper that they would have access to the GAB for reserve tranche drawings. If you want to turn this around, it will be necessary to get clear support in the forthcoming G10 meetings.

4. As regards the permanence or otherwise of the new arrangements, my suggestion in the discussion on December 17, that GAB lending for the benefit of non-participants would make only one "trip" (para. 7 of your telno 242), was jumped on by a number of G10 Directors, including Erb, and rebutted by the Managing Director on the basis that para. 7 of Dini's summary only referred to a review and did not contain any presumption that the new arrangements would be phased out. Erb has explained to me that the US attitude has been dictated essentially by congressional considerations. The Americans feel that it is only worth going to Congress for a permanent arrangement, and not for one which would require another congressional approval if it needed to be renewed in 5 years' time. In the discussion on January 5, Laske and I argued that the need for continuation of the second window should be specifically addressed in the review. Dallara (who, by then, had replaced Erb) argued that there was no need to deal with this in the decision because a review of the GAB would clearly cover all aspects of the matter; he did not want to introduce any implication of temporariness. Nicoletopoulos thought that the point made by Laske and myself was "not the preponderance of view" in the Deputies meeting. Habermeier suggested that it seemed a bit ungenerous since it implied that the review would be specifically directed to discontinuation. Laske and I did, however, put our view on the record again later in the discussion. I have since heard that the Managing Director shares the Staff view, feeling that as a purpose of the exercise is to build confidence, we should not undermine it by suggesting that it might not continue; and he does not feel that the exchanges in the Board justify a change in the drafting at this stage. Our view is however clearly on the record, as well as Dallara's observation that all aspects of the decision would be covered by the review. If you want to get more than this, it will be necessary to enlist more support at the G10 meetings, but you may have difficulty with the Americans on this point.

5. There were a few technical points which were excluded from my telno 7 in order to keep the telegram of manageable length. We will send these separately by bag.

Yours ever,

John

John Anson

cc: Mr. R.H. Gilchrist (B of E)
Mr. L.V. Appleyard (FCO)

7/1/83

GROUP OF TEN

CONFIDENTIAL

Meeting of Ministers and Governors
of the Group of Ten
Centre de Conférences Internationales
19, avenue Kléber, Paris
Tuesday, January 18, 1983, 10:30 a.m.

AGENDA*

1. Approval of the Agenda

2. World Economic Outlook in Light of Latest OECD Forecasts and the Discussions of Working Party No. 3 (WP 3)

3. Enlargement and Revision of the General Arrangements to Borrow

4. Issues Relating to the Eighth General Revision of Quotas of the International Monetary Fund (Size, Distribution, Subscription, Timetable)

5. Other Issues

6. Press Communiqué

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* As set out in Chairman's telex of January 7, 1983.

GROUPE DES DIX

CONFIDENTIEL

Réunion des Ministres et des Gouverneurs
du Groupe des Dix
Centre de Conférences Internationales
19, avenue Kléber, Paris
Mardi, 18 janvier 1983, 10h30

ORDRE DU JOUR*

1. Adoption de l'ordre du jour

2. Perspectives économiques mondiales à la lumière des dernières prévisions de l'OCDE et des discussions du Groupe de Travail No. 3 (WP 3)

3. Augmentation et modification des Accords Généraux d'Emprunt

4. Questions liées à la Huitième Révision Générale des Quotes-Parts du Fonds Monétaire International (taille, repartition, souscription, calendrier)

5. Autres questions éventuelles

6. Communiqué de presse

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* Conformément au telex du Président du 7 janvier 1983.

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

SM/82/249
Revision 1

January 7, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Draft Report to the Interim Committee on the Eighth General Review of Quotas

The attached draft of the report to the Interim Committee on the Eighth General Review of Quotas has been revised in the light of the discussion at Executive Board Meeting 83/3 on January 4, 1983, and has been scheduled for discussion on Wednesday, January 12, 1983.

Att: (1)

Other Distribution:
Department Heads

DRAFT

INTERNATIONAL MONETARY FUND

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

January 7, 1983

I. Introduction

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

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

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

existing arrangements to deal with major strains in the international financial system."

3. In its assessment of the adequacy of existing arrangements, the Executive Board considered an extension and enlargement of the Fund's existing standing borrowing arrangements (the General Arrangements to Borrow). In view of the strains in the international monetary situation, the Executive Board considers that a major extension and enlargement of the standing borrowing arrangements would be useful to provide the Fund with additional resources needed to meet contingencies arising from exceptional increases in demand on the Fund's resources.

4. As regards the Eighth General Review of Quotas, it is agreed that quotas must provide the primary source for the Fund's financing, and the Executive Board has considered (i) the size of the overall increase in quotas; (ii) the distribution of the overall increase, including the position of countries with very small quotas in the Fund; and (iii) the mode of payment for the increase in quotas. The range of views of Executive Directors on these main issues has greatly narrowed since the last meeting of the Committee. As outlined below, some differences remain among the Executive Directors. The principal elements of an agreement are now available for the Interim Committee to resolve the remaining issues and provide an early conclusion of the Eighth General Review.

II. Size of the Overall Increase

5. The Executive Directors agree that the overall increase in quotas should be of a size that would enable the Fund to deal effectively

with the problems of financing and adjustment that are within its competence and are likely to be encountered in the 1980s. In particular, the increase in quotas should accommodate the likely needs for Fund resources in the 1980s, and borrowing by the Fund, which may be resorted to temporarily, or in exceptional circumstances, should not be a regular feature of its operations. Many Directors are of the view that some of the issues relating to the distribution of quotas, and in particular the size of the adjustment in quota shares to better reflect relative economic positions of members, would be more readily resolved if the size of the overall increase in quotas were larger rather than smaller.

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

7. In the light of these considerations, Directors' views on the size of the overall increase, which have narrowed considerably since the

last meeting of the Committee, may be summarized as follows: Most Directors believe that an approximate doubling of the Fund's quotas, from the present total of SDR 61.1 billion to SDR 125 billion, would be appropriate. Some of these Directors are of the view that more than a doubling of present quotas is needed. A few Directors believe that an increase in quotas of 50 per cent to the order of SDR 90 billion is a minimum. But, in the course of discussion, most Directors have indicated that an increase in Fund quotas to SDR 100 billion would be acceptable. However, the view is also held that an increase in quotas to SDR 85 billion would suffice.

8. A number of Directors believe that if the total of Fund quotas fell in the range of SDR 100-125 billion, or less, the interval between the end of this Review and the next (Ninth) General Review of Quotas should be shortened to less than the maximum period of five years. The view is also put forward that the acceleration in the timetable for completing the Eighth General Review can be expected to result in the new quotas coming into effect in early 1984, rather than late 1985, with the result that the normal period for the start of the next review of quotas would be effectively advanced.

III. Distribution of Overall Increase

9. In their discussion of the distribution of the overall increase in quotas, the Executive Directors are guided by the view of the Interim Committee that the overall increase in quotas under the Eighth Review should be used to bring the quotas of individual members more in line with their relative positions in the world economy. Directors are also

of the view that the distribution of the increase in quotas should not result in abrupt changes in quota shares and that all members should receive a meaningful increase in quotas. Furthermore, Directors agree that the method to be used to distribute the increase in quotas will apply uniformly to all members.

10. The quota calculations used for the purposes of this Review have been based on the revised quota formulas agreed by the Executive Board in August 1982. In its last Report to the Interim Committee on the Eighth General Review, the Executive Board noted that, "Whilst accepting the agreed quota calculations as reasonable indicators of the relative economic positions of countries in the world economy, some Executive Directors are of the view that they do not provide a wholly satisfactory measure of relative economic positions. It is understood that the changes that have been made do not preclude further appropriate changes in connection with future reviews."

11. The Executive Board considered different methods that could be used to distribute increases in quotas, taking into account the various aims noted in paragraph 9 above. After long deliberation, the Executive Board agrees that a part or all of the overall increase should be distrbuted on the basis of each member's share in the total of calculated quotas. This method directly reflects members' relative economic positions, as measured by the calculated quotas, in the distribution of quota increases. In order to assure a meaningful increase in quotas for each member, most Directors also agree that a part of the overall increase should be used for an equiproportional increase in quotas--i.e., each member's present quota should be increased by the same percentage.

12. The Executive Directors have not yet reached a consensus on the proportion of a given overall quota increase that should be devoted to the equiproportional increase and the proportion that should be devoted to effecting selective increases in quotas. The Tables appended to this report show illustrative alternative distributions between equiproportional increases and selective increases for four sizes of Fund--viz. SDR 85 billion, SDR 90 billion, SDR 100 billion and SDR 125 billion. The Tables also show for each calculation the extent to which quota shares are adjusted toward shares in calculated quotas and the distribution of shares in the Fund between the major groups of countries, which have been classified as in IFS. 1/ For ease of reference, the individual quota calculations that are summarized in the Appendix are shown in a separate document which is circulated concurrently.

13. A few Executive Directors stress that in view of the large and growing differences for many members between their shares in present and in calculated quotas, it would be appropriate to distribute the entire increase in quotas in the form of selective adjustments. This would imply that there would not be an equiproportional increase in quotas. On the other hand, a number of Directors believe that a significant part, of the order of two thirds to three quarters, of the overall increase in quotas should be distributed as an equiproportional increase in quotas. These Directors stress the need to avoid abrupt changes in

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1/ The IFS classification is used for presentational purposes only and it is not intended to have operational significance for the purposes of the General Review of Quotas.

the quota shares of members and wish to ensure that each member receives a meaningful increase in its quota. These Directors recall that in the last communique of the Interim Committee it was stated that in bringing quotas better into line with relative economic positions, account should be taken of "the case for maintaining a proper balance between the different groups of countries." They believe that a large equiproportional component would help safeguard the position of the non-oil developing countries, taken as a group. On the other hand, many Directors continue to feel that quota increases should be based on members' individual positions and not on the positions of groups of members. However, between these two views, an intermediate position is held by other Directors who feel that 50-70 per cent of the overall increase should be devoted to effecting selective increases in quotas.

14. The Executive Board discussed the position in the Fund of the small quota countries. As regards the very small quota countries--i.e., those with quotas that are at present less than SDR 10 million--many Directors feel that on many grounds the share in the Fund of this group of countries should be raised slightly, after taking account of the increase in quotas and its distribution that will be agreed under the Eighth General Review. These Directors believe that in terms of the likely amount of the increase in quotas over the agreed overall increase, the cost of special quota adjustments for these members would be very small. But against this, most other Directors strongly hold the view that it is important to maintain uniformity of treatment of members in distributing increases in quotas. They also point out

that a special adjustment in very small quotas could result in these members satisfying their needs for Fund resources through use of facilities which do not involve upper tranche conditionality. Some Executive Directors suggest that the small quotas might be increased so as to effectively double the number of basic votes for such members. It is generally felt that such an adjustment in quotas would result in relatively high quotas for small countries. Some Executive Directors put forward the view that the issue of a possible increase in basic votes, which would need an amendment to the Articles, might be further examined. A few Directors thought it appropriate to examine the matter of small quotas later, and in the light of the increases in quotas that are agreed under the Eighth General Review, and particularly in the context of any rounding procedures that might be adopted as regards these increases.

IV. Payment for Increases in Quotas

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

16. Almost all Directors agree that twenty-five per cent of the increase in quotas should be paid in reserve assets. Most of these

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

17. Directors recognize that a member may face difficulties in making its reserve asset payment and might need to borrow to make the payment to the Fund. Some of them believe that in such circumstances members should not be required to pay 25 per cent of the increase in quotas in reserve assets. Others point out that under existing decisions a reserve asset payment to the Fund either creates a reserve tranche position for a member, or enlarges the paying member's existing reserve tranche, by an amount equal to the reserve asset payment. Thus, a

reserve asset payment to the Fund results only in a change in the composition of a member's reserves, and does not represent a net drain on them. Furthermore, a member can draw on its reserve tranche without challenge to its representation of balance of payments need. Directors also noted that in the event that members would experience difficulties in making the reserve asset payment because they do not hold sufficient official foreign assets (SDRs and foreign exchange), arrangements could be put in place to assist such members to engage in very short-term bridging finance to make the payment to the Fund. In the light of the technical assurances that have been provided by the staff regarding the feasibility of such arrangements, Directors agree that members that engage in such arrangements and that need to do so could repay promptly the reserve assets used in payment of 25 per cent of the quota increase by drawing on their reserve tranches. Many Directors also feel that the question of an allocation of SDRs in the fourth basic period should be addressed urgently. In this connection, whilst noting that a decision to allocate SDRs would facilitate a payment of 25 per cent of the quota increase in SDRs, these Directors consider that the decision on SDR allocations has to be examined on its own merits, which they believe are strong. In the light of these considerations, almost all Directors agree to the payment of 25 per cent of the quota increase in reserve assets on the understanding that the Interim Committee would request the Executive Board to review the latest trends in world inflation and liquidity as a matter of urgency, so that consideration could be given at the next Annual Meeting as to whether a new allocation of SDRs would be called for at that time.

Table 1. Alternative Illustrative Distributions of the Overall Increase in Quotas (Fund of SDR 85 Billion)

(In per cent)

	Present quota shares (1)	Apportionment of overall increase into equiproportional/selective increases 75/25 (2)	66.7/33.3 (3)	50/50 (4)	40/60 (5)	33.3/66.7 (6)	30/70 (7)	0/100 (8)
1. Overall increase		39.3	39.3	39.3	39.3	39.3	39.3	39.3
Of which:								
Equiproportional increase, per cent of present quota 1/		29.4	26.2	19.6	15.7	13.1	11.8	--
Selective increase, per cent of of present quota 2/		9.8	13.1	19.6	23.6	26.2	27.5	39.3
2. *Adjustment coefficient 3/*	--	*7.0*	*9.4*	*14.1*	*16.9*	*18.8*	*19.7*	*28.2*
3. Distribution of shares (per cent of total)								
Industrial countries	61.3	61.7	61.8	62.0	62.2	62.3	62.3	62.8
Developing countries	38.7	38.3	38.2	38.0	37.8	37.7	37.7	37.2
Of which:								
Major oil-exporting countries	10.9	11.1	11.2	11.4	11.5	11.5	11.6	11.8
Non-oil developing countries	27.8	27.2	27.0	26.6	26.3	26.2	26.1	25.4

1/ The equiproportional increase plus the increase allocated to the member with the lowest ratio of calculated to present quota (Lao, P.D.R.) provide the smallest increase, in per cent of present quota, of 30.4, 27.4, 21.5, 18.0, 15.6, 14.5, and 3.8 per cent, respectively, in Cols. 2 through 8 in the table.

2/ The figure shown in this table is a weighted average for all members and is the same as the percentage ratio of the aggregate of selective increases to the total of present quotas. Selective increases, by definition, vary across members and are allocated in absolute terms in accordance with members' shares in the total of calculated quotas.

3/ This figure represents the percentage reduction for each member of the difference between its share in the total of present quotas and its share in calculated quotas. The adjustment coefficient is the same for each member and it measures the degree to which quota shares are adjusted to reflect members' relative economic positions as indicated by the calculated quotas. The degree of adjustment could also be expressed as a proportion of the maximum that can be effected, i.e., if the entire overall increase were distributed selectively (see footnote 2), in which case it would be identical with the apportionment of the overall increase into selective increases as indicated at the heading of the table.

Table 2. Alternative Illustrative Distributions of the Overall Increase in Quotas (Fund of SDR 90 Billion)

(In per cent)

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

1/ The equiproportional increase plus the increase allocated to the member with the lowest ratio of calculated to present quota (Lao, P.D.R.) provide the smallest increase, in per cent of present quota, of 36.7, 33.2, 26.0, 21.8, 18.9, 17.5, and 4.6 per cent, respectively, in Cols. 2 through 8 in the table.

2/ The figure shown in this table is a weighted average for all members and is the same as the percentage ratio of the aggregate of selective increases to the total of present quotas. Selective increases, by definition, vary across members and are allocated in absolute terms in accordance with members' shares in the total of calculated quotas.

3/ This figure represents the percentage reduction for each member of the difference between its share in the total of present quotas and its share in calculated quotas. The adjustment coefficient is the same for each member and it measures the degree to which quota shares are adjusted to reflect members' relative economic positions as indicated by the calculated quotas. The degree of adjustment could also be expressed as a proportion of the maximum that can be effected, i.e., if the entire overall increase were distributed selectively (see footnote 2), in which case it would be identical with the apportionment of the overall increase into selective increases as indicated at the heading of the table.

Table 3. Alternative Illustrative Distributions of the Overall Increase in Quotas (Fund of SDR 100 Billion)

(In per cent)

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

1/ The equiproportional increase plus the increase allocated to the member with the lowest ratio of calculated to present quota (Lao, P.D.R.) provide the smallest increase, in per cent of present quota, of 49.4, 44.6, 35.0, 29.3, 25.4, 23.5, and 6.2 per cent, respectively, in Cols. 2 through 8 in the table.

2/ The figure shown in this table is a weighted average for all members and is the same as the percentage ratio of the aggregate of selective increases to the total of present quotas. Selective increases, by definition, vary across members and are allocated in absolute terms in accordance with members' shares in the total of calculated quotas.

3/ This figure represents the percentage reduction for each member of the difference between its share in the total of present quotas and its share in calculated quotas. The adjustment coefficient is the same for each member and it measures the degree to which quota shares are adjusted to reflect members' relative economic positions as indicated by the calculated quotas. The degree of adjustment could also be expressed as a proportion of the maximum that can be effected, i.e., if the entire overall increase were distributed selectively (see footnote 2), in which case it would be identical with the apportionment of the overall increase into selective increases as indicated at the heading of the table.

Table 4. Alternative Illustrative Distributions of the Overall Increase in Quotas (Fund of SDR 125 Billion)

(In per cent)

	Present quota shares	Apportionment of overall increase into equiproportional/selective increases						
		75/25	66.7/33.3	50/50	40/60	33.3/66.7	30/70	0/100
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1. Overall increase		104.8	104.8	104.8	104.8	104.8	104.8	104.8
Of which:								
Equiproportional increase, per cent of present quota 1/		78.6	69.9	52.4	41.9	34.9	31.4	--
Selective increase, per cent of of present quota 2/		26.2	34.9	52.4	62.9	69.9	73.4	104.8
2. *Adjustment coefficient 3/*	--	*12.8*	*17.1*	*25.6*	*30.7*	*34.1*	*35.8*	*51.2*
3. Distribution of shares (per cent of total)								
Industrial countries	61.3	62.0	62.2	62.7	62.9	63.1	63.2	64.0
Developing countries	38.7	38.0	37.8	37.3	37.1	36.9	36.8	36.0
Of which:								
Major oil-exporting countries	10.9	11.3	11.5	11.8	11.9	12.0	12.1	12.6
Non-oil developing countries	27.8	26.7	26.3	25.6	25.2	24.9	24.7	23.4

1/ The equiproportional increase plus the increase allocated to the member with the lowest ratio of calculated to present quota (Lao, P.D.R.) provide the smallest increase, in per cent of present quota, of 81.1, 73.3, 57.5, 48.0, 41.7, 38.6, and 10.2 per cent, respectively, in Cols. 2 through 8 in the table.

