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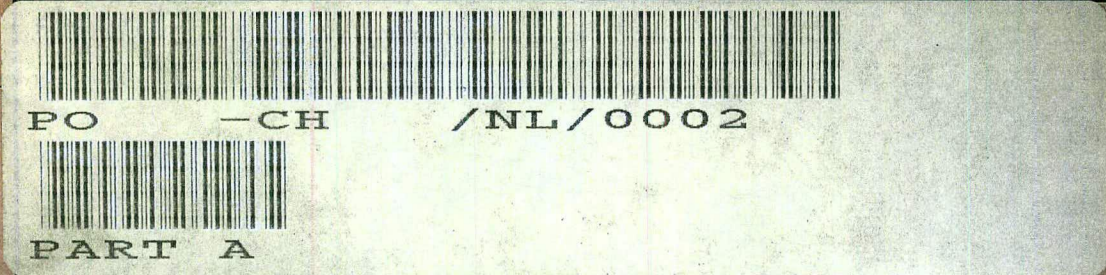
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CHANCELLORS SPEECHES
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FROM: J O KERR

DATE: 30 September 1983

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MR BATTISHILL

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
PCC
Mr A Ridley
Mr Lord
Dr Rouse
Mr Makeham

IMF/IBRD ANNUAL MEETINGS: CHANCELLOR'S SPEECH: 28 SEPTEMBER

I attach the full text of the Chancellor's speech in Washington on Wednesday.

J O KERR

~~1. Mr. A. Smith~~
~~2. Mr. [unclear]~~

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28 September 1983

IMF SPEECH

It is 22 years since I first had the privilege of attending the Annual Meetings of the Bank and Fund-- although on that occasion, in Vienna, I held the very different responsibility of a financial journalist.

Last year's Annual Meetings in Toronto, when the UK was represented by my distinguished predecessor, Sir Geoffrey Howe, coincided with the low point of the recession for the world economy as a whole. Deep concern was then expressed about the prospects of recovery, and there was some hesitation over the right strategies for national economies. And the first major outbreak of the debt problem had just occurred.

/Since then we have

Since then we have experienced an eventful and troublesome year, for governments and peoples alike, and for the institutions in which we meet today. Debt problems have multiplied, and we are still far from seeing a clear way through all of them. The course of exchange rates and interest rates has been unsettled, and present levels, particularly interest rate levels, cannot be regarded as satisfactory. The economic and political strains of adjustment have inevitably proved painful. Impatient voices are heard demanding new approaches, new systems, new institutions.

But despite all that there has been undoubted progress; particularly on the all-important struggle against inflation; and recovery is now clearly under way. We are not yet out of the wood, but we are moving forward again. It is a good time to take stock of how best to make further progress, and tackle the problems which remain.

That is our common purpose at these meetings. An occasion such as this is one on which the Finance Ministers who bear many of the political burdens of painful adjustments can share their experiences and

/perhaps even

perhaps even fortify each other thereby. So it may be helpful if I spend a few minutes describing our recent experience in the United Kingdom, where a clear adjustment strategy was adopted four years ago, has since been steadily pursued, and is showing good results.

UK Economy

In the United Kingdom we have, during these past four years, followed a three-part strategy. We have exercised steady downward pressure on monetary conditions. Despite the recession, we have reduced our budget deficit significantly as a percentage of GDP. And we have introduced reforms to remove structural rigidities in the economy, abolishing a whole raft of controls, on pay, prices and dividends, on industrial development and consumer credit, and perhaps most important of all, on foreign exchange transactions.

What results has the strategy brought? First, inflation has been reduced dramatically. It has fallen from a rate of around 15 per cent for much of the 1970s to around 5 per cent now. The long upward trend of rising inflation rates from one cycle to another has been decisively broken. Secondly, we have secured

/renewed economic growth

renewed economic growth. Despite unfavourable world trade conditions which impact particularly sharply on the UK, our economy has been growing at an average annual rate of around $2\frac{1}{2}$ - 3 per cent since the trough of the recession in the first half of 1981. This compares favourably with our long-run pre-recession trend. And unemployment, although still tragically high, is starting to level off.

Some observers in the UK used to argue that such a recovery was impossible without government stimulus, So far from that being the case, economic recovery in the UK can now be seen to have started in the immediate wake of my predecessor's courageously tough budget of 1981.

Now the critics argue that the recovery is not sustainable; that it is unbalanced; and that inflation is bound to rise again. I shall briefly explain why I believe they are wrong on all counts.

It is true that the recovery so far has been primarily based on increased personal spending and the end of destocking. But that is not a cause for concern, for all recoveries have that characteristic in the early stages. That is a well-established cyclical patte

What is significant is that on this occasion the familiar first stages of an end to destocking, a rise in spending on consumer durables, and an acceleration of house-building, came about without any Government stimulus to demand: they resulted instead from lower interest rates, increased confidence and above all low inflation, which in turn have been the result of responsible monetary and fiscal policy.

It would now be normal for the emphasis of the recovery to switch from the personal sector to the company sector, in the form of increased capital investment and positive stockbuilding. The pattern -- in no way unusual or surprising -- that investment follows consumption increases should be encouraged by the very substantial increase in company sector profitability which we have seen over the past year. Certainly, there are no signs, in the forward indicators, that the UK recovery is coming to an end. Quite the contrary.

Provided that monetary control is maintained -- and it will be -- and that inflationary expectations continue to improve, and providing we can continue to hold down our budget deficit and avoid unnecessary pressure on interest rates, which are still too high, we will see the recovery spread more widely throughout the economy.