2/ The figure shown in this table is a weighted average for all members and is the same as the percentage ratio of the aggregate of selective increases to the total of present quotas. Selective increases, by definition, vary across members and are allocated in absolute terms in accordance with members' shares in the total of calculated quotas.

3/ This figure represents the percentage reduction for each member of the difference between its share in the total of present quotas and its share in calculated quotas. The adjustment coefficient is the same for each member and it measures the degree to which quota shares are adjusted to reflect members' relative economic positions as indicated by the calculated quotas. The degree of adjustment could also be expressed as a proportion of the maximum that can be effected, i.e., if the entire overall increase were distributed selectively (see footnote 2), in which case it would be identical with the apportionment of the overall increase into selective increases as indicated at the heading of the table.

(pwp)

CONFIDENTIAL

FROM: A R H BOTTRILL
DATE: 11 JANUARY 1983

MR ATKINSON

cc Mr Kerr
Mr Littler
Mr Lavelle
Mr Carey
Mr Odling-Smee
Mr Peretz
Mr Turnbull
Mr Graham
Mr Horton

WP3/G10 DEPUTIES/G10 MINISTERS, 16-18 JANUARY

This is to confirm the briefing arrangements for this series of meetings.

WP3

2. The Working Party will have before it the two papers left over from December's cancelled meeting on:

'Balance of payments developments and possible external tensions' - CPE WP3(82)9; and

'Prospective financial flows to non-oil developing countries and related policy implications' - CPE WP3(82)10.

3. A short paper by the Secretariat based on the December Economic Outlook will also apparently be circulated at the meeting. I should be grateful if Mr Graham would revive and update the briefing prepared in December. I should also be grateful if Mr Peretz and Mr Turnbull would arrange to let me have some defensive material on recent movements in sterling and the reserves, and the implications for UK monetary policy/interest rates.

G10 Deputies/G10 Ministers

4. The G10 Deputies' agenda is confined to the GAB and the IMF Quota Review. G10 Ministers will also consider the world economic outlook. The briefing will need to cover both meetings, although

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Mr Littler will of course brief the Chancellor orally on the results of the Deputies' meeting. We shall need 'Points to Make' and background notes on each topic.

GAB

(i) Size: Deploy the arguments for SDR 20 billion.

(ii) Shares: Illustrative calculations for both SDR 15 billion and SDR 20 billion. UK position.

(iii) Denomination: SDRs.

(iv) Interest rates: Cost to UK if sterling used.

(v) Reserve tranche drawings.

(vi) Swiss status: New members - Australia? Austria?

(vii) Parallel lenders: Saudi attitude.

(viii) Second window: Conditions for activation.

Quota Review

(i) Size: G10 views. Margin for negotiation. US position.

(ii) Distribution: Ready reckoners for quota levels of 90, 92, 95, 100 with equiproportional/selective splits of 0, 25, 50, 75, 100.

(iii) Access: Not formally on the agenda but perhaps useful to co-ordinate G10 views in order to present as united a front as possible at the Interim Committee. Form and substance to be offered to LDCs.

(iv) Other considerations: An increase in basic votes is probably ruled out, but some guarantee on constituences may be needed.

(v) SDR allocation: This is not formally on the agenda but both the French and the Saudis have mentioned it, so the Chancellor may need a G10 steer for the Interim Committee.

5. Mr Lavelle is already preparing a record of the Saudi visit which the Chancellor can presumably use as the basis for his report to G10 colleagues. I should be grateful if Mr Atkinson and Mr Sheridan could take on the rest.

6. In addition to the formal sessions, the Chancellor is also to have bilaterals with M. Delors and Mr Takeshita, the Japanese Finance Minister. The object of the meeting with M. Delors will be to seek an understanding on what the G10 Ministers might try to set as their negotiating stance before the Interim Committee. The meeting with Mr Takeshita is to warn the Japanese not to rock the boat on distribution.

7. The Chancellor may also have a separate meeting with Mr Regan or with G5 colleagues to discuss world economic developments and, particularly, the US. Mr Graham is preparing a brief on the former and Mr Horton one on the latter.

8. Finally, I should be grateful if Mr Carey would consider whether there is any material the Chancellor should have on debt problems.

9. I should be grateful for contributions by lunchtime on Thursday, 13 January.

A Bottrill

A BOTTRILL

SECOND PERM SEC'S ... OVERSEAS FINANCE ...

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Mr Atkinson

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POSSIBLE SAUDI RELATIONSHIP WITH ENLARGED GAB

IN OUR DISCUSSIONS NEXT WEEK WE WILL NEED TO CONSIDER TOGETHER IN SOME DETAIL THE FORM THE INVOLVEMENT OF OTHERS WITH AN ENLARGED GAB MIGHT TAKE, PROBABLY FALLING SHORT OF FULL MEMBERSHIP.

2. DURING THE CHANCELLOR'S RECENT VISIT TO RIYADH WE FORMED THE IMPRESSION THAT, PROVIDED THEY WERE FULLY CONVINCED THAT THE BASIC ARRANGEMENTS WERE INDEED NON-DISCRIMINATORY, THE SAUDIS WOULD BE INTERESTED IN PARTICIPATION. THEY RECOGNISED THE DESIRABILITY OF REACHING A VIEW ON THE MATTER BY THE TIME OF THE INTERIM COMMITTEE AND WOULD BE PREPARED TO RECEIVE A DELEGATION TO TAKE MATTERS FORWARD AFTER OUR PARIS MEETING.

3. WHILE WE MADE CLEAR THAT WE HAD NO MANDATE TO NEGOTIATE IT WAS POSSIBLE TO GO SOME WAY TO CLARIFY THE AREAS OF SAUDI CONCERNS. THESE ARE SET OUT BELOW, IN BROADLY DESCENDING ORDER OF PRIORITY WITH A FEW COMMENTS. I COULD ELABORATE FURTHER IN OUR DISCUSSIONS, WHICH MAY NEED ALSO TO TAKE ACCOUNT OF OTHER POSSIBLE PROSPECTIVE PARTICIPANTS.

AREAS OF SAUDI CONCERN

(I) ADEQUATE GENERAL ARRANGEMENTS FOR PROVISION OF INFORMATION.

(II) ADEQUATE CONSULTATION ARRANGEMENTS.

(III) RIGHT TO WITHDRAW TOTALLY AND TO OPT OUT OF SPECIFIC CALLS.

(IV) RIGHT TO PARTICIPATE IN ANY VOTING ARRANGEMENTS WHEN CONTRIBUTORS.

(V) NO BAR ON CONTRIBUTIONS TO ANY CALL ON BEHALF OF G-10 COUNTRIES.

(VI) REASONABLE QUANTITATIVE BASIS FOR CONTRIBUTION.

(VII) INVOLVEMENT OF OTHERS IN PARTICIPATION ARRANGEMENTS.

COMMENTS

(I)-(III) OUR IMPRESSION IS THAT THESE WERE THE KEY POINTS. (I) REFLECTS A TRADITIONAL CONCERN TO BE AS WELL PLACED AS OTHERS IN DECISION-MAKING. UNDER (II) THEY DID NOT SPECIFICALLY SUGGEST SOME FORM OF JOINT CONSULTATION BUT THIS COULD BE RELEVANT. ONLY ONE NAME WAS MENTIONED UNDER (III). IN PRACTICE THERE ARE CERTAINLY MORE. THE SAUDIS WOULD STILL WISH TO BE CREDITED WITH A PRESUMPTION OF PARTICIPATION OTHER THAN AT TIMES OF BALANCE OF PAYMENTS DIFFICULTY.

(IV) THEY APPEARED TO SEE NO MAJOR ASSYMETRY BETWEEN (III) AND (IV) ALTHOUGH VOTING RIGHTS WERE DESCRIBED AS ''WINDOW-DRESSING''.

(V) IN DISCUSSION IT WAS NOT MADE CLEAR IF THEY CONTEMPLATED RECIPROCAL ARRANGEMENTS FOR CONTRIBUTIONS TO RESERVE TRANCHE DRAWINGS AS WELL AS CONDITIONAL BORROWINGS UNDER THE SECOND WINDOW.

(VI) THIS WAS NOT DISCUSSED IN DETAIL. WE GAVE A BROAD INDICATION OF THE INDICATORS THAT MIGHT BE TAKEN INTO ACCOUNT IN G-10 DISCUSSIONS.

(VII) WE ESTABLISHED THAT THEY WERE NOT THINKING SPECIFICALLY OF ARAB COUNTRIES. AUSTRALIA WAS MENTIONED, AND AUSTRIA, AS CONCEIVABLE OTHER CANDIDATES.

4. THIS TELEX IS BEING COPIED TO OTHER DEPUTIES OF G. 10.

KIND REGARDS

GEOFFREY LITTLER

25701 TRESOR B

262405 TRSY G

GR 400

CONFIDENTIAL

1. Mr Bottrill
2. Mr Lavelle.

CONFIDENTIAL
DESKBY 130900Z
FM UKDEL IMF/IBRD WASHINGTON 122352Z JAN 83
TO IMMEDIATE FCO
TELEGRAM NUMBER 17 OF 12 JANUARY

IMF: DRAFT REPORT--SIZE OF THE FUND

1. FOLLOWING TELCON LITTLER/ANSON, I HAD A NUMBER OF CONVERSATIONS WITH LASKE AND ALSO WITH DALLARA (US ALTERNATE EXECUTIVE DIRECTOR), WHO WAS IN TOUCH WITH SPRINKEL. THE UPSHOT WAS THAT THE THREE OF US AGREED ON A FORM OF WORDS WHICH DALLARA WOULD PROPOSE IN THE BOARD, WHICH WAS SUBSTANTIALLY THE SECOND INDENT IN THE REDRAFT BELOW.

2. IN THE BOARD, THERE WAS CONSIDERABLE DISCUSSION OF PARA. 7, WHICH WAS ULTIMATELY REDRAFTED AS FOLLOWS, (SUBJECT TO POSSIBLE MINOR EDITING):

BEGINS
IN THE LIGHT OF THESE CONSIDERATIONS, DIRECTORS' VIEWS ON THE SIZE OF THE OVERALL INCREASE, WHICH HAVE NARROWED CONSIDERABLY, IN A SPIRIT OF COMPROMISE, SINCE THE LAST MEETING OF THE COMMITTEE, MAY BE SUMMARISED AS FOLLOWS:
- MOST DIRECTORS BELIEVE THAT AN APPROXIMATE DOUBLING OF THE FUND'S QUOTAS, FROM THE PRESENT TOTAL OF SDR 61.1 BILLION TO SDR 125 BILLION, WOULD BE APPROPRIATE. SOME OF THESE DIRECTORS ARE OF THE VIEW THAT MORE THAN A DOUBLING OF PRESENT QUOTAS IS NEEDED. ALL OF THEM WERE HOWEVER PREPARED TO ACCEPT SDR 100 BILLION AS A MINIMUM.
- OTHER DIRECTORS INDICATED THAT THEY COULD SUPPORT AN OVERALL SIZE OF THE FUND THAT LIES WITHIN THE RANGE OF SDR 85 BILLION TO SDR 100 BILLION, A FEW OF WHOM BELIEVE THAN AN INCREASE IN QUOTAS OF 50 PER CENT TO THE ORDER OF SDR 90 BILLION IS A MINIMUM.
- BUT, IN THE COURSE OF DISCUSSION, MOST DIRECTORS HAVE INDICATED THAT AN INCREASE IN FUND QUOTAS TO SDR 100 BILLION WOULD BE ACCEPTABLE.

ENDS

3. COMMENT: THE FORMULATION PROPOSED BY DALLARA WAS SUBSTANTIALLY ACCEPTED, AND HE THANKED LASKE AND MYSELF AFTERWARDS FOR OUR SUPPORT. BOTH LASKE AND I HAD SUGGESTED THAT HE WOULD HAVE DONE BETTER TO INTRODUCE IT AT THE END OF THE PARAGRAPH, SO THAT THE PARAGRAPH WOULD HAVE PRESENTED A CONTINUOUS RANGE OF VIEWS. WE FELT THAT BY INTRODUCING IT IN THE MIDDLE OF THE PARAGRAPH, THE AMERICANS MAY TO SOME EXTENT HAVE KICKED THROUGH THEIR OWN GOAL, SINCE THE TOTAL EFFECT IS TO IMPLY A CONVERGENCE ON SDR 100 BILLION.

CONFIDENTIAL

HOWEVER

HOWEVER, DALLARA, WHO WAS VERY CLOSELY BOUND BY SPRINKEL'S INSTRUCTIONS, FELT THAT IT WAS NEVERTHELESS PREFERABLE TO PROPOSE THE ORDERING INDICATED ABOVE, AND THIS WAS ACCEPTED. THE FINAL RESULT IS SATISFACTORY FROM OUR OWN POINT OF VIEW.

4. THE DISCUSSION OF THE REPORT WAS BROKEN OFF THIS EVENING, AND THE REMAINDER WILL BE CONSIDERED TOMORROW.

5. FCO PLEASE ADVANCE TO LITTLER (TREASURY).

ANSON

ADVANCED AS REQUESTED

MONETARY
ERD

British Embassy
PARIS

JK

PWP

12 January 1983

EXCHEQUER
13 JAN 1983

13/1

Mr Lavelle

J O Kerr Esq
Principal Private Secretary
to the Chancellor of the Exchequer
HM Treasury

Dear John,

G10 : PARIS, 17/18 JANUARY

1. You and the copy addressees might find it helpful to have the enclosed note setting out where we have reached on next week's programme. A more detailed note will be handed to you on arrival.

2. In case you feel the need to send for re-inforcements, you will wish to know that Takeshita will be backed up at the bilateral by Watanabe, Vice-Minister for International Affairs, Gyoten, Assistant Director General for Monetary Affairs, Ida, Assistant to Watanabe and two others from the Finance Ministry called Izawi and Asami

3. The telephone number of the Kleber Centre, should your colleagues need to contact you direct, is 501.59.40.

Yours ever,
Philip

P J Hurr

cc: R N Springthorpe Esq
PS/Mr Littler

Miss M Abraham
PS/Governor
Bank of England

C Enoch Esq
PS/Deputy Governor
Bank of England

P Wright Esq
PS/Mr Loehnis

A Bottrill Esq, HM Treasury

R F Stone Esq, ERD, FCO

G10 MEETINGS, 17/18 JANUARY

(a) Outline Arrangements

Sunday 16 January

	Mr McMahon (Deputy Governor, Bank of England), Mr Loehnis (Bank of England) and Mr J G Littler (Second Permanent Secretary, HM Treasury) in Paris on OECD business (WP3).

Monday 17 January

0800	Bilateral Littler/Sprinkel (US) at Hotel Crillon.
1000 - 1800 (approx)	Meeting of G10 Deputies at the Kleber Centre attended by Messrs McMahon, Loehnis and Littler.
1730	Chancellor of the Exchequer with Private Secretary (Mr Kerr) and Governor of the Bank of England arrive Roissy.
1900 - 2000	Bilateral Chancellor of the Exchequer/ Japanese Finance Minister at HM Ambassador's Residence.

Tuesday 18 January

0830	Bilateral Chancellor of the Exchequer/ Delors at 93 rue de Rivoli. Chancellor accompanied by Messrs Littler and Kerr.
1000 - 1800	Meeting of G10 Finance Ministers and Central Bank Governors at the Kleber Centre. Lunch at the Kleber Centre.
PM	Governor of the Bank of England and Mr McMahon return to the UK.
2000	Dinner given by M Delors at 93 rue de Rivoli. Chancellor plus officials to attend.

Wednesday 19 January

0830	Chancellor and Mr Kerr return to London
0930	Mr Littler returns to London.

(b) Outline Accommodation Requirements

Night of 16 January

Nil. All visitors accommodated in hotels.

Night of 17 January

Chancellor, Governor, Messrs McMahon, Littler, Loehnis and Kerr at the Residence.

Night of 18 January

Chancellor, Messrs Littler, Kerr (? Loehnis) at the Residence.

(c) Possible Meal Requirements

Monday 17 January

Dinner for Chancellor, Governor, Messrs McMahon, Littler, Loehnis and Kerr plus two.

(?) Light refreshments for bilateral at 1900.

Tuesday 18 January

Breakfast for the six staying overnight.

Wednesday 19 January

Breakfast for Chancellor, Messrs Littler, Kerr (and Loehnis).

~~262405~~ TRSY G
MOF J24980

JANUARY 12 1983

SECOND PERM SEC'S OFFICE
OVERSEAS FINANCE SECTOR

ACTION

COPIES TO

Mr Lavelle
Mr Bottrill
Mr Atkinson

9/
\#.12.

MR. J.G. LITTLER
SECOND PERMANENT SECRETARY
TREASURY
LONDON, U.K.

DEAR MR. LITTLER:

LET ME CONGRATULATE ON YOUR RECENT APPOINTMENT TO SUCCEED SIR KENNETH COUZENS. I LOOK FORWARD TO WORKING WITH YOU CLOSELY.

1. IN A SERIES OF MEETINGS OF OUR SMALL GROUP LAST OCTOBER AND NOVEMBER IN WASHINGTON AND OUR MINISTERS' MEETING AT KRONBERG, WE HAVE MADE STRENUOUS EFFORTS TO CONVERGE OUR POSITIONS ON THE EIGHTH GENERAL REVIEW OF IMF QUOTAS.

IN THE LIGHT OF THE FINACIAL STRAINS CAUSED BY THE DEBT SITUATIONS IN SUCH LDCS AS SOME LATIN AMERICAN COUNTRIES, IT IS DESIRABLE TO REACH AN EARLY AGREEMENT ONTHE EIGHTH QUOTA INCREASE AND THE SPECIAL BORROWING ARRANGEMENT AND THEREBY STRENGTHEN THE MARKET CONFIDENCE. FROM SUCH A VIEWPOINT, JAPAN HAS BEEN COOPERATING IN AN ENDEACOR TO ADVANCE THE SCHEDULE OF THE NEXT INTERIM COMMITTEE MEETING AND TO MAKE IT SUCCESSFUL, BY GETTING ACTIVELY IN TOUCH WITH LDCS.