/As for

As for the critics' concern that UK inflation would rise with economic recovery, the fact is that there is no sign so far of re-emerging inflationary pressure even though, as I have explained, the recovery has already been under way for two years. Of course, there will be temporary variations caused by special factors, but there is no sign in the inflation figures, when we strip out the volatile impact of changes in housing costs (themselves the result of changing interest rates) and seasonal food prices, of any change in the underlying trend. The growth of labour costs per unit of output continues to be low, helped by substantial increases in productivity.

THE WIDER STRATEGY

I think it worthwhile to set out these facts from this rostrum, for there is an important conclusion to be drawn from all this, and it applies, I believe, not only to the United Kingdom.

It was one of the characteristics of the cycles of the 1960s and 1970s that many observers underestimated the continuing strength of recovery. Indeed, one of

/ the reasons for

the reasons for accelerating world inflation during the 60s and 70s was that, at the stage of the cycle which the UK has now reached, governments worried about the strength of recovery and were persuaded to stimulate the level of demand. Because that stimulus was in addition to the already powerful forces of recovery the result was excessive inflationary pressure.

The lesson of that experience is one which we should all heed. It is important that we all recognise that powerful forces arising from lower inflation, lower interest rates and lower labour costs can both start and sustain recovery; and that the factors which are most likely to damage recovery would be an excessive expansion of demand by mistaken monetary and fiscal policies, bringing about their own inevitable reverse, and in particular an unsustainable structural budget deficit that puts damaging pressure on interest rates.

Let us also remember that high interest rates bear particularly heavily on developing and debtor countries; and that protectionist forces are inevitably strengthened when exchange rates are determined more by capital flows than by trade flows.

/So let me

So let me now draw some specific conclusions from our UK experience -

First, the strategy works: our experience demonstrates that it is possible for governments to reduce and control inflation through appropriate monetary and fiscal policies; and that financial discipline does not stifle growth - on the contrary, it helps to create the conditions for healthy and sustainable growth.

Secondly, perseverance is necessary, and it is important for the government to convey its determination to persevere; this is not easy, because it takes time before benefits are seen, and it may take additional time to see the benefits convincingly, even after they have begun to take effect. But it is crucial to demonstrate to the markets that there is, and will remain in place, a firm medium-term financial strategy.

Thirdly, although conditions in different countries may vary, I am convinced of the need to have monetary and fiscal policy operating in harmony. Otherwise, there will be risk of severe strain,

/especially if public

especially if public sector borrowing so pre-empt^s flows of savings that monetary restraint can be achieved only at the cost of very high real interest rates.

Fourthly, while no country can insulate itself against the rest of the world economy, the more firmly engaged any country is on a sound financial strategy, the better it will be able to withstand external shocks or weaknesses.

Fifthly, liberalising industry, cultivating competition, and giving free rein to market forces helps recovery. This applies across as well as within national frontiers: liberalisation of trade and payments contribute importantly to the development of world trade and economic activity.

Sixth, our general election result earlier this year has demonstrated that, despite all the inescapable pains of adjustment, a Government which steadfastly pursues this strategy, and which clearly explains to the people the need for the policies it is carrying out, has no cause to fear that it is exceeding the bounds of the politically possible.

/I make no apology

I make no apology for having dwelt at some length on the U.K. experience. At repeated international meetings Finance Ministers have agreed that the successful pursuit of a firm anti-inflationary strategy is the only sound basis for recovery. The Managing Director of the Fund has consistently and helpfully urged this on us all, not just those who are immediate clients in drawing on IMF resources. He did so again, most eloquently, from this rostrum yesterday. What is happening in my country is, I believe, both relevant and encouraging.

DEBT

The Fund's main concern over the past year - and that of the World Bank too - has been with countries facing debt problems. The growth of such problems in the last 18 months has been dramatic because a number of factors came together at the same time. A combination of world recession and sharply reduced commodity prices has limited export earnings by debtors. Very high dollar interest rates, applying to borrowing of which an increasing amount had become short-term, have magnified their problems.

Both elements in this squeeze have already eased a little, and should ease still further as world economic recovery continues, and particularly if the relative

/ burden of dollar

burden of dollar interest rates can be reduced. Because of this, it is important not to overstate the problem, while remaining mindful of the risks.

On the other hand, it is abundantly plain with hindsight that the scale of reliance on borrowing by some countries had by 1981 become greatly excessive, reflecting the over-ambitious quest to maintain unsustainable growth rates in a deteriorating world environment.

Balancing these various factors, the IMF have produced, in their latest survey of the World Economic Outlook, a careful assessment of the risks and possibilities in both directions. I do not dissent from it. My own view is that our joint efforts to sustain world recovery and maintain the attack on inflation will help, but that there is an unavoidable, urgent and continuing need for adjustment by the major debtors.

There can be no escaping the need for adjustment, and the IMF has served us all well in holding firmly to this basic requirement. I should also like to add a word of appreciation, indeed congratulation, to those of our colleagues who have displayed the determination and political will to move quickly and decisively in the right direction.

/If adjustment is crucial

If adjustment is crucial, so also is the provision of some time for its effects to be achieved. I believe we have developed a sensible emergency strategy, with the IMF playing a central role in working out necessary programmes of adjustment, which unlock IMF assistance, and in turn some mobilisation of new commercial lending. But I suggest we should now begin thinking further into the future.

Three issues might be worth pursuing.

First, many of the arrangements which are being made create the prospect of a very considerable hump of debt maturities a few years ahead. If - and I emphasise this basic requirement yet again - if the course of adjustment is satisfactory, it seems to me that it would be right for the borrowers and lenders concerned to think in terms of trying to reshape maturities for a further period ahead, on a longer time-scale. Much will depend on the degree of confidence in the borrower, and on world prospects generally; much may also depend on the evolution of interest rates and international flows of funds generally. In the main, however, we are dealing with countries which have considerable potential resources, if they can be effectively mobilised.