2. WHILE DIFFERENCES IN OUR VIEWS ON THE SIZE OF THE QUOTA INCREASE HAVE BEEN FAIRLY NARROWED AS A RESULT OF OUR DICUSSIONS IN THE PAST, WE ARE FAR FROM REACHING AN AGREEMENT WITH RESPECT TO THE METHOD OF DISTRIBUTION OF HE QUOTA INCERASE. IN PARTICULAR, I AM VERY MUCH WORRIED ABOUT THE RECENT DISCUSSIONS AT THE IMF EXECUTIVE BOARD WHERE THE ARGUMENTS FOR LESSER DEGREE OF ADJUSTMENT IN QUOTA SHARES TEND TO BE PRESENTED STRONGLY.

3. IN THE FACE OF THE PRESENT INTERNATIONAL FINANCIAL CONDITIONS, IT IS EXTREMELY IMPORTANT THAT MAJOR INDUSTRIAL COUNTRIES TAKE RESPONSIBLITIES IN ACCORDANCE WITH THEIR ECONOMIC REALITIES AND MAINTAIN CLOSE COOPERATIVE RELATIONSHIP AMONG THEM . I WOULD LIKE TO STRESS AGAIN, THEREFORE, THAT IT IS INDISPENSABLE FOR MEMBERS' QUOTA SHARES TO BE BROUGHT IN LINE WITH THEIR ECONOMIC REALITIES ON THIS OCCASION OF THE QUOTA REVIEW. AT THE TIME OF THE SEVENTH QUOTA REVIEW, IT WAS AGREED THAT ONE OF THE MAJOR PURPOSES OF THE EIGHTH QUOTA REVIEW WAS TO ADJUST MEMBERS' QUOTA SHARES TO REFLECT MEMBERS' RELATIVE ECONOMIC POSITIONS. IN ADDITION, IT HAS BEEN REPEATEDLY RE-AFFIRMED IN THE FOLLOWING MEETINGS OF THE INTERIM COMMITTEE.

4. SINCE THE FIFTH GENERAL REVIEW OF QUOTAS IN 1970, THE DIFFERENCE BETWEEN JAPAN'S CALCULATED QUOTA SHARE AND ITS ACTUAL QUOTA SHARE HAS PERSISTENTLY WIDENED. CURRENTLY, THE ACTUAL QUOTA SHARE OF JAPAN IS ONLY 56 PERCENT OF ITS CALCULATED QUOTA SHARE. THERE IS A STRONG ARGUMENT IN OUR COUNTRY THAT, UNDER SUCH CIRCUMSTANCES, JAPAN CANNOT BE SAID TO ENJOY AN EQUAL TREATMENT IN THE FUND. AT THE TIME OF THE SEVENTH QUOTA REVIEW, OUR DIET ADOPTED A SPECIAL RESOLUTION REQUESTING JAPANS'S QUOTA SHARE TO BE INCREASED TO REFLECT ITS ECONOMIC REALITY.

JAPAN HAS SO FAR CONTRIBUTED TO THE IMF'S BORROWING SCHEMES SUCH AS THE GAB, SFF AND EAR TO THE EXTENT FAR EXCEEDING ITS QUOTA SHARE. HOWEVER, IT HAS BECOME VERY DIFFICULT TO PURSUADE THE JAPANESE PEOPLE AND THE DIET TO GET ALONG WITH SUCH CON-TRIBUTIONS WHICH DO NOT RESULT IN AN INCREASE IN JAPAN'S QUOTA SHARE ITSELF

5. AT PRESENT, FAVORABLE CONSIDRATION HAS BEEN GIVEN TO METHOD 3, UNDER WHICH THE OVERALL INCREASE IS DISTRIBUTED ON THE BASIS OF EACH MEMBER'S CALCULATED QUOTA SHARE. NEVERTHELESS, METHOD 3, EVEN IN ITS PURE FORM, NAMELY WITHOUT EQUIPROPORTIONAL INCREASE, CAN REDUCE ONLY ONE THIRD OF THE DISPARITIES BETWEEN MEMBERS'CALCULATED AND ACTUAL QUOTA SHARES. IN OTHER WORDS, TWO THIRDS OF THE NEW QUOTA STRUCTURE WHOLLY DERIVES FROM THE PRESENT QUOTA STRUCTURE.'

I TRULY RECOGNIZE THE ARGUMENT FOR PAYING DUE CONSIDERATION TO THE PRESENT QUOTA STRUCTURE BY AVOIDING ABRUPT CHANGES IN QUOTA SHARES. HAWEVER, IT IS OF GREAT IMPORTANCE THAT THE IMF SHOULD ADJUST ITSELF ADEQUATELY TO CHANGES IN EONOMIC CIRCUMSTANCES AND CONTRIBURE EFFECTIVELY TO THE STABILITY OF THE INTERNATIONAL FINANCIAL SYSTEM.

ALTHOUGH METHOD 3, IN ITS PURE FORM, DOED NOT PROVIDE FOR A SUFFICIENT DIGREE OF SHARE ADJUSTMENT, WE HAVE DARED TO ACCEPT IT ON THE CONDITION THAT THE SIZE OF THE QUOTA INCERESE IS SUBSTANTIALLY LARGE, WITH A VIEW TO REACHING AND EARLY AGREEMENT ON THE EIGHTH QUOTA INCREASE. IT IS EXTREMELY DIFFICULT, THEREFORE, FOR THE DIET AND THE JAPANESE PEOPLE TO ACCEPT METHOD 3 WITH A LARGE EQUIPROPORTIONAL COMPONENT, WHICH MITIGATES THE DEGREE OF SHARE ADJUSTMENT ALL THE MORE.

6. IF MEMBER'S NEW QUOTA SHARES AFTER THE QUOTA INCREASE DO NOT SUFFICIENTLY REFLECT THEIR NEW ECONOMIC REALITIES BY PAYING TOO MUCH ATTENTION TO THE STABILITY OF THE PRESENT QUOTA STRUCTURE, I AM AFRAID THAT IT WOULD BRING ABOUT SERIOUS DISTURBANCES TO THE SYSTEM OF INTERNATIONAL FINANCIAL COOPERATION THROUGH THE IMF.

NAMELY, IT WOULD BECOME DIFFICULT FOR THE SURPLUS COUNTRIES TO PROVIDE THE IMF WITH NECESSARYRESOURCES AS EXPECTED, WHILE TOO MUCH OR TOO LITTLE FUND FINANCING COULD BE EXTENDED TO ITS MEMBERS. AS A RESULT, THE FUND WOULD BE LOSING ITS ABILITY TO COPE WITH CHANGES IN ECONOMIC AND FINANCIAL CONDITIONS.

7. I UNDERSTAND THAT THERE LIE COMPLEX FACTORS IN THE NEGOTIATION WITH THE LDC'S ON THE ISSUE OF THE DISTRIBUTION OF THE QUOTA INCREASE . HOWEVER, IN VIEW OF PROMOTING SMOOTHE FUNCTIONING OF INTERNATIONAL FINANCIAL COOPERATION THROUGH THE FUND, I WOULD APPRECIATE IT IF YOU FULLY UNDERSTAND AND GIVE CONSIDERATION TO OUR POSITION.

I WOULD LIKE TO HAVE AN OPPORTUNITY TO DISCUSS THE MATTER WITH YOU MORE THOROUGHLY WHEN WE WILL MEET NEXT WEEK.
MAY THE YEAR OF 1983 BE A FRUITFUL YEAR FOR YOU.

BEST PERSONAL REGARDS,

KIICHI WATANABE
VICE MINISTER FOR
INTERNATIONAL AFFAIRS
MINISTRY OF FINANCE
TOKYO, JAPAN

END
262405 TRSY G

CONFIDENTIAL

FROM: R.N. SPRINGTHORPE
DATE: 12 JANUARY, 1983

pwp

MISS RUTTER

cc Mr. Lavelle
Mr. Bottrill
Mr. Atkinson

G.10 - PARIS, 18 JANUARY

Mr. Jerry Newman at the US Embassy this evening telephoned to give me the following information, which he asked to be conveyed to the Chancellor.

2. Due to urgent budgetary issues arising in Washington on 19 January, Secretary Regan will be required to leave the G.10 meeting by 3.30 p.m. He (Regan) very much hopes that by then the main business will have been concluded. Mr. Volcker and Sprinkel will be staying on to attend the dinner.

3. Mr. Newman confirmed that other members of G.10 were being informed of Secretary Regan's early departure.

(R. N. SPRINGTHORPE)

CONFIDENTIAL

FROM: C J CAREY
DATE: 12 January 1983

MR BOTTRILL

cc Mr Kerr
Mr Littler
Mr Lavelle
Mr Odling-Smee
Mr Hawtin
Mr Peretz
Mr Turnbull
Mr Graham
Mr Horton

pup

WP3/G10 DEPUTIES/G10 MINISTERS, 16-18 JANUARY

On paragraph 8 of your note commissioning briefing for these meetings, it should not be necessary to offer the Chancellor any special or separate material on debt problems. The current preoccupation on this front is Yugoslavia. The Foreign Secretary is likely to be writing to the Chancellor within the next day or two, making new proposals about the UK line. This will need to be agreed between Ministers in time for the next meeting of creditor countries, which is due to take place in Berne on 18/19 January. There should be no need for G10 Ministers or Deputies to concern themselves with this matter.

2. At the moment it doesn't look as if the Chancellor will need any briefing on other debt situations (Mexico, Brazil etc) but if anything develops over the next few days which looks as if it might call for a brief we will of course supply.

CJC

(C J CAREY)

Second Permanent Secretary to the Treasury

MISS RUTTER

Draft of Telex reply attached.

The Bank of England have received a separate Telex, and will be replying shortly.

R.N. SPRINGTHORPE
13 January, 1983

Note

Said OK – Nigel Springthorpe will send

VR
13/1

CONFIDENTIAL

FROM: Chancellor's Office, HM Treasury, London.

TO: The Secretaries, c/o IMF, Office in Europe, Telex No.610712, Paris.

DATE: 13 January, 1983

GROUP OF TEN

Your Telex No.233 of 11 January refers.

The following will attend the January 17 and 18 Meetings:

Sir Geoffrey Howe
Mr. A.~~J.~~ R.H. Bottrill
Mr. M.A. Hall
Mr. J.O. Kerr
Mr. J.G. Littler

262405 TRSY G
OCDE A PARIS

TLX 233

FROM
OECD PARIS TELEX 620160 PARIS

TO
TE RT. HON. SIR G. HOWE, Q.C., M.P.

CHANCELLOR OF THE EXCHEQUER
H.M. TREASURY
LONDON

12 JAN 1983
ACTION: MR SPRINGTHORPE.
COPIES TO: Mr LITTLER
Mr Lavelle
Mr BOTTRILL.
6/12.

GROUP OF TEN
THE SECRETARIES

CONFIDENTIAL
JANUARY 11, 1983

NOTE FROM THE SECRETARIES

THE CHAIRMAN OF THE MINISTERS AND GOVERNORS OF THE GROUP OF TEN HAS ASKED US TO REQUEST YOU TO COMMUNICATE THE NAMES OF YOUR DELEGATES THAT WILL BE ATTENDING THE JANUARY 17 AND 18 MEETINGS, RESPECTIVELY, WITH A VIEW TO FACILITATE PRACTICAL ARRANGEMENTS.

COULD YOU KINDLY PROVIDE THIS INFORMATION TO THE SECRETARIES, C/O IMF, OFFICE IN EUROPE, TELEX NO. 610712, PARIS.

THE SECRETARIES

M. ATKINSON
DEVELOPECONOMIE

262405 TRSY G
OCDE A PARIS

pmp

OECD f'casts for Japan.

(1.) Exports to grow by 6 per cent in 1983, compared to 3 per cent for imports.

(2.) Current balance to increase to \$11 billion in 1983 and to more than \$20 bn annual rate by H1 1984.

(3.) General government deficit to fall from 3-3½ per cent of GDP in 1982 to 2-2½ per cent in 1983 – notwithstanding Yen 2 trillion package.

(4.) Japanese GDP to rise by 3½ per cent in 1983 of which 1 percent due to net externals demand.

– [illegible] / [illegible] / [illegible]

– [illegible] / IMF / C.I.O.

DO YOU WANT

TO COMMENT ON

ANY OF THIS?

– OR TONY?

NO. IT WOULD BE BETTER
NOT TO LABOUR THE POINT.
WE WANT THEIR HELP ON GAB
AND QUOTAS.

JOK:

Briefing NOT v. satisfactory in light of what I shall have to do. Particularly

(1) No steering note on how I report on my Saudi mission. Little telex to Dimi inadequate. Conflict between steering brief ("be careful not to rock Anglo-Saudi relations") + details main brief.

(2) No brief or steering note IMF/GAB matters for

talk to Japs (who' Watanabe's Telex to little Jacksonians problems)

(3) <u>No</u> briefing, stdy note for my talk with Delors

- Handling Interim
- Issues ..
- .. GAB
- Handling G.10
- Saudi pos.

Since RGL + JGL both in Paris (?) stay 1 more

Pup

FROM: A R H BOTTRILL
DATE: 13 JANUARY 1983

1. MR LITTLER 14/1
2. CHANCELLOR

cc Sir D Wass
Mr Carey
Mr Lavelle
Mr Hall
Mr Atkinson
Mr Graham
Mr Horton
Mr Anson - UKDEL/IMF
PS/Governor)
Deputy Governor) B/E
Mr Loehnis)
Mr Gilchrist)

G10 MINISTERS, G10 DEPUTIES AND WP3 - PARIS, 16-18 JANUARY

The Chancellor is attending the G10 Ministers' meeting in Paris on 18 January, accompanied by the Governor. This will be preceded by meetings of OECD's Working Party No 3 and G10 Deputies. This steering brief follows the order of the G10 Ministers' meeting agenda (Flag A).

2. The Chairman, M. Delors, has proposed an initial discussion of the world economy in the light of the latest OECD Economic Outlook and the WP3 discussion. The substantive IMF business of the meeting will be the discussion of the General Arrangements to Borrow and the Eighth Quota Review which will have been the subject of the G10 Deputies' meeting (agenda at Flag B). The Chancellor is also to have bilateral meetings with the Japanese Finance Minister and with M Delors. He has also indicated that he will seek to discuss US economic prospects with Mr Regan.

World economy

3. Discussion of the world economy is likely to centre on the modest prospects for recovery this year. Inflation has fallen more sharply than expected, but the OECD expects output growth in the major economies to pick up only gradually to an annual rate of about 3 per cent later this year. This would perhaps stop the rise in unemployment, but not reduce it.

4. The UK has taken the view that the prolonged nature of the recession has reflected largely the difficult adjustment process to lower inflation. The recent falls in both inflation and interest rates offer better prospects for recovery. It would be wrong to change policies radically now. Some flexibility in both monetary and fiscal policy, however, is perhaps justified as long as the medium-term counterinflationary thrust is maintained.

5. Discussion may also turn to recent exchange rate movements, particularly the depreciation of the dollar and corresponding rise in the yen and DM. These are in general a welcome adjustment to the overshooting of recent years. We are concerned, however, that the adjustment of exchange rates should be orderly. This re-emphasises the need for policy convergence among the major reserve currency countries. The Chancellor may wish here to mention recent developments in sterling.

6. The problems of developing countries and the difficulties of the international banking system may also be raised. Financial constraints on the LDCs have reflected partly the effects of the slowdown in OECD economies and partly loss of confidence by investors as a result of over-ambitious policies in the LDCs themselves. Recovery of the OECD economies and the putting in place of firm policies in the major LDC debtor countries should help to improve their situation. The LDCs and the banking system, however, could both remain convalescent for some time. A brief on the world economy is at Flag C.

US economy

7. The Chancellor has expressed interest in the US budget problem which is currently at a critical phase. We have, therefore looked carefully at US fiscal trends. The preparation of the 1984 budget - due to be published at the end of this month - is provoking lively debate and is the subject of numerous press leaks. The Administration seems to have revised down its short-term growth projections sharply and is doing is budget sums on a more realistic basis.

8. Significant spending cuts seem to be being sought and defence is no longer immune. A commitment to medium-term tax increases if the deficit does not fall is also apparently being considered. This last is perhaps a rather Augustinian approach to virtue but it at least recognises the need for a convincing medium-term fiscal strategy. Our own analysis of the likely trend in deficits to 1988 suggests that economies in defence and social spending or higher taxes may be essential if the deficit is to be reduced. A brief is at Flag D.

General Arrangements to Borrow

9. There is a strong case for the G10 agreeing now on both the size of an enlarged GAB and the shares that each is prepared to take in it. This would enable the industrial countries to present the Interim Committee with a firm commitment. It would help to head off any linkage between the size of the Eighth Quota increase and the GAB. It might also make it easier to keep any arrangements with other lenders (such as the Saudis) rather separate from the original GAB. It would be helpful, however, if the Executive Board were to settle before the Interim Committee probably the conditions under which GAB lending to the Fund through a 'second window' might be activated.

10. On size, we see a persuasive case for a figure at the top end of the SDR 15-20 billion range so far mentioned. This would be justified in terms of G10 potential needs, let alone additional calls for lending to non-members. On shares, we could accept a share of about 10 per cent but we should resist German and Japanese pressure to increase it much above that. There are a number of subsidiary issues such as SDR denomination of shares and a move to market-related interest rates which should cause us no difficulty.

11. A main focus of attention will be the conditions for activating GAB lending to the Fund through a new second 'window'. We are content that this should be decided by G10 members on a proposal from the Managing Director at times of threats to the stability of the international monetary system. Some LDCs,

however, want the Executive Board to take the decision. It would be helpful if G10 could agree a united front to have this settled before the Interim Committee. It would be helpful also if G10 could agree on provisions for deactivating calls on the second window.

SAUDI REPORT — Flag DD

12. The Chancellor's G10 colleagues will expect a report from him on his visit to Saudi Arabia. Mr Littler has already circulated a telex to G10 Deputies which records the Saudis' interest in being involved in GAB lending under either first or second windows in return for information, adequate consultation and voting power. The G10 will need to consider the relationship with the Saudis (and other potential lenders) carefully. We see a good case for the Saudis being associated with lending under the second window and of course being adequately consulted. We see less reason for their being admitted to full participation under the first window, which is designed to finance payments imbalances and adjustment among major industrial countries. It is also not difficult to envisage a situation in which the Saudis would find it politically difficult to participate in a particular operation.