/Second, it is very

Second, it is very likely that the pattern of international flows of funds in the next decade will differ sharply from what we have seen in the last decade. We are already well past the peak period of accumulation of surplus wealth by the major oil-producing countries. We may well be moving into a period in which the current deficits which are the natural condition of most of those countries in the developing stage will have as their counterpart the more traditional surpluses of industrial countries, whose capital formation and distribution are very different. There is food for reflection here for commercial banks, but particularly also for the borrowing countries themselves. I suggest in particular that many of them ought to look again at their attitudes towards private investment, and to reflect on the advantages they could draw from encouraging long-term flows in that form, rather than the short-term borrowing of which they have had such uncomfortable recent experience, and which may in any case be less freely available.

Finally, as the world economy recovers strength, we need to give increasing attention to ways of strengthening the role of the World Bank, and to means of association between it and private investment. No country should delude itself that massive increases of official assistance are likely--or indeed would be helpful in securing sustainable growth. But there is some scope for a stronger role here.

IMF FINANCE

I have already spoken of the key role of the IMF in helping to encourage and support adjustment policies. Recognising that the Fund must be equipped with sufficient resources to discharge this task, the Interim Committee, under the Chairmanship of my predecessor, reached important decisions in February on the 8th Quota Review. The effect of this, together with that of the decisions reached in advance on the enlargement of the GAB, should be to double the useable resources available to the Fund.

It is clearly essential that these decisions are implemented as soon as possible by all Fund members. I am glad to say that the United Kingdom has already passed the necessary legislation. It would be difficult to overstate the importance of the US Congress doing so too, and on time.

Provided that they do, the decisions reached, at the end of the day, at the latest meeting of the Interim Committee, in which the United Kingdom was glad to have been able again to offer some assistance, will provide a firm but flexible basis for carrying forward the Fund's work.

/Given uncertainties

Given uncertainties about future developments it would not have been sensible to seek to reach a view on the level of members' access to the Fund more than a year ahead: nor was that necessary. The Committee, rightly in my view, envisage a gradual phasing out of the enlarged access arrangements. But it is evident that their extension into 1984 was necessary and fully justified.

I believe the Committee was also right not to conclude that a case has yet been established for a further SDR allocation. There clearly is imbalance in the distribution of world liquidity: but I am not convinced that there is an overall world liquidity shortage. At the same time I welcome the fact that further studies in this field are being put in train, and that the issue remains on the table.

IBRD/IDA FINANCING

The World Bank, too, cannot perform its role without adequate funds, and a selective capital increase is now required in order to help raise the level of lending which the Bank can sustain. I have accordingly suggested that an increase of around \$8 billion might be appropriate, provided that the details were settled in a satisfactory way, taking account of adjustments in the relative positions

/ of shareholders

of shareholders.

But we must recognise that an increase in World Bank lending will not help the poorer countries whose credit-worthiness precludes substantial borrowing from commercial banks. For them, IDA is crucial. The UK has always been a strong supporter of IDA, which we regard as a highly efficient means of channelling resources to the poorest countries. We are prepared to play our part, with due regard to our relative economic capacity, in securing a Seventh Replenishment of adequate size. I hope that all countries will be willing similarly to play their part, and I would particularly like to appeal to our United States colleagues, as IDA's originators and generous supporters, to consider whether there is more they can do to contribute to a satisfactory agreement. Their role in the final settlement will be crucial.

/INTERNATIONAL MONETARY SYSTEM

INTERNATIONAL MONETARY SYSTEM

I would like, in conclusion, Mr. Chairman, to add a word on the perennial question of the overall working of the international monetary system. The International Financial Institutions represented here have served us well over the years, developing to match changing circumstances and meet new needs. Provided that we continue to equip them with adequate resources, I am convinced that this will remain the case.

They have shown resilience and adaptability in confronting the difficult issues arising in a period of transition from one of high inflation. The past few years have in a very practical sense been a period of evolution in which all our countries have shared, in particular through participation in the operational decisions of the Fund.

In the wake of the second oil price increases, the international community has reached a general agreement on the stance of policy which can best provide the basis for sustainable non-inflationary growth. This strategic consensus provides a framework in which we can consider what further improvements to the operation of the monetary system might be sensible.

/It is right that there

It is right that there should be continuing exploration and debate about specific aspects of the system. The recent Commonwealth Study Group report represents a thoughtful contribution to that debate. And I welcome the decision of the Group of Ten to carry out further work to identify areas where progressive improvements might be sought.

But I would just add this. Let us remember that it was inflationary domestic policies that precipitated the breakdown of the original Bretton Woods arrangements, not the other way about. When things go wrong, there is a temptation to blame the system. This is a temptation to assume that all problems that are not cyclical must be systemic, and can be solved only by changes to the international system. But none of us can in fact duck responsibility for the way we conduct our domestic economic and financial policies. That in the end is still what this discussion is really all about.

/Conclusion

CONCLUSION

It was for that reason, Mr. Chairman, that I began my remarks today with an account of our recent experience in the United Kingdom, and suggested some conclusions about the roots of our current recovery which might have wider relevance and applicability. It was for that reason too that, in discussing current debt problems, and putting forward some suggestions for their handling in the medium and longer term, I have stressed the cardinal importance of appropriate adjustment programmes. And it is precisely because both the Fund and the Bank play a key role in encouraging the adoption of such policies, and helping countries see them through, that I have today emphasised the importance of ensuring that both institutions continue to have the resources they need to do their job, supporting and sustaining a soundly-based recovery in national economies, and hence in the world economy. If we do not fail them, I am confident that they will not fail us.