13. Negotiations with the Saudis, therefore, could be tricky. The most satisfactory outcome would be to secure first Saudi agreement to the third SDR 4 billion SAMA loan to the Fund and then to suggest their participation under the second window. Only if the Saudis then pressed, would participation under the first window be considered - but we should want to look carefully at voting arrangements and the basis of Saudi commitment.

14. The UK line at G10 Deputies and Ministers, however, should take full account of the extreme sensitivity of UK - Saudi relations. This suggests that in reporting the Saudi visit we should limit ourselves to mentioning the wide range of options in which the Saudis expressed an interest. In general discussions of parallel lending, however, we should make clear that we do not share Dini's conclusion from the last G10 Deputies that parallel lenders should have the same access to GAB resources as participants. (A full GAB brief is at Flag E).

...

Eighth Quota Review

15. Our objective is to define the negotiating position of G10 countries for the Interim Committee. This does not imply a fixed position but an understanding perhaps on the margins for maneouvre. On size, the Fund's draft report for the Interim Committee suggests that most countries would find an increase in quotas to SDR 100 bn acceptable. Our own position is still that a minimum increase of 50 per cent, ie to SDR 92 bn is needed. Most G10 countries could probably accept SDR 90-100 bn. The sticking point is whether the US is ready to move up from SDR 85 bn. The Japanese are still keen on SDR 100 bn for distribution reasons. A brief is at Flag F.

16. On distribution, it now seems likely that Ministers will be presented at the Interim Committee with a single decision on what proportion of the quota increase to allocate equiproportionately and what selectively. LDCs typically favour a large equiproportional element which slows the decline in their quota share. Among G10, the Japanese are perhaps most anxious to limit the equiproportional element, although the Germans too, are anxious that if the selective element is small this time there should be further selective increases in the Ninth Review. This may provide the basis for a compromise. It fits with our own view that adherence to the 'Australian' distribution system over a series of reviews would lead to a gradual and orderly evaluation of quota shares to reflect relative economic positions. A brief is at Flag G, together with illustrative table.

17. There are a number of further issues connected with the Quota Review which may be mentioned, including the form of subscription of the reserve tranche, the possibility of basic votes or minimum quota increases, the revision of constituences and the question of access limits. There is unlikely to be time for detailed discussion of these.

18. Two points are worth noting. First, we should like reserve tranche subscriptions to be in SDRs or hard currencies. If this provokes calls for an SDR allocation, we should be prepared to

review it before the Annual Meeting. Second, we are not anxious to discuss access limits before or at the Interim Committee. They will need to be reviewed after the quota size and distribution is settled. Nevertheless, G10 may need to be ready to concede to LDCs at the Interim Committee at least a guarantee of no reduction in nominal access and possibly a modest increase for all. A brief
... is at Flag H. A background note on the Fund's liquidity position
... is at Flag J.

Bilateral meeting with Mr Takeshita

19. The Japanese have asked to see the Chancellor to state their case for a larger selective element in the quota increase. The Vice-Minister, Mr Watanabe, has sent us a telegram recording the
... Japanese concern (Flag K). Our own position is that we argued originally (with the Japanese in mind) for a pure Australian approach but there now seems substantial support both among industrial countries and LDCs for an equiproportional element.

20. We appreciate the need for adequate selective increases to reinforce the availability of resources from stronger countries to the Fund and this will be one of the arguments that will need to be put to the LDCs in limiting the equiproportional elment. We believe that the end result will need to be a compromise on both sides. It might be useful, however, to seek agreement that there should also be a selective element in the Ninth Review since one of the benefits of the Australian approach is that it should secure orderly adjustment of shares over time.

21. The Japanese may float the idea of a special quota increase for themselves after the Eighth Review is agreed. We would not encourage discussion at this stage for fear of jeopardising the review itself - but perhaps it could be raised in G5 after the review is settled.

Bilateral meeting with M. Delors

22. The Chancellor has asked to see M. Delors with a view to agreeing what objectives G10 Ministers should set themselves for the day. One potential problem is timetable. M. Delors has put the world economy at the head of the agenda and in a press conference yesterday he made great play with the need for reflationary

measures by those countries with a margin for maneouvre.

23. Discussion of this could be very time-consuming. Nevertheless, we shall want to leave time for Ministers to settle any points of contention on the GAB and Quota Review referred from the Deputies' meeting. In view of Mr Regan's need to leave in mid-afternoon, it would be a mistake to let the macroeconomic discussion last too long. We shall want to do our best to reach decisions on both the size and shares of the GAB, the relation with parallel lenders and the G10 negotiating position for the Interim Committee on the Quota Review.

Background material

24. A separate folder of background documents on both the GAB and the Quota Review is being prepared for the Chancellor and Mr Littler.

A Bottrill

A BOTTRILL

A.

13/1/83

262405 TRSY G
OCDE B PARIS

TLX 145

FROM
OECD PRIS TELEX 620160 PARIS

TO
THE RT. HON. SIR G. HOWE, Q.C., M.P.

Mr. Littler cc Mr Carey
Mr Lavelle
Mr Bottrill
Mr Atkinson
Mr J. Graham.

CHANCELLOR OF THE EXCHEQUER
H.M. TREASURY
LONDON

''

GROUPE DES DIX

CONFIDENTIEL

LE PRESIDENT DES MINISTRES
ET DES GOUVERNEURS

7 JANVIER 1983

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

LES MINISTRES ET GOUVERNEURS DU GROUPE DES DIX SONT CORDIALEMENT INVITES A SE REUNIR A PARIS LE MARDI 18 JANVIER 1983 AU CENTRE DE CONFERENCES INTERNATIONALES, 19 AVENUE KLEBER (PARIS 16EME).

LES FORMALITES D'ACCUEIL AURONT LIEU A PARTIR DE 10 HEURES. LA REUNION COMMENCERA A 10 HEURES 30, SERA SUSPENDUE A 13 HEURES ET REPRENDRA A 14 HEURES 30 POUR SE TERMINER A 18 HEURES.

L'ORDRE DU JOUR DE LA REUNION SERA LE SUIVANT (SOUS RESERVE DE PRECISIONS ET MODIFICATIONS QUI POURRAIENT ETRE APPORTEES A L'ISSUE DE LA REUNION DES SUPPLEANTS QUI SE TIENDRA A PARIS LE 17 JANVIER):

1. ADOPTION DE L'ORDRE DU JOUR

2. PERSPECTIVES ECONOMIQUES MONDIALES A LA LUMIERE DES DERNIERES PREVISIONS DE L'OCDE ET DES DISCUSSIONS DU GROUPE DE TRAVAIL NO. 3 (WP 3)

3. AUGMENTATION ET MODIFICAZIBN DES ACCORDS GENERAUX D'EMPRUNT

4. QUESTIONS LIEES A LA HUITIEME REVISION GENERALE DES QUOTES-PARTS DU FONDS MONETAIRE INTERNATIONAL (TAILLE, REPARTITION, SOUSCRIPTION, CALENDRIER)

5. AUTRES QUESTIONS EVENTUELLES

6. COMMUNIQUE DE PRESSE.

UN DEJEUNER SERA OFFERT AUX PARTICIPANTS A 13 HEURES DANS LES LOCAUX DU CENTRE DE CONFERENCES. PAR AILLEURS, JE SERAIS HEUREUX DE VOUS RECEVOIR A DINER A 20 HEURES, AVEC LES SUPPLEANTS DES MINISTRES, DANS L'HOTEL DU MINISTRE DE L'ECONOMIE ET DES FINANCES, 93 RUE DE RIVOLI.

JACQUES DELORS

''

M. ATKINSON
)EVELOPECONOMIE

262405 TRSY G
OCDE B PARIS

CHAIRMAN OF THE
DEPUTIES

JANUARY 7, 1983

(B)

13/1/83

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

THIS IS TO INFORM YOU THAT THE NEXT MEETING OF THE DEPUTIES OF THE GROUP OF TEN WILL TAKE PLACE AT THE INTERNATIONAL CONFERENCE CENTER, 19 AVENUE KLEBER, PARIS 16, ON MONDAY, JANUARY 17, 1983, BEGINNING AT 10 A.M. AND WILL BE DEVOTED TO THE PREPARATION OF THE FORTHCOMING MEETING OF THE GROUP OF TEN MINISTERS AND GOVERNORS. ACCORDINGLY, I WOULD LIKE TO PROPOSE THE FOLLOWING AGENDA:

1. APPROVAL OF THE AGENDA

2. REVISION AND ENLARGEMENT OF THE GENERAL ARRANGEMENTS TO BORROW

3. THE EIGHTH REVIEW OF QUOTAS OF THE IMF

   A. SIZE, DISTRIBUTION AND SUBSCRIPTION

   B. POLICIES ON THE USE OF FUND RESOURCES

4. OTHER BUSINESS

ARRANGEMENTS ARE KINDLY BEING MADE BY THE IMF FOR A WORKING LUNCHEON TO BE SERVED ON THE PREMISES OF THE CENTER.

KINDEST REGARDS,

LAMBERTO DINI

M. ATKINSON
DEVELOPECONOMIE

262405 TRSY G
OCDE A PARIS

13/1/83

WORLD ECONOMIC PROSPECTS

Points to make

(i) World economic activity has not yet shown convincing signs of a vigorous recovery. Growth prospects have been revised downwards, particularly in Europe and the US, as have prospects for world trade. But inflation has come down faster than expected.

(ii) 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 and the effects more severe. Financial strains on developing countries and their impact on trade have been greater than expected.

(iii) Latest OECD forecast still expects some recovery in the US throughout 1983 though the timing remains uncertain. Japan's growth rises this year based largely on domestic demand. Output in the European economies remains broadly flat lacking any strong recovery.

(iv) Essential to maintain firm medium-term economic policies and to resist calls for excessive reflation. Elusive recovery does however demand a careful analysis of economic developments and the impact of policies.

(v) For monetary policy this implies taking account of a wide range of factors when setting monetary targets. Welcome flexible US approach, but important that as economy recovers, monetary growth should be consistent with preventing renewed upsurge in inflation.

(vi) On fiscal policy important to distinguish between the structural and cyclical component of the deficit. Recession inevitably increases the cyclical component but firm action is required to reduce the structural deficit and put budget deficits on a continuing declining medium-term path. All countries have responsibility here, but US particularly important.

(vii) Recent fall in the dollar and appreciation of the yen and DM perhaps reflect unwinding of excessive swings in recent years. Gradual realignment needed so as not to destabilize the international financial system. Prospective current account imbalances, growing US deficit and Japanese surplus, may usher in further exchange rate volatility. Important, therefore, that countries should take account of international repercussions of their policies.

(viii) The international financial system remains fragile, though perhaps calmer than during the summer, and requires adherence to firm policies by the major reserve currency countries. It also requires adjustment on the part of major sovereign debtors together with the provision of adequate finance by the IMF and other financial institutions. Lower interest rates should ease debtors' problems.

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

Background

1. Real GNP growth in the industrial countries is estimated to have fallen slightly in 1982. The December OECD forecast sees output picking up during this year and growing by 2 per cent. The US, Germany and Canada all experienced a sharp fall in output last year while Japan achieved reasonable growth and output in Europe as a whole stagnated. Growth prospects have been revised down for this year with the US growing by perhaps 1½-2 per cent, Japan by 3½ per cent but little revival in Europe.

2. The protracted nature of the recession reflects poor real income growth, higher savings ratios, sluggish investment and continued stock adjustment to depressed levels of activity. The industrial world has also been affected in the past year by reduced demand from developing countries who have faced increasingly tight financial constraints. World trade fell last year for the first time since 1975. OECD predict a mild recovery in world trade this year.

3. Unemployment has continued to increase throughout the industrial world except Japan. The major economies now have an unemployment rate of over 8½ per cent with no early prospects of any reduction.

4. Inflation has come down much faster than expected as wage costs have moderated and import prices have remained weak. Consumer price inflation for the major countries has been halved, falling from 12 per cent on average in 1980 to 6 per cent for the 12 months to November 1982. A wide range however still exists with inflation in Italy at 16½ per cent compared to the 9-10 per cent in Canada and France, 6½ per cent in the UK, 4½ per cent in Germany and 2½ per cent in Japan.

5. The fall in inflation together with weak private credit demand has allowed some reduction in interest rates. Form their peak of 15-16 per cent during the summer three month money market rates in the US have fallen down to around 8½ per cent now, Elsewhere interest rates have also fallen but to a lesser extent. In Italy nominal rates remain near 20 per cent, against 12 per cent in France, 7 per cent in Japan and 6½ per cent in Germany.

6. The narrowing of the interest rate differential in favour of the US and large prospective US current deficits have contributed to exchange rate swings. Since November the dollar's effective rate has fallen by around 8 per cent, though the depreciation against the yen has been much greater at around 18 per cent. In effective terms the yen has appreciated by more than 10 per cent since last November. The DM has risen 2-3 per cent.

7. After moving towards rough current balance in 1981 the OECD is now forecasting a growing aggregate deficit for the major countries which is dominated by the prospective US deficit. The US deficit is expected to grow over the next 18 months reaching $45 billion, at an annual rate in the first half of 1984. In contrast, despite a minor deficit last November, the Japanese current account surplus is forecast to grow steadily to reach $20 billion at an annual rate by the start of 1984.

8. The task for policy is to ensure that a durable recovery is established without rekindling inflation. This implies probably some short-term flexibility in the operation of policies, particularly by those countries with room for maneouvre, but also a commitment to prudent medium-term strategy, particularly for those countries where structural budget problems could undermine the recovery.

9. The appropriate stance of monetary policy is proving difficult to assess, particularly in the US at a time of institutional change and changing liquidity demands. The Federal Reserve Board has suspended its M1 target and adopted a more flexible approach but some have argued its stance is now too lax. M2 growth accelerated at the end of 1982. The Fed is considering returning to the original targets for this year though no final decsion has been announced.

10. Monetary growth in Germany for 1982 remained within the 4-7 per cent target and this target is to be continued this year. In France monetary growth after being well above the 12½-13½ per cent target early last year has decelerated recently and the out-turn for 1982 may have been close to target. For this year France has adopted a tighter single figure target of 10 per cent. Canada has recently abondoned monetary targets but aims to keep its exchange rate closely in line with the US dollar.

11. The reduction of budget deficits has been hampered by the recession. The industrial economies' deficits have risen less from 2 per cent of GDP in 1979 to 4 per cent last year and may remain at that level during 1983. Only Japan and the UK have reduced their deficits although Germany has managed to offset much of the effects of recession by tight discretionary policies. Expansionary policies in France and particularly the US have contributed along with depressed activity to the overall increase in fiscal deficits.

12. The Japanese announced a Yen 2 trillion reflationary package in October, but the budget for fiscal 1983 (starting in April) still projects a reduction in the central government deficit compared to the likely fiscal 1982 out-turn. The US deficit

however is expected to increase this year and next despite the recovery in activity. The Administration's budget plans for FY 1984 are to be announced at the end of January. (See separate brief).

13/1/83

UNITED STATES ECONOMY

Points to make

(i) A durable recovery of the US economy without rekindling inflation is in the interests of the world as a whole.

(ii) Welcome marked reduction in US inflation over past year. This, together with decline in interest rates, should help to encourage recovery.

(iii) Important that policies should be both flexible but prudent at this stage.

(iv) Welcome flexibility of Federal Reserve's approach to monetary targets. Need to take account of wide range of factors. Important, however, as economy recovers that monetary growth should be kept within prudent limits.

(v) Acknowledge Administration's commitment to reduce the budget deficit in the medium-term and that part of current increase reflects recession. Essential, however, that deficit is put on a convincing declining path if interest rates and inflation are not to rise again as the economy recovers.

(vi) Our own analysis suggests that even with recovery in the economy, growth in spending on defence and social programmes when coupled with the effects of recent changes in the tax structure could still leave the deficit uncomfortably high.

(vii) Have read Press reports that Administration is now basing budget decisions on rather cautious assessment of growth prospects, that sizeable spending cuts (including defence) are being considered and that a provision for higher taxes is possible if the deficit does not fall below 2 per cent of GDP in the medium-term. Choice of measures obviously a matter for the Administration but moves in these directions could be helpful.

(viii) US monetary and fiscal policies relevant not only to progress on inflation and recovery of output but also to stability of international financial and trading system.

(ix) Depreciation of US dollar as US interest rates have declined has perhaps helped unwind some of excess movements of past two years. Should help to curb protectionist pressures in US. Important, however, that adjustment of dollar exchange rate should remain orderly. Implies need for Administration to have a care for the exchange rate in setting monetary and fiscal policies.

/Background

Background

According to the "flash forecast" which is prepared on the basis of 2 months' figures United States GNP fell back in the fourth quarter. There was little growth during the earlier part of 1982 so output is now at about the same level as in the first quarter, 2 per cent below the 1981 average. Industrial production was still falling in November and was 12 per cent below its July 1981 peak.

2. The 12-month inflation rate fell to 4.6 per cent in November largely because the shelter (housing) index which accounts for a third of the total fell with the cut in interest rates.

The outlook

3. Most forecasters expect a recovery to begin during the course of 1983 as housebuilding picks up, stocks stop falling and consumption begins to rise faster. Our own forecast for GNP growth in the US in 1983 is only 1.3 per cent (although other forecasters are slightly higher) and the US Administration is said in the Wall Street Journal of 6 January to be predicting 1.4 per cent. Both these forecasts imply that GNP in fiscal 1983, which started in October, will be less than ½ per cent higher than in fiscal 1982.

4. The Administration is also said to assume that growth from 1983 to 1988 averages 4 per cent a year. This performance over 5 years would be better than at anytime since the early 1960s and we expect a slightly lower outcome of 3½ per cent.

5. Neither we nor the Administration, as reported in the Wall Street Journal, expect inflation to fall much further in 1983. The continuing impact of lower interest rates is likely to take the 12-month increase in the consumer price index down below 4 per cent in the middle of the year but this index is somewhat misleading and will not be published after this month. Underlying inflation is likely to be 4½-5 per cent in 1983. The Administration apparently expects it to fall a little further in later years, but we expect it to rise slightly.

6. There are 3 reasons for believing that inflation will stop falling and may well rise again. As the recovery gets under way earnings growth will probably stop falling and may rise again: the world recovery will bring an end to the fall in non-oil commodity prices; a continuing fall in the dollar will raise the price of US imports, now an eighth of GNP, more than those of other countries.

7. The dollar has fallen about 8 per cent in the last two months in effective terms. A fall was expected after the decline in US interest rates and the move into substantial current account deficit in the third quarter of last year but was probably delayed because uncertainty about financial markets drove investors towards well-regulated US markets. Along with other forecasters, including the Administration, we expect a large current account deficit this year of almost $40 billion, equivalent to 1¼ per cent of GDP, and a deficit of a similar size in 1984. These are larger than the ¾ per cent of GDP deficits recorded in 1977 and 1978 when the dollar fell almost 15 per cent. They also come after a dollar rise of over 30 per cent in the last 2 years. We expect the dollar to continue to fall by as much as a further 15-20 per cent in the next 2 years or so.

Monetary policy

8. In spite of somewhat half-hearted statements to the contrary monetary policy has been changed since October last year to a less restrictive stance. The most closely watched aggregate, M1, was said to be affected by 3 distortions: money from maturing savers' certificates was being temporarily parked in bank accounts, new interest-bearing cheque accounts were being introduced, and general uncertainty was causing more of wealth to be held as money. The Federal Reserve therefore said it would pay less attention to M1 and more to M2 and set new, higher M2 targets for the last part of the year.

9. M1 now looks as if it will have grown 8½ per cent during 1982 instead of the 2½-5½ per cent target range and the November M2 figures were above both old and new targets. These two aggregates, together with M3, were a little outside their target ranges

before the relaxation and before the distortions took effect. Some leading analysts attribute all the increase in monetary growth to increases in the Fed's provision of reserves to the banking system in order to accommodate the greater demand for liquid balances. This behaviour contrasts with that in 1981 when distortions increasing M1 growth by 4 per cent (the growth of NOW accounts) were not accommodated and so monetary policy was much more restrictive than the unadjusted figures suggest.

Fiscal policy

10. After the large deficits of the second world war the Federal government oscillated between surplus and deficit in the 1950s and 1960s with largest deficits a little over 2 per cent of GNP in a calendar year. In the 1970s the oscillations have continued but with a slightly higher average deficit so that there has been a deficit every fiscal year, although not in every calendar year. It seems likely on current policy, however, that the 1980s will see a large increase in the average level of the deficit.

11. During the 1970s defence spending fell after the end of the Vietnam war. Much of this fall was matched by a growth in transfer payments over and above the growth of social security contributions. During the 1970s the number of recipients of social security and other retirement and disability benefits (two-thirds of transfer payments) rose by 40 per cent while the number of recipients of medicare (half the remainder) doubled. The real value of social security benefits rose on average by 1 per cent a year but almost all the rise occurred at the beginning of the decade.

Percentage of GNP	Personal taxation	Transfer payments	Total defence spending
1970	9.7	5.9	8.1
1979	9.4	8.5	5.0

12. As the table below shows the last few years have seen a substantial rise in defence spending and in transfer payments while personal taxation has been held down by the recession and by conscious attempts to offset the effects of fiscal drag by tax cuts.

The increase in the deficit so far has not been much larger than that in the mid-70s and the OECD calculates that changes in revenue and expenditure as a result of the recession account for most of the rise since 1979.

Percentage of GNP, fiscal years

	1970	1971	1972	1973	1974	1975	1976	1977
Federal surplus	-0.1	-2.0	-1.7	-1.2	-0.5	-3.1	-3.4	-2.5

					WEP estimates(incl defence cuts)						
	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Federal surplus	-1.7	-0.6	-2.0	-1.9	-3.9	-4.6	-4.5	-4.8	-4.5	-4.3	-4.2
Personal taxes	8.9	9.4	9.7	10.1	9.7	9.2	9.0	9.0	9.0	9.0	9.0
Social security payments	6.4	6.5	6.7	6.8	6.9	7.1	7.2	7.4	7.5	7.7	7.8
Defence spending on goods/services	4.7	4.5	4.9	5.1	5.5	5.9	5.8	5.9	5.8	5.7	5.7
Transfer payments	8.7	8.5	9.3	9.7	10.2	10.8	10.8	10.8	10.7	10.6	10.5
Interest payments	1.6	1.7	2.0	2.3	2.6	2.7	2.9	3.2	3.3	3.5	3.6

13. The disturbing feature is that, even under fairly favourable assumptions a recovery does not seem likely to reduce the deficit given current policy. Most of the improvement in the table above is the result of assumed policy changes on social security contributions.

14. Our, necessarily rather crude, calculations in the table above illustrate why the deficit does not decline in the recovery.

The effects of the tax cuts which are coming through now and will still be felt next year are compensating for past fiscal drag which has concealed the underlying size of the deficit in the recent past. Transfer payments are not likely to decline significantly as a proportion of GNP because a continuing increase in the number of recipients counterbalances the effects of recovery. The upward underlying trend continues and is not matched by a declining trend in defence but, on the contrary, the rise in spending is maintained. In addition, with no very substantial further falls in interest rates in prospect, the continuing large deficits raise the size of the public debt and so interest payments, although the rate of increase slows as debt rises to a new equilibrium consistent with 4 per cent GNP budget deficits.

15. The sums of money needed to change the situation are large. The deficit we expect for this year is $150 billion rising to $220 billion by 1988 and these estimates are below others available, including some which appear to be originating from the Administration itself. The Reagan corporate and personal tax cuts are worth $95 billion this year and $150 billion in fiscal 1984, but had they not been introduced, personal taxation would have been 12 per cent of GNP next year and activity would have been lower. The entire 1983 defence budget is, at rather over $200 billion dollars, about the same size as some estimates of the deficit.

16. The fundamental problem is that the rise in the number of elderly, a growing trend towards early retirement and an increase in the number of single parent families has been accommodated in the past largely by a falling share for defence. The rise is still continuing but the defence share has increased instead of falling leaving a gap of well over 2 per cent of GNP to be financed mainly by higher taxes, lower levels of benefits and abandoning defence goals. Shared out equally, the first round effects would be to reduce real personal disposable income by more than 1 per cent, the level of benefits by over 7 per cent, and the defence budget by 12 per cent.

17. It is clear from press reports that difficult choices are being considered. Spending cuts of up to $30 billion next year (including $12 billion defence savings) have been mooted together with further energy tax increases. There are also reports of a conditional tax increase which would take place in fiscal 1986 if the projected deficit was over 2 per cent of GNP (or about $100 billion). The whole social security problem is being considered by a commission under ex-Council of Economic Advisers Chairman, Alan Greenspan, which is due to report on 15 January. Members of the commission have been unable to reach agreement and their request for a political steer from the President and the Speaker of the House of Representatives did not elicit a reply.

RESTRICTED

FROM: R.N. SPRINGTHORPE
DATE: 14 JANUARY, 1983

c. This was your plan. JPM. 14/1.

Remind

MISS RUTTER

VISIT OF MONSIEUR CHEYSSON

Philip Hurr in our Paris Embassy has mentioned that it would be courteous if, in the margins of next week's G10, the Chancellor was able to mention to M. Delors that he will be meeting with Cheysson on 1st February. The point here is the rather obvious one that our usual contact is with the French Finance Ministry.

(R. N. SPRINGTHORPE)

ICMS/Doc/83/2

January 14, 1983

To: Members and Associates of the Interim Committee

From: The Secretary

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

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

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

Att: (1)

INTERNATIONAL MONETARY FUND

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

January 14, 1983

I. Introduction

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

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

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

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

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

II. Size of the Overall Increase

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

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

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

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

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

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

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

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

III. Distribution of Overall Increase

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

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

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

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

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

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

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

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

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

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

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

IV. Payment for Increases in Quotas

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

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

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

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

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

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

* * * * * * * *

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

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

(In per cent)

	Present quota shares (1)	Illustrative apportionment of overall increase into equiproportional/selective increases							
		75/25 (2)	66.7/33.3 (3)	50/50 (4)	40/60 (5)	33.3/66.7 (6)	30/70 (7)	20/80 (8)	0/100 (9)
1. Overall increase		39.3	39.3	39.3	39.3	39.3	39.3	39.3	39.3
Of which:									
Equiproportional increase, per cent of present quota 1/		29.4 *(30.4)*	26.2 *(27.4)*	19.6 *(21.5)*	15.7 *(18.0)*	13.1 *(15.6)*	11.8 *(14.5)*	7.9 *(10.9)*	— *(3.8)*
Selective increase, per cent of present quota 2/		9.8	13.1	19.6	23.6	26.2	27.5	31.4	39.3
2. *Adjustment coefficient 3/*		*7.0*	*9.4*	*14.1*	*16.9*	*18.8*	*19.7*	*22.6*	*28.2*
3. Distribution of shares (per cent of total)									
Industrial countries	61.3	61.7	61.8	62.0	62.2	62.3	62.3	62.5	62.8
Developing countries	38.7	38.3	38.2	38.0	37.8	37.7	37.7	37.5	37.2
Of which:									
Major oil-exporting countries	10.9	11.1	11.2	11.4	11.5	11.5	11.6	11.7	11.8
Non-oil developing countries	27.8	27.2	27.0	26.6	26.3	26.2	26.1	25.9	25.4

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

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

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

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

(In per cent)

	Present quota shares (1)	Illustrative apportionment of overall increase into equiproportional/selective increases 75/25 (2)	66.7/33.3 (3)	50/50 (4)	40/60 (5)	33.3/66.7 (6)	30/70 (7)	20/80 (8)	0/100 (9)
1. Overall increase		47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5
Of which:									
Equiproportional increase, per cent of present quota 1/		35.6 (36.7)	31.6 (33.2)	23.7 (26.0)	19.0 (21.8)	15.8 (18.9)	14.2 (17.5)	9.5 (13.2)	— (4.6)
Selective increase, per cent of present quota 2/		11.9	15.8	23.7	28.5	31.6	33.2	38.0	47.5
2. *Adjustment coefficient 3/*		*8.0*	*10.7*	*16.1*	*19.3*	*21.5*	*22.5*	*25.7*	*32.2*
3. Distribution of shares (per cent of total)									
Industrial countries	61.3	61.7	61.9	62.1	62.3	62.4	62.5	62.7	63.0
Developing countries	38.7	38.3	38.1	37.9	37.7	37.6	37.5	37.3	37.0
Of which: Major oil-exporting countries	10.9	11.2	11.3	11.4	11.5	11.6	11.7	11.8	12.0
Non-oil developing countries	27.8	27.1	26.9	26.4	26.1	25.9	25.9	25.6	25.0

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

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

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

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

(In per cent)

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

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

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

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

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

(In per cent)

	Present quota shares (1)	Illustrative apportionment of overall increase into equiproportional/selective increases: 75/25 (2)	66.7/33.3 (3)	50/50 (4)	40/60 (5)	33.3/66.7 (6)	30/70 (7)	20/80 (8)	0/100 (9)
1. Overall increase		104.8	104.8	104.8	104.8	104.8	104.8	104.8	104.8
Of which:									
Equiproportional increase, cent of present quota 1/		78.6	69.9	52.4	41.9	34.9	31.4	21.0	---
		(81.1)	*(73.3)*	*(57.5)*	*(48.0)*	*(41.7)*	*(38.6)*	*(29.1)*	*(10.2)*
Selective increase, per cent of present quota 2/		26.2	34.9	52.4	62.9	69.9	73.4	83.8	104.8
2. *Adjustment coefficient 3/*		*12.8*	*17.1*	*25.6*	*30.7*	*34.1*	*35.8*	*40.9*	*51.2*
3. Distribution of shares (per cent of total)									
Industrial countries	61.3	62.0	62.2	62.7	62.9	63.1	63.2	63.5	64.0
Developing countries	38.7	38.0	37.8	37.3	37.1	36.9	36.8	36.5	36.0
Of which: Major oil-exporting countries	10.9	11.3	11.5	11.8	11.9	12.0	12.1	12.3	12.6
Non-oil developing countries	27.8	26.7	26.3	25.6	25.2	24.9	24.7	24.3	23.4

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

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

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

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TO PRIORITY FCO

TELEGRAM NUMBER 36 OF 14 JANUARY

INFO SAVING LILLE BORDEUAX LYON MARSEILPE

FRANCE : INTEREST RATES ON SAVINGS ACCOUNTS

SUMMARY

1. PRIME MINISTER MAUROY'S ANNOUNCEMENT YESTERDAY THAT HE WOULD NOT FOR THE TIME BEING SIGN THE DECREE TO IMPLEMENT A PROPOSAL PUT FORWARD BY THE MINISTER OF FINANCE TO LOWER THE INTEREST RATE ON BANK SAVINGS ACCOUNTS HAS BEEN WIDELY INTERPRETED AS A DISAVOWAL OF DELORS. MAUROY'S DECISION HAS CLEARLY BEEN TAKEN ON DOMESTIC POLITICAL GROUNDS UNDER PRESSURE FROM THE SOCIALIST AND COMMUNIST PARTIES. IT HAS ONCE AGAIN EXPOSED THE MITTERAND GOVERNMENT TO CARGES OF INCONSISTENCY IN ITS DECISION MAKING.

DETAIL

2. REPORTS THAT DELORS INTENDED TO REDUCE INTEREST RATES ON BANK SAVING ACCOUNTS FIRST LEAKED AT THE BEGINNING OF JANUARY. DELORS CONFIRMED BEFORE AN AUDIENCE OF BUSNESSMEN ON 6 JANUARY HIS INTENTION TO REDUCE THE INTEREST PAYABLE ON THE PRINCIPAL SAVINGS ACCOUNTS (THE LIVRETS) FROM 8.5 TO 7.5 PER CENT. HE JUSTIFIED THIS BY REFERENCE TO THE SUCCESS OF THE WAGES AND PRICES FREEZE IN BRINGING DOWN INFLATION AND THE NEED TO GIVE THE GOVERNMENT ROOM TO REDUCE THE COST OF BORROWING BY INDUSTRY. INDEED IT WAS PART OF A PACKAGE DESIGNED TO DO THAT. (GARSIDE'S LETTER TO INGRAM, DOI OF 12 JANUARY). SOCIALIST AND COMMUNIST PARTY LEADERS SAW MATTERS DIFFERENTLY. THEY REGARDED THE REDUCTION IN INTEREST RATES PAYABLE TO SMALL SAVERS IN THE RUN UP TO THE MARCH MUNICIPAL ELECTIONS AS A MAJOR POLITICAL GAFFE. MITTERAND, WHO IS SAID TO HAVE LEARNT OF THE PROPOSAL FROM THE RADIO, ALSO APPEARS TO HAVE BEEN DEEPLY DISPLEASED. MAUROY HAS THEREFORE DECIDED THAT THE REDUCTION IN INTEREST RATES SHOULD NOT TAKE EFFECT PENDING FURTHER STUDIES.

3. THIS AFFAIR IS A DAMAGING INSTANCE OF GOVERNMENT IRRESOLUTION IN THE CONDUCT OF ITS ECONOMIC POLICY. BY BACKING DOWN IN THE FACE OF DOMESTIC POLITICAL PRESSURES, THE GOVERNMENT RISKS FURTHER UNDERMINING THE CREDIBILITY OF ITS PROCLAIMED READINESS TO ACCEPT POLITICAL SACRIFICES TO IMPLEMENT ITS ECONOMIC POLICIES. SINCE LAST SUMMER MAUROY AND DELORS HAVE WORKED CLOSELY TOGETHER TO PROMOTE THE GOVERNMENT'S NEW ECONOMIC STRATEGY. MAUROY'S DECISION NOT TO BACK DELORS ON THIS OCCASION SUGGESTS THAT THE MINISTER OF FINANCE CAN NO LONGER COUNT SO FIRMLY ON THE PRIME MINISTER'S SUPPORT.

FRETWELL

THIS TELEGRAM WAS NOT ADVANCED

FINANCIAL

WED

CONFIDENTIAL

H. M. TREASURY

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17 January 1983

MEETING OF GROUP OF 10 FINANCE MINISTERS IN PARIS: 18 JANUARY

The Chancellor of the Exchequer, Sir Geoffrey Howe, QC, MP, will be leaving this afternoon for Paris. He will tomorrow be attending the meeting of the Group of 10 industrialised countries' Finance Ministers at the Kleber Centre in Paris. This will be a preparatory meeting for the next Interim Committee of the International Monetary Fund, now to be held in Washington on 10 and 11 February. The main item on the agenda at the Paris meeting will be proposals to enlarge the resources available to the IMF under the General Arrangements to Borrow.

The Chancellor plans to return to London on Wednesday morning.

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13/83

NOTES TO EDITORS

1. The Group of 10 countries are as follows: USA, UK, West Germany, France, Japan, Italy, Canada, Belgium, Holland and Sweden. Switzerland is also associated with the General Arrangements to Borrow under separate bilateral understandings.

2. The Chancellor will be accompanied by Treasury officials, including his Press Secretary, Martin Hall, who will be contactable either at the Kleber Centre or through the Information Section of the British Embassy in Paris (Tel. No: 266 9142.)

FROM: R G LAVELLE
17 January 1983

CHANCELLOR ←

cc Mr Kerr (+2)
Mr Atkinson

G-10: SPEAKING NOTES

I attach as requested speaking notes/additional material on which you may like to draw in:

(i) reporting on the Saudi visit;

(ii) your bilateral with the Japanese;

(iii) your bilateral with M. Delors.

2. The notes at (i) may well need some amendment or qualification in the light of the Deputies' discussion today. You will doubtless also wish to check (iii) with Mr Littler against later developments.

R G LAVELLE

ANNEX A

VISIT TO SAUDI ARABIA

Points to make: general

May be helpful to report briefly on visit. Saudi voice very influential. Important that part they play in G-24 constructive. Found that on main issues Saudi views were thoughtful, moderate and co-operative. They favoured the acceleration of the Interim Committee meeting which has now been announced.

On quotas, they emphasise their concern that this should remain the main source of Fund resources. They believed that a Fund of SDR 100 billion would be regarded as a minimum by most developing countries. For their part they would settle in the area SDR 90-100 billion, and even if necessary at the lower end of this bracket.

On distribution the Saudis could accept the generally agreed basic method (commonly called Method 3). They would see merit in an equiproportional distribution of 50 per cent. They recognised that this outcome might be thought to represent a less significant move towards calculated quotas than might be desired, and that even a 40 per cent equiproportional element would yield an average increase for all of some 22 per cent.