Thank you, Mr. Chairman.

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TELEGRAM NUMBER 73 OF 12 APRIL

SPRING 1984

IMF: INTERIM COMMITTEE

1. FOLLOWING IS TEXT OF STATEMENT DELIVERED BY THE CHANCELLOR OF THE EXCHEQUER TO THE INTERIM COMMITTEE ON APRIL 12.

BEGINS

INTRODUCTION

MORE THAN ONE SPEAKER THIS MORNING HAS SOUNDED A NOTE OF QUALIFIED OPTIMISM. I SHARE THAT SENTIMENT, AND WOULD LIKE TO DISCUSS HOW THE RECOVERY THAT IS NOW SO CLEARLY IN EVIDENCE IS TO BE SUSTAINED. I WILL ALSO SAY A WORD OR TWO ABOUT THE INTERNATIONAL DEBT PROBLEM AND THE QUESTION OF WORLD LIQUIDITY.

SUSTAINING THE RECOVERY: UK AND WORLDWIDE

FIRST THE RECOVERY. ACTIVITY IS NOW UNMISTAKEABLY BEGINNING TO PICK UP IN THE INDUSTRIAL COUNTRIES. AND THE REVIVAL OF WORLD TRADE AND FIRMER COMMODITY PRICES ARE ALREADY SHOWING THROUGH IN THE RISING EXPORT EARNINGS FOR THE DEVELOPING COUNTRIES.

IN THE UNITED KINGDOM, INFLATION HAS FALLEN FROM A PEAK OF OVER 20 PERCENT IN 1980 TO UNDER 5 PERCENT LAST YEAR. WHILE THE BULK OF THIS REDUCTION IN INFLATION OCCURRED DURING THE DOWNSWING OF THE RECESSION, IT IS SIGNIFICANT THAT THE RECOVERY, WHICH FOR US BEGAN IN THE FIRST HALF OF 1981, HAS NOT LED TO ANY RESURGENCE OF INFLATION: ON THE CONTRARY, IT IS STILL EDGING DOWN.

LAST YEAR UK GDP GREW BY 3 PERCENT, BRINGING OUTPUT BY THE END OF THE YEAR BACK TO THE LEVEL OF THE PRE-RECESSION PEAK, AND WE ARE EXPECTING A FURTHER 3 PERCENT GROWTH THIS YEAR, WITH BOTH INVESTMENT AND EXPORTS CONTINUING TO RISE FASTER THAN THE ECONOMY AS A WHOLE. AS I SUGGESTED WHEN I ADDRESSED THE ANNUAL MEETING OF THE FUND LAST SEPTEMBER, OUR RECOVERY IN THE UK IS SHOWING ALL THE SIGNS OF DURABILITY.

THERE ARE LESSONS FROM THIS EXPERIENCE THAT I BELIEVE CAN HELP TO ENSURE THAT WORLDWIDE RECOVERY IS SUSTAINED INTO THE MEDIUM-TERM.

FIRST, WE NEED TO MAKE CLEAR THAT WE WILL MAINTAIN A BALANCED AND SECURE FINANCIAL FRAMEWORK, AND IN THIS WAY PROVIDE A FIRM BASIS FOR EXPECTATIONS— FOR INVESTMENT, FOR FINANCIAL MARKETS, AND FOR WAGE BARGAINING ALIKE. WE NEED TO SHOW UNAMBIGUOUSLY THAT INFLATION WILL BE KEPT FIRMLY IN CHECK, WITHOUT EXCESSIVE INTEREST RATES. THIS MEANS THAT MONETARY AND FISCAL POLICY MUST OPERATE IN HARMONY. WE HAVE TO DEMONSTRATE OUR INTENTION TO KEEP BOTH MONEY AND BORROWING UNDER CONTROL.

/second

SECOND, WE MUST KEEP A FIRM HOLD ON PUBLIC SPENDING. THE LAST DECADE SAW IN MOST OF OUR COUNTRIES A MASSIVE ENLARGEMENT OF THE ROLE OF THE STATE. I REGARD IT AS NO COINCIDENCE THAT OF THE MAJOR INDUSTRIAL COUNTRIES, IT IS THE TWO WITH THE LOWEST PUBLIC EXPENDITURE AS A PROPORTION OF GDP— I REFER TO THE UNITED STATES AND JAPAN— WHICH HAVE ENJOYED THE STRONGEST RECOVERY. WE IN THE UK HAVE ANNOUNCED PLANS FOR AN UNCHANGED LEVEL OF PUBLIC EXPENDITURE IN REAL TERMS OVER THE NEXT 3 YEARS. AS THE ECONOMY GROWS BOTH PUBLIC EXPENDITURE AND GOVERNMENT BORROWING WILL FALL STEADILY AS A PROPORTION OF GDP.

THIRD, WE NEED TO IMPROVE THE SUPPLY SIDE OF OUR ECONOMIES, REMOVING RIGIDITIES AND DISTORTIONS AND ALLOWING THE MARKET TO DO ITS JOB. AS SOME OF YOU MAY KNOW, THE BUDGET I INTRODUCED LAST MONTH WAS DESIGNED TO ASSIST IN THIS PROCESS. IT IS IN IMPROVEMENTS ON THE SUPPLY SIDE, RATHER THAN IN AN INJECTION OF MONETARY DEMAND, THAT WE WILL FIND THE SOLUTION TO THE PROBLEM OF PERSISTENTLY HIGH UNEMPLOYMENT.