They expressed some concern about the question of an SDR allocation. They set this against the background of some

possible developing country dissatisfaction with the remainder of the package, but perhaps more persuasively suggested that the issues had changed since previous examination given the fall in inflation and the decrease in world liquidity. In their view might open the way to (say) a one year allocation. They accepted that this would be not an issue for settlement at the present meeting but saw merit in some sympathetic reference to its examination with a view to decision at the time of the Annual Meeting.

On other matters, they did not press views on access. I am not sure how representative or briefed they were on the question. But they seemed not to find unsatisfactory the concept that this issue should be remitted to the Executive Board.

Points to make: GAB

I think it would be a matter of common agreement amongst us that some form of Saudi participation would be desirable not only to add to Fund resources but as further evidence of political cohesion within the international financial community.

In this area I thought it useful first to reinforce the process of exposition and education which M Delors undertook before Christmas in relation to the general objectives of the new GAB arrangements. Some concerns seemed to remain in their minds, given the relatively short time they had had

to digest the proposals, about the possibility that they might involve some form of discrimination or variation in conditionality arrangements: and that there might be some trade-off with quotas. I believe that between us the Managing Director and myself were able to bring them to recognise, subject to some final process of reflection, that these fears were without foundation: and in particular that the arrangements in no sense were "degrading" to smaller countries.

Turning to the detail of participation, my impression was that in principle they would like to participate and they recognised the desirability of reaching a decision on the issue by the time of our next meeting, recognising that this might be in February. Given their relatively recent exposure to the subject, and indeed the stage reached in our own consideration of some of the detail, they felt it would not be easy for them to express more than some first reactions. They contemplated the possibility of an early second round of talks.

Our Deputies will have been discussing some of these issues and /I look forward to hearing a little later how they have got on7.

My own broad impressions of their approach were as follows. First - and I think this is a traditional anxiety they hold, given their sense of representing in some sense a natural mediator - they wished to be as closely informed as possible

on the factors leading to a decision to activate a new facility, and probably look for something like parity of consultation arrangements with G-10 countries. This seems an understandable concern and one we should wish to respect.

As regards the form of participation in more detail, they wished the arrangements to allow for both total withdrawal - which is a basic right for any member no doubt - but also freedom to not be associated with individual calls on some occasions. However they did not wish "discrimination" to be a feature of the arrangements and indeed made the point that they would wish to be able to lend to founder members themselves. Notwithstanding the need for freedom, they saw some presentational merit in domestic terms in participation in voting arrangements where they did contribute, although this was not perhaps a major priority for them.

As regards <u>contribution</u>, we did not discuss the matter in detail and indeed there remains some progress required in securing their acceptance that a distinction should be drawn between the arrangements for current financing (the third tranche) on the one hand, and participation in a new facility on the other. Given the stage reached in our own discussions we could only give a broad indication of the indicators that might be taken into account and said that these would themselves be the subject of judgment amongst us. Subject to that the order of magnitude of possible contribution that they may have in mind might be some SDR 2 billion. But it is really too early to say anything here.

ANNEX 17/1/83

GENERAL ARRANGEMENTS TO BORROW

Summary

We want

a. A large GAB - SDR 20 bn if possible, with additional contribution from the Swiss.

b. To contribute no more than a reasonable 10%

c. The GAB to continue as it is in normal circumstances, with the following technical changes:

i. Contributions to be SDR-denominated;

ii. Contributions to carry a market-related interest rate;

iii. Where GAB is used to finance reserve tranche drawings, GAB should be repaid progressively as tranche is reconstituted and not in one sum at the end of five years.

d. A second window for on-lending to LDCs in crisis conditions.

e. Saudis and other parallel lenders (Kuwait?, Emirates?) to be associated with the second window, but not with the normal operations of the GAB.

Points to Make

1. The enlargement and reform of the GAB has been discussed intensively over last month, both in G10 and in Executive Board. Executive Board discussion has thrown up divergent G10 views on some key issues, particularly on relationship with parallel lenders. These now need further consideration, taking into account also the views expressed us by the Saudis. Desirable to reach conclusion on

this by the time of Interim Committee. Even more important to reach view by then on size of GAB and conditions for activating the second window.

2. On size, we favour an increase to SDR 20 bn (plus whatever the Swiss contribute). This will help restore confidence in the Fund's access to resources in case of need to lend to a major country or in case of strain in the international system as a whole. It would barely restore the GAB to its original size in relation to GDP and reserves, and would be justified on the basis of the needs of contingent G10 countries alone, quite apart from the possibility of having to provide resources for other members in times of crisis.

3. Desirable but not essential to agree on shares now.(if needed: believe that quotas are not very relevant for determining how to share liabilities between limited group of industrial countries. Sounder basis is a 50/50 weighting of relative GDP and relative non-gold reserves.] Agree that in future contributions should be SDR-denominated to avoid arbitrary fluctuation in relative GAB shares as exchange rates move.

4. Other desirable changes to the basic GAB are a shift to market-related interest rates (a feature of the Fund's other borrowing arrangements) and an understanding with the Fund that where the GAB is mobilised in support of a reserve tranche drawing, the borrowing will be repaid as the reserve position is reconstituted.

5. These are first substantive changes since 1960's, and are necessary simply to take account of intervening developments. In other respects prefer to keep the normal character and composition of the basic GAB as it is ie a mutual cooperative of leading industrial countries. Have an open mind about other leading industrial countries joining the GAB. Hope that Switzerland will eventually become full GAB participant if she joins the Fund. In the meantime hope that she will retain her unique associated status with the GAB and be prepared to join G10 in increasing her contribution.

6. We see a clear distinction between the GAB in normal times and in times of abnormal strain upon the international system. In latter circumstances entirely right that G10 should join with others in being prepared to supplement Fund resources for the benefit of other Fund members. Broadly satisfied with the proposed procedure for activating the second window and form asking calls under it. But provision needed for de-activating the second window when crisis is past. We can accept either a. termination of the second window at say next quota review (in which case no special deactivation required) or b. activation lapses after 2 years unless fresh activation is justified. A specific review of the second window would still be desirable in 5 year's time.

7. Discussions with Saudis were useful in clarifying their concerns. They recognised fully the political importance of broadly-based response to a crisis in international system. They also indicated a preparedness to be involved in the normal mutual lending of the G10, although they did not lay great stress on reciprocal access. Major concern - quite reasonably - was for adequate information and consultation wherever they were expected to participate.

8. Key questions:

a. Should we be making approaches to other potential parallel lenders? We have an open mind - the sums forthcoming are unlikely to be large.

(Inconsistent with second window)

b. Should Saudis be invited to participate in normal mutual GAB lending as well as at second window? This would be a major departure from original thinking on Saudi role. Implications need to be thought out. Saudis would probably add only SDR 1-2bn to sums available for mutual lending, but Character of GAB could be affected. Saudis would become close to full participants except for attendance: it could become politically awkward to deny full participation in due course if they wanted it. Other oil exporters might demand similar status. Suggest their participation limited to second window for time being, but we do not rule out participation in mutual lending at a later stage.

9. Detailed points on Saudi relationship:

a. Consultation: Saudis should be jointly consulted and be fully involved in the decision making process on activation and deactivation of the second window, but individually consulted on calls.

b. Information: Saudis would receive same information as GAB participants on all second window activities.

c. Opting out: Saudis would be expected, but not committed, to accept calls except on grounds of weak balance of payments. Having accepted a call, they may not discriminate between recipients. GAB participants would no doubt take into account a parallel lender's opting out in framing their own response

There should be flexibility for other parallel lenders to have a different relationship with GAB.

Background

10. The G10 Deputies considered the GAB on December 10th, and Dini then prepared a summary of conclusions which in a number of key respects did not fully conform to the understandings reached. The two main areas of difficulty were whether the second window should be regarded as temporary or permanent; and the relationship of potential parallel lenders to the GAB. Dini's summary was then considered by the Executive Board on December 17th and January 5th. It was also fleshed out in considerable detail by the Fund's Legal Adviser who regrettably seemed to treat the

summary as immutable holy writ and has resisted alternative interpretations which would provide for a looser, more flexible relationship with the Saudis. At the end of the last Executive Board discussion it was left on the basis that the matter would need further discussion in the G10.

11. We had been consistently arguing throughout 1982 that the GAB in its original form needed to be updated and increased in parallel with a quota increase in order to cover the contingent demands upon the Fund of the major industrial countries. Later, post-Toronto, and with some initial hesitation, we were prepared to see a "second window" for onlending to LDCs grafted on to the GAB as an alternative to Sprinkel's early ideas for a new crisis fund. Many other countries and even the IMF staff seem to have approached the problem the other way round: the need for a separate crisis fund for LDCs provides the grounds for increasing and modifying the GAB. This may account for the rather different perspective against which others approach the GAB.

12. Size. The GAB currently stands at SDR 6½ billion. Most indicators seem to justify a tripling of the GAB simply to fulfill its original functions. Thus, between 1962 and now, G10 quotas have risen from SDR 12 billion to SDR 33 billion (and are likely to rise to SDR 50 billion after the Eighth Review). The size of the GAB can also be considered from the ability of members to contribute. In 1962, the GAB was equivalent to 15 per cent of G10 reserves; now it is 4 per cent. Restoration of the ratio would imply a GAB of SDR 20-25 billion. To inspire confidence that the GAB can provide resources for on-lending to LDCs in addition to its original function, its size needs to be at the top end of the SDR 15-20 bn range. An approximate further figure for Switzerland would be SDR 1 bn.

13. Shares. There has already been some detailed discussion in the margins of the G5 Deputies and G10 Deputies' discussion last month. Dini circulated a 'non-suggestion' prepared by Sir K Couzens which shows:

15. Cost to UK. A 10 per cent share of SDR 20 bn implies a UK contribution of SDR 2bn. Hitherto, contributions have been experienced in national currencies so that our effective share has fallen sharply since 1962; but there is no dissent from the view that contributions should now be denominated in SDR in order to ensure that politically agreed shares are maintained. The proposal to increase the interest rate from the rate charged to users up to a market-related rate - which also commands general G10 support - greatly reduces the burden of contributing. GAB contributions by the UK would affect reserves but not form part of public expenditure or PSBR; the interest rate differential between Treasury bills and the SDR market rate would have only a minimal effect on PSBR.

16. Changes in basic GAB. Apart from SDR-denomination and adoption of a market-related interest rate, we see a need for only a few changes in the basic GAB. Several G10 Directors, (Germany, Japan, Canada) have suggested that the Fund should make early repayment to the GAB if a participant, having drawn its reserve tranche, went on to reconstitute, it, whether by a repurchase or by a Fund use of the relevant currency. The effect would be to reduce the period during which the GAB was used to finance a G10 reserve drawing. It seems a sensible provision. Another possible change might be increase the minimum contribution (now set at SDR 0-1 bn) in line with the increase in the total size of the GAB (say to SDR 0.25 bn).

Which?

17. Switzerland and other new (industrial) candidates. Switzerland, a non-member of the Fund, nevertheless has since 1964 had an associated borrowing arrangement with the Fund equivalent (at today's prices) to about SDR 350 m. Their agreement is couched in virtually identical language to the GAB. It binds them to contribute (unless they can please balance of payments difficulties) whenever the G10 contribute. The Swiss attend G10 meetings as observers and participate in the discussions, but have no vote, nor do they have reciprocal access to the GAB (as a non-member they are not of course eligible to draw from the Fund, but in addition, they are not entitled to have their loan claims encashed

against GAB finance). Apart from updating their arrangement in line with the GAB itself, we see merit in retaining the Swiss arrangement as something unique. To encourage the Saudis or others to see it as a model for their own relationship with the GAB implies a much greater intimacy with G10 than we would probably wish to see. It is likely than Switzerland would become a full GAB participant if she joins the Fund: IMF membership is under consideration but is not imminent.

18. A number of other industrial countries (Australia, Austria) are potential candidates for GAB membership or for parallel lender status. Given that the G10 want to restrict full GAB participation to large industrial members, only Australia and Spain, with quotas of SDR 1185 m and SDR 836 m respectively, are serious contenders for full participants. Neither has expressed any recent interest so far as we know. Few seem keen to admit Spain as a full participant. Other industrial countries have quotas well below those of the smallest G20 member. Sweden (quota - SDR 675 m). However, some interest has been shown by Austria (quota - SDR 495 m), possibly in becoming a parallel lender, but they have also made the point that they would have little incentive to put up money in parallel with an expanded GAB scheme unless offered some formal membership or at least association with G10.

Second window - conditions for activation

19. Most Executive Board discussion has focused on this aspect, and it has been the greatest cause for concern by LDC Directors. We are broadly content with the main condition, that:

> 'The Fund faces an inadequacy of resources readily available to meet actual and expected requests for conditional financing that reflect the existence of an exceptional situation associated with balance of payments problems of a character or aggregate size that could threaten the stability of the international monetary system.'

and also with the understanding that in considering a proposal to activate the GAB G10 will not impose their judgement on whether the individual programmes warrant Fund support: this is properly a matter for the Executive Board.

20. Several LDC Directors (particularly India) expressed concern that the G10 would nevertheless have too much of a financial stranglehold over the Fund in times of crisis and preferred the sort of arrangement the Fund now has with Saudi Arabia in which the credit lines are put at the Fund's disposal to draw down as required. This is a weak argument. The G10 cannot be expected to be any less rigorous in achieving the GAB for non-participants than for participants. The Saudis in lending to the Fund took their pound of flesh in the form of a special quota increase. In any event, the existence of the GAB second window does not preclude the Fund supplementing its finances from other sources (eg market borrowing).

Deactivation

21. The Chancellor advanced the view in G5 that the second window should not be a permanent facility but one simply to tide the Fund over the present period of imbalances. There should be a presumption that it should be terminated at the time of the Ninth Quota Review. This view received little support and was strongly and widely in the Executive Board subsequently. The Americans in particular believe they will have difficulty in securing Congressional approval for an obviously temporary arrangement. We have accordingly fallen back upon the proposition that the second window should be specially reviewed in five years as part of the general GAB review, and that there should be no pre-supposition that it will continue.

22. If the second window is to be a permanent feature of the GAB, however, there will need to be some provision for declaring that the crisis which justified its activiation has passed. Otherwise, the Managing Director, having activated the GAB and made calls totalling say SDR 5 bn, might find because of programme breakdowns that he needed only SDR 2 bn; but would still be entitled to draw the remainder for other programmes long after international stability has returned. A provision that the second window would need to be reactivated at intervals of say 2 years should prevent this anomaly.

Parallel lenders

23. The Chancellor will no doubt be invited to give his impression of how the Saudis view the GAB proposals and in particular how they see their relationship with the GAB. The association of Saudi Arabia with the GAB is an important political development. But in financial terms, it is unlikely that the Saudis would agree to make available more than their objectively-determined share, say SDR 2 bn. For such a small increment, there is little reason for the G10 to make major unwelcome concessions.

24. The Saudi relationship will be characterised by three factors - whether their parallel loan is available at all times or only when the second window is activated; what consultation, attendance at G10 meetings, voting power, etc, they enjoy; and what reciprocal access they have to GAB resources.

25. Strangely, the question of whether they would participate in the GAB's normal lending as well as at the second window was not addressed in Executive Board discussion until a late stage. The Fund's Legal Adviser resisted our attempt to restrict parallel loans to the second window, and it was agreed that it would need to be considered by the G10. Restricting parallel loans to the second window seems to accord better with two basic concepts; first, that changes to the existing GAB arrangements should be kept to a minimum, and secondly, that the desirability of parallel loans, when originally raised in the context of Sprinkel's Toronto proposals, related to a crisis fund for large LDCs. It is also a much simpler and clear-cut relationship. It avoids some of the awkward questions on reciprocal access and consultation. If the Saudis are involved in all activations of the GAB, it may eventually prove awkward to deny them attendance at G10 meetings to discuss the GAB or to treat them in practice as other than a full participant. Although the resources available to G10 participants for mutual lending would be augmented by the SDR 2 bn contribution, the increase in the GAB to SDR 20 bn, plus the quota increase, should be enough by itself to meet the needs of G10 members in non-crisis conditions. The main argument in favour of Saudi 'first-window' lending is that they would like to do it.

26. If Saudi participation is limited to the second window, we would favour involving them closely in the decision-making process. The Saudis themselves gave the highest priority to adequate consultation and information-sharing. There are two stages. The first is the activation of the second window, ie the determination that a crisis exists. It would be reasonable to concede parallel lenders the same rights here (including voting rights) as GAB participants, since both are equally affected: joint consultation would be logical. The second stage is the process of making specific calls. Here, it seems more practical to consult parallel lenders individually. The Saudis attached some importance to being allowed to opt out of particular calls on political grounds. This is controversial on two counts. First, it implies a lesser degree of commitment than borne by GAB participants who enjoy a right to opt out only on balance of payments grounds. Nevertheless, this objection could be mitigated by an understanding that the ability to opt out will be used only sparingly, and that they would make up in subsequent calls for what they had earlier not contributed. It would be desirable too that a parallel lender should be obliged to indicate he was opting out before the GAB participants responded to the call so that they could take this into account in deciding how much to lend themselves. The second objection is stronger. Much emphasis has been put on the need for the GAB participants to avoid discriminating between recipients in deciding whether to lend through the second window. It would be invidious to allow a parallel lender the right to discriminate on purely political grounds. In practice, however, calls at the second window will probably be made to finance programmes for a series of borrowers. There should be scope for quiet understandings between the Saudis and the Managing Director that the Saudi contribution will be steered to countries other than Israel or South Africa.

27. Reciprocal access seems a minor concern for the Saudis (although it could be of greater significance to other potential lenders). It has assumed importance, however, because of the disputed paragraph 6 of Dini's summary that "There was some discussion regarding the relationship with other potential lenders willing to provide resources in parellel with the GAB. It was

assumed that lending under such a parallel arrangement would be available to finance purchases by GAB participants as well as non-participants and that parallel lenders would have the same access to GAB resources as participants".; and the interpretation by the Fund's Legal Adviser that parallel lenders would enjoy reciprocal access not simply in respect of conditional drawings (ie, those available at the second window) but also all other drawings, including reserve tranche drawings, which can be financed under the present GAB arrangements. Our own view is that reciprocal access should be limited to conditional drawings (eg in support of standby arrangements). In addition, it would be reasonable to agree that if a parallel lender (or GAB participant) needs to cash their parallel (or GAB) loan claim on balance of payments of grounds, the Fund can refinance the encashment by reeourse to the GAB (or parallel lenders) respectively.