GIVEN THE RIGHT POLICIES, THERE IS NO REASON WHY THE WORLD RECOVERY SHOULD NOT BE SUSTAINED. OF COURSE THERE ARE UNCERTAINTIES, NOT LEAST THE LEVEL OF WORLD INTEREST RATES, AND ITS IMPACT ON THE DEBTOR COUNTRIES. HERE, THE BIGGEST SINGLE CAUSE IS THE MASSIVE SIZE OF THE UNITED STATES BUDGET DEFICIT, AND I WELCOME THE NEWS THAT THE FIRST STEPS TOWARDS TACKLING THIS VERY SERIOUS PROBLEM MAY NOW BE ABOUT TO BE TAKEN.

INTERNATIONAL DEBT

PROBLEMS OF INTERNATIONAL DEBT HAVE DOMINATED MUCH OF THE DISCUSSION IN THIS COMMITTEE AND THE WORK OF THE IMF FOR NEARLY TWO YEARS. HERE TOO THERE HAS BEEN PROGRESS AND THE PROSPECTS ARE ON THE WHOLE LESS WORRYING THAN THEY WERE— HELPED BY THE GRADUALLY SPREADING BENEFITS OF WORLD RECOVERY.

NO PRAISE IS TOO HIGH FOR THE ROLE PLAYED DURING THE DIFFICULT PERIOD—AND WE ARE NOT OUT OF THE WOOD YET—BY THE MANAGING DIRECTOR, JACQUES DE LAROSIERE. THE FORMULA THE FUND HAS ADOPTED, OF OFFERING HELP ONLY WHEN PROPER ADJUSTMENT IS UNDERTAKEN, HAS BEEN PROVED TO BE EFFECTIVE, AND WE MUST CLEARLY PERSEVERE WITH IT. NOTHING MUST BE DONE TO UNDERMINE IT, OR TO UNDERMINE THE AUTHORITY OF THE FUND.

BUT WHILE I SEE NO CASE FOR ANY NEW GLOBAL SCHEME TO RELIEVE DEBT, I BELIEVE WE COULD USEFULLY EXPLORE WAYS OF COMPLEMENTING OUR PRESENT STRATEGY BY LAYING THE FOUNDATIONS FOR HEALTHIER FLOWS OF CAPITAL TO DEVELOPING COUNTRIES IN FUTURE YEARS.

ALL OF US (BUT PARTICULARLY THE DEBTOR COUNTRIES THEMSELVES) WOULD DO WELL TO REFLECT ON THE NATURE OF CAPITAL FLOWS NEEDED. WE CAN SURELY SEE THE DANGERS OF EXCESSIVE RELIANCE ON SHORT-TERM BANKING FINANCE. WHAT IS NEEDED IS LONG-TERM CAPITAL. WHICH WILL NOT BURDEN BORROWERS WITH SERVICING COSTS DEPENDENT ON FLUCTUATIONS IN US INTEREST RATES AND WITH REPAYMENT SCHEDULES THREATENING RECURRENT CRISIS.

MOST OF THE ECONOMIES THAT HAVE ENCOUNTERED DEBT DIFFICULTIES HAVE GREAT POTENTIAL FOR THE FUTURE, AND IN MANY CASES ASSETS OF MORE IMMEDIATE AND ATTRACTIVE VALUE. I AM SURE THAT THE WORLD'S INVESTORS COULD BE INDUCED TO TAKE AN INTEREST IN THIS POTENTIAL AND THESE ASSETS. GIVEN SOME RESTORATION OF CONFIDENCE IN ECONOMIC POLICIES, AND A CLIMATE OF ENCOURAGEMENT, THERE IS A PROSPECT OF MASSIVE FLOWS OF LONG-TERM CAPITAL WHICH WOULD GIVE A REAL BOOST TO THE DEVELOPMENT AND FUTURE PROSPERITY OF THESE COUNTRIES. THIS NEEDS TO BE ENCOURAGED.

I SEE TOO A GROWING ROLE FOR OUR LEADING INTERNATIONAL FINANCIAL INSTITUTIONS: THE IMF AND THE WORLD BANK. THE FUND OF COURSE IS PRIMARILY CONCERNED WITH SHORTER-TERM ADJUSTMENTS.

I WOULD LIKE TO SEE THESE INSTITUTIONS, WITH EACH PLAYING ITS APPROPRIATE ROLE, WORKING OUT IN CONCERT AN APPROACH TO THE LONGER-TERM STRUCTURAL EVOLUTION OF DEVELOPING AND DEBTOR COUNTRY ECONOMIES, AND ENCOURAGING LONG-TERM FOREIGN CAPITAL TO FLOW IN SUPPORT OF SOUNDLY-BASED DEVELOPMENT POLICIES. MEANWHILE, IT IS WORTH EMPHASISING THE URGENT NEED TO GO AHEAD WITH THE SELECTIVE CAPITAL INCREASE IN THE IBRD AND THE 7TH REPLENISHMENT OF IDA.

GLOBAL LIQUIDITY AND THE SDR

I END WITH A BRIEF WORD ON GLOBAL LIQUIDITY.

IN THE LATE 1960S, WHEN THE SDR WAS INTRODUCED, IT WAS FELT THAT WORLD RESERVES, OR AT LEAST NON-GOLD RESERVES, WERE TOO SMALL. SINCE THEN, TAKING THE PERIOD END-1969 TO 1983 NON-GOLD RESERVES OF INDUSTRIAL COUNTRIES HAVE MULTIPLIED BY 7; THOSE OF NON-OIL DEVELOPING COUNTRIES HAVE MULTIPLIED BY 8. THEY DID FALL BACK A LITTLE IN 1981 AND 1982, BUT ARE NOW RISING AGAIN. I SEE NO CASE FOR ANY ARTIFICIAL INCREASE IN OVERALL WORLD LIQUIDITY HERE.

THERE REMAINS THE QUESTION OF THE DISTRIBUTION OF RESERVES.

IT IS A FACT THAT CERTAIN COUNTRIES - ESPECIALLY THE MAJOR DEBTORS AND THE VERY POOREST - HAVE VERY LOW RESERVES NOW BY ANY MEASUREMENT, AND LITTLE PROSPECT OF INCREASING THEM. BUT THIS IS NOT A LIQUIDITY PROBLEM. WHAT THESE COUNTRIES NEED IS NOT 'LIQUIDITY', BUT MORE BALANCED DOMESTIC ECONOMIC POLICIES, OUTLETS FOR THEIR EXPORTS, AND OPPORTUNITIES TO ATTRACT LONG-TERM FOREIGN CAPITAL TO HELP FINANCE THEIR CONTINUED FUTURE DEVELOPMENT.

FINALLY, MR. CHAIRMAN, MAY I ADD THAT A NUMBER OF THE IMPORTANT SUBJECTS WE TOUCH ON TODAY WILL OF COURSE FIGURE PROMINENTLY IN DISCUSSIONS AT THE ECONOMIC SUMMIT WHICH MY COUNTRY WILL HAVE THE PRIVILEGE OF HOSTING LATER THIS YEAR.

ENDS

2. FCO PLEASE ADVANCE TO PAGE (TREASURY PRESS OFFICE) CHANCELLOR'S PRIVATE OFFICE, AND LAVELLE (TREASURY).

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IMF/IBRD SPRING MEETINGS

FOLLOWING IS TEXT OF CHANCELLOR OF THE EXCHEQUER'S STATEMENT
TO THE INTERIM COMMITTEE PLENARY SESSION ON APRIL 17.

BEGINS:

1. THESE MEETINGS BEING HELD AT A MUCH MORE PROPITIOUS TIME FOR THE WORLD ECONOMY THAN ANY OVER THE LAST SIX YEARS. DESPITE UNSETTLED EXCHANGE MARKETS AND SOME SERIOUS IMBALANCES, THE INDUSTRIAL COUNTRIES HAVE HAD AT LEAST TWO YEARS -- IN THE CASE OF THE UK FOUR YEARS -- OF STEADY GROWTH AND RELATIVELY LOW INFLATION. OUTLOOK IS FOR THIS TO CONTINUE. IMPORTANT FOR US IN OUR DISCUSSIONS OVER COMING DAYS TO REFLECT ON WHAT GAVE RISE TO THIS IMPROVEMENT -- AND TO THE PREVIOUS DISTURBANCES -- AND SEE WHAT WE NEED TO CONSOLIDATE, AND WHAT STILL NEEDS TO BE CORRECTED.
2. OVER THE 1970S -- AS BROUGHT OUT IN A NUMBER OF THE EXCELLENT BACKGROUND PAPERS THAT HAVE BEEN PRODUCED FOR THESE MEETINGS -- ENORMOUS STRAINS BUILT UP BY DIVERGENT AND GENERALLY INFLATIONARY ECONOMIC POLICIES IN THE MAJOR COUNTRIES.
3. DURING THAT PERIOD EASY, CHEAP CREDIT MEANT THAT MANY DEVELOPING COUNTRIES WERE ABLE TO GROW QUICKLY -- BUT, AS WE NOW SEE, IN AN UNSUSTAINABLE FASHION.
4. THE LAST FEW YEARS OF ADJUSTMENT HAVE BEEN EXTREMELY PAINFUL FOR MANY DEVELOPING COUNTRIES. LIVING STANDARDS HAVE FALLEN. UNEMPLOYMENT -- RECORDED AND DISGUISED -- HAS RISEN SHARPLY. IMPORTS HAD TO BE CUT DRAMATICALLY. BUT MORE RECENTLY THEIR EXTERNAL POSITIONS HAVE BECOME MUCH MORE SUSTAINABLE. THEIR VULNERABILITY TO FURTHER EXTERNAL SHOCKS MUST NOW HAVE BEEN REDUCED. THE IMPROVING WORLD CLIMATE HAS ALSO MADE IT MUCH EASIER TO BRING ABOUT SUBSTANTIAL IMPROVEMENTS TO THEIR TRADE ACCOUNTS AND HAS ASSISTED RENEWED GROWTH.
5. MEANWHILE, THE NEED FOR FINANCE TO SUSTAIN ADEQUATE LEVELS OF INVESTMENT WILL CONTINUE. THIS SHOULD COME FROM SECURE AND SUSTAINABLE SOURCES, NOT ENOUGH IS YET BEING DONE TO RAISE THE LEVELS OF PRIVATE SAVINGS IN DEVELOPING COUNTRIES OR ATTRACT INWARD DIRECT INVESTMENT. I HOPE WE WILL HEAR MORE OF INITIATIVES IN THESE AREAS OVER THE NEXT TWO DAYS. I ALSO BELIEVE WE NEED TO DISCUSS THE INTERESTING PROPOSALS FOR A MULTILATERAL INSURANCE GUARANTEE AGENCY AND PROGRESS ON THE DEVELOPMENT OF MULTI-YEAR RESCHEDULING AGREEMENTS.