17/1/83

BRIEF ON JAPANESE MACRO-ECONOMIC POLICY

Points to note

i. Japan has benefitted from open world trade and financial systems - particularly in past few years when it has surmounted second oil price shock more successfully than other industrial countries.

ii. This was achieved to a significant extent through reliance on external demand. Growth of protectionist pressures and slower world trade however, led to slowdown in Japanese economy at the end of 1981 and showed problems such a policy can cause.

iii. Japan and international community therefore both have an interest in greater Japanese reliance on domestic growth. Modest recovery in domestic activity early last year may now have petered out so important that domestic demand should be allowed to recover in future.

iv. Recognise importance Japanese government attaches to reducing budget deficit in medium-term, but Japan should take account of short-term prospects for private demand in deciding how fast to reduce its budget deficit. Welcome recent fiscal package to support domestic activity as a preliminary step in the right direction.

v. Large Japanese private savings should make it possible to finance budget deficit without putting undue strain on credit markets, as long as government bond yields are consistent with market rates.

vi. Welcome recent yen appreciation though exchange rate adjustments should be more gradual so as not to destabilise financial markets. Despite recent appreciation important that Japanese monetary policy does not inhibit yen from reflecting fully competitive strength of economy.

vii. In the longer-term, liberalisation of domestic financial markets to make the yen more attractive to foreign investors, coupled with development of the yen's role as a reserve and trading currency, should contribute to maintaining a more realistic value for the yen.

BACKGROUND

Japan adjusted to the second oil price shock more successfully than competitors. GDP growth averaged 3½ per cent per year in 1980 and 1981, compared with less than 1 per cent in other Summit countries. The annual rate of increase in consumer prices is now around 3 per cent, compared to almost 7 per cent on average in other major countries. Unemployment is currently 2½ per cent, and although this probably understates the true figure, the underlying level is well below the 8-9 per cent average elsewhere. The current balance of payments which showed a deficit of $11 billion in 1980, moved into a $5 billion surplus last year and achieved a further $5½ billion surplus over the first-three quarters of 1982.

2. This impressive performance has not been without its problems both for other countries and for Japan. Growth in 1980 and 1981 relied heavily on external demand with exports of goods and services rising by almost 18 per cent a year, while imports rose less than 1 per cent a year. The external sector accounted for three quarters of Japan's growth over these 2 years. Some switch of resources into the balance of payments after the rise in oil prices was natural and desirable, but both the speed and size of Japan's adjustment has provoked international criticism. At a time when many other countries are suffering high unemployment, it has also added to protectionist pressures.

3. The dangers of relying too heavily on external demand were brought home to the Japanese at the end of 1981 when the combination of a slowdown in world trade and restraints on Japanese exports caused a fall in GDP. Growth picked up in the second quarter of 1982 with an unusually large and, in the event, temporary boost from private consumption to domestic demand though GNP growth fell back again in the third quarter. Investment, has remained sluggish and the corporate sector is still adjusting stock levels down to the unexpectedly low level of activity. Industrial production fell in the first half of 1982 but showed some recovery in the third quarter.

4. The official growth target of 5.2 per cent for FY82 (ending April 30 1983) has been progressively revised down to the authorities December estimate of 3.1 per cent as both domestic and external demand have remained depressed. This estimate and the government's forecast of 3½ per cent growth next fiscal year is broadly similar to the OECD's recent projections. External demand next year is however expected to play a more significant role then in 1982. OECD expects exports to outstrip imports over the next eighteen months to bring an $11bn current surplus in 1983.

5. Criticism of Japan has tended to centre on its macro-economic policies and the rigidly controlled non-market nature of parts of the economy. These two factors have at times tended to reinforce each other. The need to follow policies which take account of their impact on other countries was the central theme of the Versailles communique. The argument that countries such as Japan which have benefitted enormously from free market open trading systems, should also open up their own economies, similarly has a powerful logic.

6. Japan's macro-economic policies have tended to increase her reliance on external demand as a source of growth. Unduly stringent fiscal policies and, in particular, a rising tax burden have tended to hold back domestic demand. Japan's general government budget deficit was reduced from 5½ per cent of GDP in 1978 to 3½ per cent in 1982. Over the three years since the second oil price shock Japan's fiscal policy has been the tightest amongst the major OECD countries. The OECD Secretariat estimates Japan, along with the UK, actually managed to reduce its general government deficit relative to GDP over this period. The deficit is particularly low taking account of the high level of private savings available in Japan.

7. The government had pledged to abolish the current deficit on the budget by 1985 but Mr Takeshita, the new finance minister, acknowledged in his December policy statement that this objective has been postponed as a result of the effects of slower growth, at home and abroad, on public finances. The Supplementary Budget for 1982, passed by the Diet in late December, allowed for the Yen 2 trillion additional public spending announced in October and increased the deficit for FY 1982 by Yen 4 trillion to Yen 14.3 trillion, 5.4 per cent of GDP.

How much → do we want?

8. The Yen 2 trillion spending package, which includes extra public works expenditure should help support domestic activity (it is expected to have added about ¾ per cent to GDP growth in the current fiscal year). It is a small step in the right direction. However after taking account of this extra expenditure the OECD still expect the general government deficit relative to GDP to decline again in 1983. The draft 1983 budget presented just before the New Year put the FY1983 deficit at Yen 13.3 trillion, 4.7 per cent of GDP, which is lower than for 1982. While we share the Japanese wish to reduce budget deficits over the medium term, this tight policy stance is likely to restrain domestic demand, contribute to the growing current account surplus and tend to aggravate Japan's trade problems.

9. Alongside this tight fiscal policy, Japan has followed a relatively accommodating monetary policy. M2 growth in the past two years or so has typically been around 9 per cent - rather faster than the rise in nominal GDP. Nominal interest rates have been well below those abroad and between the beginning of 1981 and November 1982 the yen's effective rate declined about 13 per cent.

10. High US interest rates may have been a main factor in the yen's weakness but Japan's policies, however, have not helped. While interest rates have been brought down to stimulate domestic demand, the government's practice of controlling bank deposit rates and force-selling its own bonds at fixed prices to a syndicate of domestic banks has helped keep rates artifically low. The Japanese banks, however,have recently been refusing to buy more bonds and the government has been forced to allow long-term yields to reflect market rates more closely.

So how much higher should rates go?

11. Over the autumn Japanese interest rates have remained around 7 per cent while US interest rates have fallen from 13 per cent to 9 per cent or so. As a result the interest differential in favour of the dollar has narrowed and, partly as a result, capital has flowed into Japan. Coupled with large prospective current account deficits in the US this has been associated with a surprisingly sharp appreciation of the yen against the dollar as well as other currencies. Its effective (trade-weighted) rate has appreciated by about 13 per cent since its monthly low in October 1982 Now the yen is recovering and there is the possibility of lower US interest rates it is important that Japanese monetary policy should not inhibit the yen from reflecting the economy's competitive position.

12. Over the longer term the Japanese could also help the yen to become a firm currency by allowing its reserve role to develop. At present, the yen accounts for only about 4 per cent of international currency reserves, slightly greater than sterling but well below the DM at 13 per cent and the dollar at 71 per cent. Greater availability of short term yen financial assets would tend to encourage foreigners to hold more yen in their portfolios. Greater use of the yen in denominating international trade might also stimulate companies to increase their yen holdings. This would help to encourage Japan to play a full and responsible role in the international financial system, commensurate with the underlying strength of the economy.

How much > do we extend?
Why not "stability"?

17/1/83

ANNEX B

MEETING WITH JAPANESE FINANCE MINISTER

Points to make (if necessary)

1. We share the Japanese preference for a substantial selective element in the quota element. In the IMF Executive Board we have argued until very recently that all the quota increase should be distributed pro rata with calculated quota increases. This was contrary to our own narrow direct interest, but we subscribed to the Japanese view that quotas need to be brought as fully into line with relative economic positions as was consistent with a simple and uniform method. Clear now, however, that industrial countries will need to compromise and accept some equiproportional element, if we are to secure early agreement with LDCs. Believe equiproportional element will need to be at least 25%. Note that US have been suggesting up to 40%.

!! 2. Germans (almost as underendowed as Japanese) have suggested that if equiproportional element is large, they will press for next quota review also to be selective. This could be way of avoiding abrupt change in quota shares in present review. Alternative could be to press for very large total quota increase this time round in which there would be more headroom to adjust quota shares; but this is unrealistic in light of US views on size of quota increase.

On GAB shares

3. Calculated quotas (which depict need to borrow as well as ability to lend) are less satisfactory criterion for GAB shares than indices which give fuller weight to relative ability to lend, eg GDP and non-gold reserves - of which Japan holds 16.5 per cent of the G10 total for 1977-1981.

4. Agree that Japan's effective share of GAB at present (18.5 per cent) is rather high, but this is due to exchange rate fluctuations since 1962. Important that future shares are denominated in SDRs to prevent such unplanned shifts in shares re-occurring.

5. UK share has fallen from 16.7 per cent in 1962 to 9.0 per cent now. This is in fact about right on the basis of GDP and non-gold reserve (8.4 per cent), but we are prepared to accept 10 per cent if others are prepared to accept their share.

Background

6. Mr Watanabe's telex to Mr Littler suggests that the Japanese may seek to enlist our support for a large selective element in the quota review. This may spill over into pressure for a lower Japanese share in the GAB (they are at present down for 16 per cent) and quite possibly a higher UK share (we are down for 10 per cent).

7. The background on the question of the selective/equiproportional mix is set out in the Brief on Quota Distribution. In the Executive Board discussion we have been relatively slow to concede the possibility of an equiproportional increase, in a large part because we were worried that the Japanese would feel wholly isolated and find it difficult to join a G5 consensus on the other chief elements in the package. Our best estimate, in the light of more informal contacts, is that the Japanese would draw the line at conceding an equiproportional element of more than 35-40 per cent (if quotas are increased to SDR 90 billion), but they might go to almost 50 per cent equiproportional if quotas were increased to SDR 100 billion. If this is right it should provide room for compromise, particularly with a sweetener that the next quota review might contain a selective element as well (this is beginning to look difficult to refuse).

17/1/83

ANNEX

SIZE OF THE QUOTA INCREASE

Summary

1. There seems now to be a general expectation that quotas will be increased to between SDR 90 bn and SDR 100 bn, (although the US are still publicly at SDR 85 bn). This is however still a sufficiently broad range to prove troublesome at the Interim Committee. It would be helpful to narrow it, even if for tactical reasons it may still not be desirable to come up with a single 'take-it-or-leave-it' figure.

2. This means getting at least a private understanding from the US that they will go a little above SDR 90bn and from the Japanese and perhaps others that they will come down below SDR 100 bn.

Points To Make

3. Glad that in Executive Board discussion so far many Directors consider that quota increase to between SDR 90 bn and SDR 100 bn would be acceptable. Difficult, perhaps undesirable at this stage, to pursue agreement on a single figure. But can we narrow the range? At any rate, hope that members will be prepared to show flexibility within this range when the time comes.

4. To us, SDR 90 bn might be a shade tight. I argued at Toronto for at least a 50% increase in quotas (i.e. to about SDR 92 bn). Our studies at that time suggested that this would meet LDC demands on the Fund, based on unchanged Fund policies and a further replenishment of quotas at the end of 1989.

5. Clearly, selection of the precise figure is a matter of judgement, especially on the contingency margin to be built in. Two contingencies have a particular bearing. Recourse to the Fund by industrial countries could absorb large sums. We hope this eventuality will be covered by increasing the GAB to the upper end of the SDR 15-20 bn. But otherwise a slightly higher quota increase might be needed. (Conversely if there was general agreement that the next quota review should be accelerated to say the end of 1988, the present quota increase would not need to last so long and could be a little lower.)

Background

6. Increasing quotas requires an 85% majority. The position of the US, who holds 20% of the voting power, is therefore crucial. Their public position at the Executive Board is to limit the quota increase for SDR 85 bn, on the grounds

that the LDC imbalances will fall to sustainable levels more rapidly than most imagine. But they have indicated privately to us that they would be prepared to move to SDR 90bn and possibly a little bit more. There are press reports of Secretary Regan's appearance before the House Banking Committee just before Christmas in which Regan was reported as having talked about an extra $40 bn (implying, at current exchange rates, about SDR 97½ bn). Some LDCs, e.g. the Indians, believe that the US has in mind a figure of SDR 100 bn. This may be optimistic. Our own impression is that they are thinking no higher than SDR 92-95 bn. To avoid false expectations in the run-up to the Interim Committee, it would be better for the US to come out rather more clearly against SDR 100 bn if they are not prepared eventually to go that high.

7. On the other hand this does not imply the G5/G10 should try to present the LDCs with a single cut-and-dried figure. As the Chancellor argued at Kronberg, this would be undesirably confrontational. What is needed is the impression that all industrial countries are prepared to contemplate figures below SDR 100 bn but above SDR 90 bn, rather than clinging to one or other extreme.

8. The views of G5 are as follows:-

Germany: 50% increase is the upper end that could be reasonably justified, but prepared to add on a safety margin up to SDR 100 bn. In private they have indicated in G5 that they regard anything below SDR 90 bn as unrealistic.

France: SDR 90-100 bn

Japan: SDR 100 bn, perhaps less if the distribution of quota shares was right. The likelihood that the distribution will fall short of what they hoped for means they will probably tend towards the top of the range. Intellectually, they believe a doubling of the Fund is probably justified.

9. Until recently most Executive Directors (apart from US, Germany and UK) had been publicly advocating an increase in Fund size to SDR 100-125bn, although privately most G10 were signalling acceptance of SDR 90-100bn. But this view did not take into account the prospect of a GAB enlargement to SDR 15-20 bn nor acceleration of of both this end and the Ninth Review. If the increase in the GAB (from SDR 6½ bn to SDR 15-20 bn) is taken into account, the divergence of view on the total resources available to the Fund is considerably narrowed. This is particularly so in respect of the useable addition to Fund resources: only about half a quota increase would be in useable currencies, but most of a GAB increase is likely to be useable. While acceleration of the present quota Review does not itself affect the appropriate size of the quota increase, it does mean that the next quota increase is accelerated. The Americans have spoken about the Ninth Quota Review

being implemented by the end of 1988, a year earlier than might have been expected, and this would mean that 1989 drawings (of say about SDR 5 bn) could be financed out of the Ninth review, rather than out of the present one.

10. These considerations seem to have been instrumental in persuading many Directors to lower their sights to SDR 90-100 bn. Larosiere's view is that it would be easier to get a more enthusiastic response if we could get a result somewhat higher than SDR 90 bn. This figure was a bit tight (we agree) but he thought that even SDR 90 bn would do in the last resort. There are not many obvious figures in the SDR 90-100 bn range around which views might collect. The most likely are:-

SDR bn	
91.6	50% increase in quotas.
95.0	mid-point between SDR 90 bn and SDR 100 bn.
97.5 (approx)	a $40 bn increase

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

ANNEX C 17/1/83

MEETING WITH M DELORS

Points to make: Interim Committee

Grateful for help in taking soundings about the prospects for success of an accelerated meeting. As said in reply, believe prospects would not be increased by delay and we should build on momentum already achieved. Executive Board been working hard. Believe outcome of meeting a major element in restoration of confidence, quite apart from replenishment of Fund resources themselves.

Helpful to exchange views on the main issues and room for manoeuvre. This relevant to handling of related item in today's discussion. In planning the timing of business, need to have in mind Mr Regan's early departure.

As we see it, essential decisions for February meeting are:

- size of Fund;
- distribution;
- enlarged GAB.

On quotas, the effective decision area is perhaps SDR 90-95 billion. We do not need a decision in Paris about where within this bracket we could come out, but we probably need to know that the Americans are in it.

On distribution, it is a great relief that we have only one main method to consider and that decisions can therefore be related to the equiproportional element. Our impression is that here the most sensitive industrial country is the Japanese. [Report on contacts.] The decision area seems to be in the region of 25-50% equiproportional element.

Come on to GAB later.

Although have described the decision areas above, not clear that this will carry LDCs. Not a great deal of room for manoeuvre. But believe that we may need to contemplate some or all of the following:

- a sympathetic reference to examination of SDR allocations in the communique;

- a sympathetic reference to maintained access and examination in the Executive Board;

- something on minimum quotas.

On handling of meeting have envisaged with Managing Director that all the main items might be grouped under one heading. This may help to concentrate attention on the issues for decision. Would propose to make some tone setting speech at outset. Thereafter the handling will depend on the extent of divergencies that reveal themselves. But do not envisage

establishment of sub-groups on particular issues. More likely may need to knock some heads together. Interested to have French views on sensitive areas (the SDR point is clearly sensitive for US and German colleagues) and room for manoeuvre.

Points to make: GAB

Clear from reports in the Executive Board that some suspicions still persist amongst developing countries, notably the Indians. These will no doubt be voiced again in Washington. But agreement in Paris on size and shares would be helpful in underlining that this was something of a gift horse. Is this how he sees it? Is there a case for reaching a clear understanding on the total size but not making it quite explicit before the Washington meeting? As regards size of GAB our own view is that SDR 20 billion is right: this would be only enough to bring original contributions up to date. French views?

Some further progress needed on shares. [Report on Deputies' discussion.] Own view that 10% would be maximum UK share: this already stretches the relevant indicators. How does he see resolution of outstanding differences?

Participation of Saudis.

[Our general impressions might be set out as in the fuller speaking notes above.] Some differences of view persist on

the degree of intimacy of Saudi engagement with founder members. We both formed much the same impressions in Saudi Arabia. Element of shopping list still. Clearly need second mission, perhaps headed by Dini. Important to get as full a commitment as possible even if this not in terms of figures. On the latter may be necessary to give priority, in last resort, to third tranche. French views?

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Annex G

DISTRIBUTION OF QUOTA INCREASE

Points to make

1. Important that the choices put to Governors at the Interim Committee are kept simple. Fortunately consensus seems to be emerging that the selective element should be distributed pro-rata with shares in calculated quotas (Method 3), and that any dilution of the shift in relative quotas should be through the medium of an equiproportional increase. Governors will be asked to focus on how much of the increase should be equiproportional. The range is wide (0-75 per cent of the increase). Strong national interests are perceived to be at stake.

2. Consensus will not be easy, but could be complicated still further if the principle of uniformity is set aside, or if members are inflexible in pressing for their quota share to be substantially increased in the context of a single quota review. Accordingly hope that:

a. Ideas for special quota increases for very small countries will not be pushed; and

b. The possibility of leaving some of the adjustment in quota shares until the Ninth Review will be borne in mind.

3. If there is to be an equiproportional element it is unlikely to be less than 25 per cent of the total increase. On the other hand, those who have argued for very large equiproportional elements (50 per cent or more) tend to be those who envisage a very large increase (a doubling or more) in the size of the Fund. The shift in quota shares which they fear would be much less if the quota increase is limited to SDR 90-100 bn. It might be reasonable in these circumstances to expect them to agree to a rather smaller equiproportional element than 50 per cent.

4. Some general understandings on the maintenance of access to the Fund's resources for LDCs who stand to lose quota share may be helpful in securing an eventual compromise. Important to

co-ordinate views on this if access limits are likely to be a major concern of LDCs at the Interim Committee.

Background

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

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

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

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

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

The term 'adjustment coefficient' measures the percentage shift of actual quota shares towards the goal of caluclated quota shares.

7. Opinions in the Executive Board on the size of the equiproportional element range from 0-75 per cent in predictable fashion. Those with most to lose (Indians, Chinese, Africans) want 75 per cent.

Other non-oil LDCs (eg Brazil are looking for over 50 per cent. (Japan, Germany and Arab oil exporters other than Saudi Arabia) want no equiproportional e ement at all. In between are the majority of industrial countries and Saudi Arabia who are looking for a 25-50 per cent equiproportional element, with the weight of opinion (including US and ourselves) in the range 25-40 per cent. No-one is suggesting an equiporportional element of between 0 per cent to 25 per cent and it is reasonable to assume that if there is to be an equiporportional element at all, it will be at least 25 per cent of the total. This seems likely. The Executive Board seems agreed that each member should receive a 'meaningful increase'. If there was no equiproportional element the most overshadowed country (Laos) would receive a scarcely 'meaningful increase' of between 4 p r cent and 6 per cent.

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

9. However, the range of views is wide, and some sweeteners may have to be offered to those with extreme views in order to reach a compromise. A number of ideas have been canvassed, some promising, others unhelpful. These are discussed below.

10. <u>Agreeing that the Ninth Quota Review should also have a selective element</u>. The Germans have already indicated they will push for this if they judge the equiporportional element in the present quota review is 'excessive'. It seems a sensible way of bringing actual quota shares more into line with calculated quota shares without involving abrupt and hence unpalatable shifts. There is a good precedent for setting the main limits of the next Review so far in advance. The decision that the present review should be the occasion for bringing quotas more into line with relative economic positions was taken in the framework of the last quota review. The idea seems worth floating in G10.

11. Smaller size of Fund. As noted at para 6(c) above, agreement on a Fund size of SDR 90-100 bn should allow the Indians and others to accept a rather lower equiproportional proportion than might be palatable with a larger size of Fund.

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

13. Minimum quota. One proposal to have gained surprisingly wide interest in the Executive Board is for Very Small Members (ie the 17 members with quotas of less than SDR 10 m - mostly Caribbean and Pacific island-states) to receive specially favourable treatment in the quota review. There is little technical merit in their case. Most are already overendowed with quota relative to their calculated quota share. Their voting power benefits strongly from the existence of Basic Votes. Many of them belong to small constituencies and are therefore adequately represented at the Executive Board. Special treatment for these members, although it would not absorb much of the quota increase and have only a negligible effect on the quota shares of other members, nevertheless cuts across the principle of uniformity. Of the G10 members, only Canada (who represents Caribbean members) and France (with Francophone African interests) supported special treatment, but LDC support was widespread. A sensible course might be to insist on uniformity and to rule out the concept of a minimum quota, but to undertake to look sympathetically at the

11. Smaller size of Fund. As noted at para 8(c) above, agreement on a Fund size of SDR 60-70 bn should allow the Indians and others to accept a rather lower equiproportional proportion than might be realistic with a larger size of Fund.

12. Voting rights. Voting power is determined by quotas, but each member also has a Basic Vote equivalent to a quota of SDR 25 m. Basic votes account in aggregate for about 4 per cent voting power, and they disproportionately boost the voting power of smaller members (Annex [illegible]). Because the size of the Basic Vote is specified in the Articles an 85 per cent majority is required to increase it. LDCs have suggested that Basic Votes might be increased as a means of offsetting the effect of a reduced [illegible] share on LDC voting power. But it is unrealistic to expect the necessary majority could be obtained for changing the Articles. An alternative might be to distribute equally to each member a tranche of quota increase as a surrogate for an increase in Basic Votes. But this would be a transparent attempt to evade the Articles, and runs counter to the conclusion that quotas express relative economic positions. It is a dangerous road to travel, and should not be encouraged.

13. Smallest quotas. The proposal to have raised surprisingly wide interest in the Executive Board is for very small members (ie the 17 members with quotas of less than SDR 10 m - mostly Caribbean and Pacific island states) to receive especially favourable treatment in the quota review. There is little technical merit in their case. Most are already over-endowed with quota relative to their calculated quota share. Their voting power benefits strongly from the existence of Basic Votes. Many of them belong to small constituencies and are therefore adequately represented on the Executive Board. Special treatment for these members, although it would not amount much of the quota increase and have only a negligible effect on the quota shares of other members, nevertheless would weaken the principle of uniformity. Of the G10 members, only Canada (who represents Caribbean members) and France (with Francophone African interests) supported special treatment, but the support was widespread. A sensible course might be to insist on uniformity and to rule out the concept of a minimum quota, but to acknowledge at least sympathetically at the

question of rounding-up of the new quotas once they have been determined. Small members would tend to benefit disproportionately if quotas are rounded up to say, the next SDR 100,000, rather than rounded to the nearest SDR 100,000.

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

15. Access to Fund Resources. Access is not formally on the agenda of the Interim Committee. It has not been discussed in detail in the Executive Board, and Larosiere is anxious to avoid Board discussion until after the main features of the quota review have been determined. How far access is likely to be in the forefront of LDC concerns is difficult to judge at this stage. It has not been raised spontaneously by any of the LDCs we have consulted. Many of the LDCs who stand to lose quota share have already drawn heavily on Fund resources (eg India, Pakistan, Zambia, Jamaica), and the question of future annual access limits may be rather academic. In these circumstances, there seems little advantage to be gained in pushing access as a bargaining counter. It is nevertheless worth reminding the G10 that it could become a feature of the negotiations and that it would be helpful to present a co-ordinated view. At the very least we should be prepared to reassure LDCs that existing cash access should be maintained for the average member, and we should be sympathetic about maintaining cash access to the Fund's conditional facilities for those members who stand to lose quota share, even if this means a slightly increased cash access for the average member.

question of topping-up of the new quotas once they have been determined. Small members would tend to benefit disproportionately if quotas are rounded up to say, the next SDR 100,000, rather than rounded to the nearest SDR 100,000.

5. Reorganisation of Executive Board. Loss of voting power would considerably jeopardise the maintenance of the existing number of LDC constituencies. Some economy it could involve some rearrangement of the existing constituencies without affecting their numbers. The constituencies most at risk would be the two African ones, the Argentinian one, China (a single-member constituency), and India. The two African constituencies are already unwieldy, each with over 20 members, many of whom are heavily involved with the Fund. Their amalgamation would cause serious practical problems in the Executive Board. Some re-assortment might be attempted, to ensure, that the 'potential constituencies' are adequate to give the African constituencies continued representation of the reduced voting power that will remain. The other constituencies in question should be able to accommodate additional members.

6. Access to Fund resources. Access is not formally on the agenda of the Interim Committee. It has not been discussed in detail by the Executive Board, and is unlikely to achieve an active discussion until after the main features of the quota review have been determined. How far Access is likely to be in the forefront of LDC concerns is difficult to judge at this stage. It has not been raised spontaneously by any of the LDCs we have consulted. Many of the LDCs who intend to seek quota share have already drawn heavily on Fund resources (eg India, Pakistan, Zambia, Jamaica), and the question of future access limits may be of greater relevance. In these circumstances, there seems little advantage to be gained in pushing access as a bargaining counter. It is nevertheless worth reminding the LDC that it could become a feature of the negotiations and that it would be helpful to pre-empt a co-ordinated line. At the very least we should be prepared to recognise the line that existing high access should be maintained for the average member, and we should be sympathetic about maintaining cash access to the Fund's conditional facilities for those members who stand to lose quota share, even if this means a slightly higher-than-usual access for the average member.

Fund Size SDR 90 bn (Australian distribution)

	Present	Split of equiproportional/selective 0/100	30/70	50/50	75/25
US	20.656	19.411	19.786	20.034	20.345
UK	7.189	6.678	6.832	6.933	7.061
Ger	5.299	6.475	6.121	5.887	5.593
Fr	4.716	5.157	5.025	4.937	4.826
Jap	4.077	5.103	4.794	4.590	4.334
Ind	61.293	63.008	62.492	62.150	61.722
Oil Exp	10.915	11.966	11.652	11.444	11.178
NOLDC	27.796	25.026	25.857	26.409	27.098
adjustment coefficient	-	32.2	22.5	16.1	8.0

Fund Size SDR 92 bn (Australian distribution)

	Present	Split of equiproportional/selective 0/100	30/70	50/50	75/25
US	20.656	19.359	19.749	20.008	20.332
UK	7.189	6.657	6.817	6.922	7.056
Ger	5.299	6.524	6.155	5.912	5.605
Fr	4.716	5.176	5.038	4.946	4.830
Jap	4.077	5.146	4.824	4.612	4.345
Ind	61.293	63.079	62.542	62.185	61.740
Oil Exp	10.915	12.010	11.682	11.465	11.189
NOLDC	27.796	24.909	25.775	26.349	27.069
adjustment coefficient	-	33.7	23.6	16.8	8.4

Fund Size SDR 95 bn (Australian distribution)

	Present	Split of equiproportional/selective 0/100	30/70	50/50	75/25
US	20.656	19.280	19.695	19.969	20.312
UK	7.189	6.625	6.795	6.906	7.048
Ger	5.299	6.599	6.207	5.949	5.624
Fr	4.716	5.203	5.057	4.960	4.838
Jap	4.077	5.211	4.869	4.644	4.361
Ind	61.293	63.186	62.616	62.239	61.767
Oil Exp	10.915	12.077	11.728	11.497	11.205
NOLDC	27.796	24.733	25.653	26.260	27.027
adjustment coefficient	-	35.8	25.0	17.9	8.9

Fund Size SDR 100 bn

	Present	Split of equiproportional/selective 0/100	30/70	50/50	75/25
US	20.656	19.149	19.604	19.903	20.279
UK	7.189	6.571	6.757	6.879	7.034
Ger	5.299	6.722	6.292	6.010	5.654
Fr	4.716	5.250	5.089	4.983	4.850
Jap	4.077	5.319	4.944	4.698	4.388
Ind	61.293	63.364	62.740	62.327	61.812
Oil Exp	10.915	12.187	11.804	11.550	11.232
NOLDC	27.796	24.440	25.448	26.110	26.955
adjustment coefficient	-	39.0	27.2	19.5	9.7

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Annex H

G10 MEETINGS: JANUARY 17/18TH

METHOD OF PAYMENT FOR QUOTA INCREASE/SDR ALLOCATION

Points to make

1. Hope that disagreement on this technical issue will not mar agreement on the size and distribution of quota increase. The argument for subscribing in reserve assets (ie SDR or hard currencies looks convincing.

2. Recognise that many Governors are interested in further SDR allocations but hope this can be looked at in the context of IMF studies of the adequacy of global liquidity.

3. [If necessary.] We ourselves have an open mind on the merits of a further SDR allocation. The risk of reigniting inflation is probably less than it was. The slowdown in bank recycling will need to be carefully monitored. But the primary need is for conditional rather than unconditional liquidity, and we should not be deflected from recognising this.

Background

4. Under the Articles, members are required to subscribe 25 per cent of a quota increase in SDR; except that the Board of Governors may prescribe, by a 70 per cent majority, that the 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.

5. There are at present roughly SDR 20 bn in existence. An increase of 50 per cent in quotas would imply that SDR 7-5 bn would have to be subscribed. This is a large fraction of the total stock and total reliance on the SDR as the vehicle of subscription would disrupt the orderly management of SDR holdings and transactions. Some LDCs have pressed to be allowed to subscribe this 25 per cent tranche in their own currencies. But they would be entitled on subscription of what in most cases is a non-useable currency to draw out their newly-created 'reserve tranche' in the form of hard currency. This would drain the Fund of useable currencies.

6. Many of those who last year advocated further SDR allocations (ie most of the membership except for the G5) have taken the opportunity of this debate to press for a further discussion on the merits of an SDR allocation. A compromise seems likely to be reached in the Executive Board under which members will agree to subscribe either SDRs or hard currencies on two understandings. The first is that members in difficulties can promptly draw the reserve tranche thus created. The second is that the next Interim Committee will ask the Executive Board to review latest trends in world inflation and liquidity and report back to the Governors as a matter of urgency so that they could consider at the next Annual Meeting whether a new allocation of SDRs was called for at that time.

7. This seems a sensible compromise. It should avoid the Interim Committee being distracted from the prime concern of securing an appropriate increase in the Fund's resources.

8. It is not known whether the views towards an SDR allocation of the US (whose support is crucial for achieving the necessary 85 per cent majority) or of other G5 members have changed. If allocations are to be resumed, the likely starting date would be January 1984. We could expect arguments that the first allocation should roll up the allocations which might have been made in 1982 and 1983. If this is conceded the first allocation would be unlikely to be less than SDR 12 bn with further allocations of SDR 4 bn in later years, ie the same annual rate as in the period 1978-1981.

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FUND LIQUIDITY

Points

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

2. The Fund should finalize arrangements soon for a third SAMA tranche of SDR 4bn.

3. The Fund should continue to explore similar medium term borrowing from others who have not so far lent enlarged Access resources (eg Kuwait). We would support market borrowing only if borrowing from official sources were inadequate.

Background

5. The small financing gap (between commitments of borrowed resources and the total borrowing available to the Fund) which had existed since November 1981 was eliminated in May, when the second SDR 4bn SAMA tranche became abailable. After the heavy burst of lending in 1981, commitments in 1982 were at a relatively low level. There were reports in the middle of 1982 that the Saudis were displeased that so little of the SAMA loan had been drawn down. (Before Mexico's drawing, only SDR 1.8bn had been disbursed.)

6. Post Toronto, however, the picture changed and there is now greater concern about the Fund's immediately available resources before the Eighth

Quota Review is put in place. The Fund currently has about SDR 13½bn of uncommitted ordinary resources which should be adequate for the next 18 months. However it has now only SDR 2½bn of uncommitted borrowed resources which are needed to finance Enlarged Access programmes. Argentina (SDR 0.8bn) and Brazil will absorb this. Without the third SAMA tranche a shortage of borrowed resources, therefore, could emerge by April. For 1983-84 the staff's estimates of commitments is SDR 5bn (including, for example, Egypt, Pakistan, Sudan, Zaire, Philippines, Portugal and Turkey), of which about two thirds would involve borrowed resources. Some of these may not materialise but a number of the OPEC high absorbers (Nigeria, Indonesia) are potential borrowers as well.

7. This makes it particularly urgent to secure the third SAMA tranche of SDR 4bn. (In 1981 the Saudis indicated their intention to consider a further commitment for the third year if their balance of payments and reserve position permitted.) During his visit to Saudi Arabia with the Chancellor (7-9 January) the MD intended to discuss the third tranche with the Saudis. No definite conclusion was reached - the Saudis gave the impression that for them the main question was enhanced resources for the Fund (whether by the third tranche or parallel Saudi lending alongside the new GAB appeared a secondary question). However, there does seem to be a good prospect for securing the third tranche in the coming months.

8. We have also been encouraging the Managing Director to approach other non-G10 potential lenders, such as Kuwait and the Emirates, so far without success. (Neither has contributed under the Enlarged Asscess policy.) We cannot rule out therefore a further approach to the G10 countries this year for loans to tide the Fund over until the proposed new implementatio

date of mid-1984 for the Eighth Quota Review. But we do not want to ease the pressure on the Saudis or other non-G10 lenders at this stage. Therefore the less said about this the better. We want to avoid giving the impression that the UK would agree to lend more than the forecast SDR 150mn already committed. We would support direct market borrowing only if funds from official sources seemed likely to be inadequate. If the Fund needs to go to the markets, it should do so from a postion of strength well ahead of any urgent financing need.

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Points for Discussion with Delors

Structure of Meetings

1. Vital importance of settling basic G.10 / G.A.B. arrangements.
2. Since Regan critical to this and leaves early, put G.A.B. first on agenda (before world economy), with possibility of reverting to it for final agreement over lunch.

Conclusions and Publicity

1. Hope Delors will be able to score a success.
2. Success turns on G.A.B. arrangements being settled.
3. IMF best left open (mistake to define views too closely before meeting others at Washington). Keynotes: good progress and determination of G10 to clinch matters in Washington.
4. How to reconcile views on world economy. (Our line: firm policies are paying off, but worries about US deficits and threats of debt problems. Latter underlines importance of GAB success.)

G.A.B.

1. On size, go for reasonable maximum — say SDR 20bn including Switzerland. U.S. SDR 15bn simply not good enough.
2. On distribution, suggest UK and France should be same figure (10% without Swiss or, slightly higher, 10% of total including Swiss). Pressure needed on Japanese, and perhaps Germans, as countries best able to provide finance.
3. On Switzerland, welcome application to join G.10 and participate fully (and, we hope, generously — 6% is 3 times their present total)
4. On Saudis, separate G.A.B. from G.10 "Industrial Countries Business." Question appropriateness of "full" participation if Saudis insist on preserving right to opt out. Grateful for helpful efforts by Delors during his visit to Riyadh — paved the way excellently.

I.M.F.

1. Keep SDR 85 – 100 bn range
2. Perhaps sound views on mix between "equi-proportional" and "Method 3", but leave negotiation for Washington.
3. S.D.R. Issue — recommend as negotiating ploy (as you did in Riyadh with MD) proposing study if Ides press the point.
4. Sprinkel's idea of going for end-1983 implementation.

World Economy

1. Avoid locomotive theories – avoid idea that Governments can create future growth.

2. Argue that basis for gentle but good recovery has been laid. – Problem is to avoid disturbances:–

   a) U.S. deficits and risk of high US interest rates later this year (bad for confidence, very bad for major debtors)

   b) Reinforce IMF and other support mechanisms – to which this G10 makes important contributions

   c) Avoid spread of protectionism.

3. ? Welcome recent exchange rate adjustments – $ v. DM and Yen.

Other

1. Understand Sprinkel thinks De Larosière should certainly be continued as M.D. after June. ? Take opportunity of checking with Regan at lunch – Good to announce at Interim Committee.