6. THE DEVELOPED WORLD HAS ALSO FACED A NEED FOR ADJUSTMENT AND IS STILL WRESTLING WITH SUBSTANTIAL PROBLEMS. TOO MANY COUNTRIES IN WESTERN EUROPE -- INCLUDING THE UK -- ARE STILL IMPEDED BY EXCESSIVE PUBLIC EXPENDITURE AS A SHARE OF GDP, BY OVER-REGULATION AND OUT-DATED WORK PRACTICES THAT THEY HAVE BEEN UNABLE TO GENERATE SUFFICIENT JOBS TO BRING DOWN UNEMPLOYMENT TO ACCEPTABLE LEVELS. JUST AS IN THE DEVELOPING WORLD IT IS ESSENTIAL THAT BARRIERS BE DISMANTLED, SO IN THE FULLY INDUSTRIALISED WORLD WE MUST ATTACK THE STRUCTURAL RIGIDITIES THAT ARE IN DANGER OF OSSIFYING OUR ECONOMIES. WE TOO HAVE HAD TO ADJUST AND TAKE DIFFICULT DECISIONS. IN THE DECADE BETWEEN 1973 AND 1983 UNEMPLOYMENT MULTIPLIED FIVEFOLD IN THE UK. OUR TRADITIONAL INDUSTRIES HAVE HAD TO SLIM DOWN -- OVER 150,000 JOBS GONE IN THE LAST 6 YEARS IN THE TEXTILE INDUSTRY, THE LABOUR FORCE IN OUR STEEL INDUSTRY HAS MORE THAN HALVED. AND RECENT EVENTS IN OUR COAL INDUSTRY HAVE DEMONSTRATED THE DETERMINATION NECESSARY TO CARRY FORWARD THE RESTRUCTURING OF THAT INDUSTRY TOO.

7. WE MUST IN PARTICULAR GIVE A STRONG LEAD TO THE DRIVE AGAINST PROTECTIONISM -- BY MOVING TOWARDS NEW GATT ROUND IN 1986, BY LOOKING AT SERVICES AND AGRICULTURE AS WELL AS MANUFACTURES, AND BY FIRMLY RESISTING THE CALLS TO EMERGENCY ACTION SUCH AS IMPORT SURCHARGES. THE COST OF PROTECTION FOR ALL OF US FAR EXCEED ANY APPARENT TEMPORARY BENEFIT TO ONE.

8. REMOVAL OF DOMESTIC AND TRADE BARRIERS WILL NOT BE A QUICK OR AN EASY PROCESS. BUT IT IS IMPORTANT NOT TO HEED THOSE VOICES CALLING FOR THE WRONG AND DISCREDITED REMEDIES FOR THE CURRENT HIGH LEVELS OF UNEMPLOYMENT WE FACE: FISCAL REFLATION WILL NOT WORK WHEN THE PROBLEM IS NOT INADEQUATE MONEY DEMAND BUT INFLEXIBLE SUPPLY. THOSE WHO LOOK TO THE INDUSTRIALISED WORLD FOR SUSTAINABLE GROWTH AND LOW INFLATION WOULD NOT BENEFIT FROM IRRESPONSIBLE POLICIES WHICH WOULD ONLY LEAD TO FURTHER INSTABILITY AND THE PERPETUATION OF PAST PROBLEMS.

9. THE STRATEGIES WE MUST FOLLOW ARE WELL BROUGHT OUT IN THE FUND WORLD ECONOMIC OUTLOOK PAPERS. IF PRUDENT MACRO-ECONOMIC POLICIES ARE MAINTAINED -- AND IN PARTICULAR IF SUCCESSFUL EFFORTS ARE MADE TO BRING DOWN THE US FISCAL DEFICIT -- AND IF STRUCTURAL RIGIDITIES ARE REDUCED IN EUROPE, AND IF JAPAN BUILDS UPON PRIME MINISTER NAKASONE'S RECENT INITIATIVE TO OPEN UP MARKETS AND ENCOURAGE IMPORTS -- THEN THE PROSPECTS FOR THE WORLD ECONOMY ARE CERTAINLY ENCOURAGING. THE HIGH GROWTH RATE OF 1984 -- ABOUT 5 PER CENT FOR THE MAJOR INDUSTRIAL ECONOMIES AS A WHOLE -- MAY NOT BE REPEATED. BUT IN ITS PLACE WE CAN LOOK FORWARD TO STEADY AND SUSTAINABLE GROWTH RATES OF 3 - 3 AND ONE HALF PER CENT PER ANNUM. WITH LOWER INFLATION AND A REDUCTION IN GLOBAL IMBALANCES THIS OUTLOOK PRESENTS A FAVOURABLE PROSPECT NOT ONLY FOR THE DEVELOPED BUT ALSO THE DEVELOPING WORLD. AND ONE BUILT PRIMARILY ON EFFECTIVE COUNTER-INFLATIONARY POLICIES. 2

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10. A SUSTAINED GROWTH IN WORLD TRADE -- OF THE ORDER OF 6 PER CENT PER ANNUM -- WOULD ALSO PROVIDE THE RIGHT ENVIRONMENT IN WHICH FURTHER EXTERNAL ADJUSTMENT CAN BE ACHIEVED BY DEVELOPING COUNTRIES WITHOUT EXCESSIVE COSTS IN TERMS OF IMPORT REDUCTIONS AND LIVING STANDARDS. WE CANNOT AND MUST NOT GO BACK TO A WORLD OF NEGATIVE REAL INTEREST RATES -- EITHER INTERNATIONALLY OR WITHIN PROTECTED ECONOMIES -- BUT THERE IS NO DOUBT THAT THE HIGH LEVEL OF REAL INTEREST RATES AT THE MOMENT IN PART REFLECTS AN UNHELPFUL MIX OF POLICIES, PARTICULARLY IN THE UNITED STATES. THE REDUCTIONS IN EXPENDITURE AND THE BUDGET DEFICIT PROPOSED BY THE UNITED STATES ADMINISTRATION WOULD PROVIDE AN ENCOURAGING FIRST STEP TOWARDS A BETTER BALANCED WORLD ECONOMIC PICTURE.

11. A LOWER FISCAL DEFICIT IN THE US WOULD, AMONG OTHER THINGS, IMPLY LESS NEED FOR AN ENORMOUS CAPITAL INFLOW TO THE US FROM THE REST OF THE WORLD, A LOWER DOLLAR AND -- WITH A SMALLER CURRENT ACCOUNT DEFICIT -- LESS PRESSURE IN THE US FOR DESTRUCTIVE PROTECTIONISM.

12. THE SURVEILLANCE PROCESS IN THE FUND OFFERS THE IDEAL FORUM FOR ENSURING THAT BOTH DOMESTIC AND INTERNATIONAL CONSIDERATIONS ARE FULLY TAKEN INTO ACCOUNT IN THE PREPARATION OF DOMESTIC POLICY.

13. BUT THE FUND HAS MANY OTHER RESPONSIBILITIES. NOT THE LEAST IS CONTINUAL INVOLVEMENT IN THE RECUPERATION AND CONVALESCENT STAGE OF DEBTOR ECONOMIES. THERE IS NOW A GENERAL ABSEPTANCE THAT CONVALESCENCE AND CURE CAN ONLY BE ACHIEVED BY SIZEABLE, IF PAINFUL, DOMESTIC ADJUSTMENT. SCHEMES FOR LIMITATIONS OF INTEREST PAYMENTS, FORGIVENESS ETC ARE COSTLY RED HERRINGS -- FOR SOME NOW AND FOR OTHERS IN THE FUTURE. IT IS NO KINDNESS TO LEAVE COUNTRIES EXPOSED TO FUTURE SHOCKS BECAUSE THEIR UNDERLYING ECONOMIC STRUCTURE HAS NOT BEEN PUT RIGHT. THE SDR TOO IS YET ANOTHER RED HERRING -- FOR THE REASONS I SET OUT AT OUR LAST MEETING, I STILL BELIEVE THAN AN ALLOCATION WOULD NOT HELP THE REAL PROBLEMS WE FACE.

14. SO THIS NEEDS TO BE OUR SUSTAINED THEME: PROPER EXPOSURE TO THE MARKET AND MARKET DISCIPLINES AGAINST THE BACKGROUND OF A DECLINING PUBLIC SECTOR AS A PROPORTION OF GDP, LOWER FISCAL DEFICITS AND PRUDENT RATES OF MONETARY GROWTH SET IN A MEDIUM-TERM CONTEXT. WE HAVE SEEN OVER THE LAST FEW YEARS IN THE INDUSTRIAL WORLD THE REWARDS THESE POLICIES CAN BRING. FURTHER EFFORTS IN THESE DIRECTIONS WILL PROVIDE THE RIGHT BASIS ON WHICH WE CAN LOOK WITH CONFIDENCE FOR SUSTAINED AND STEADY GROWTH IN A BETTER-BALANCED AND NON-INFLATIONARY WORLD ECONOMY.

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FM UKDEL IMF/IBRD WASHINGTON 251624Z SEP 84

TO IMMEDIATE FCO

TELEGRAM NUMBER 204 OF 25 SEPTEMBER

FOLLOWING TELEGRAM SENT TO YOU FOR ACTION AT REQUEST OF ORIGINATOR.
WAS SENT TO UKMIS NEW YORK TELNO 1 OF 23 SEPT.

BEGINS:

FM UKDEL IMF/IBRD WASHINGTON 231939Z SEP 84

TO IMMEDIATE UKMIS NEW YORK

TELEGRAM NUMBER 001 OF 23 SEPTEMBER

FOR PRIVATE SECRETARY TO SECRETARY OF STATE

FOLLOWING IS TEXT OF CHANCELLOR OF EXCHEQUER'S STATEMENT TO THE
INTERIM COMMITTEE ON SEPTEMBER 22. FOR YOUR INFORMATION, THE TEXT
HAS NOT (REPEAT NOT) BEEN MADE AVAILABLE TO OTHER PARTICIPANTS OR
TO THE PRESS.

BEGINS

1. MR CHAIRMAN, YOU ARE PRESIDING OVER OUR DISCUSSIONS TODAY IN THE
KNOWLEDGE THAT THIS PARTICULAR SET OF RESPONSIBILITIES WILL SHORTLY
COME TO AN END. WE WISH YOU WELL IN YOUR IMPORTANT NEW ROLE.
MEANWHILE, WE WILL NEED, AND I KNOW WE WILL RECEIVE, THE BENEFIT
OF YOUR GOOD SENSE AND EXPERIENCE TO GUIDE US TODAY AS IT HAS IN THE
PAST.

THE WORLD RECOVERY

2. THE WORLD RECOVERY IS PROVING STRONGER THAN MANY EXPECTED A YEAR
AGO WITH PARTICULARLY RAPID GROWTH IN THE UNITED STATES, AND A MORE
GRADUAL UPTURN IN OTHER INDUSTRIAL COUNTRIES. THE RISE IN ACTIVITY
IN THE INDUSTRIAL WORLD, COUPLED WITH THE ADJUSTMENT EFFORTS OF
DEVELOPING COUNTRIES, HAS BROUGHT A SHARP REDUCTION IN THE CURRENT
PAYMENTS DEFICITS OF MANY DEBTOR COUNTRIES. A PARTICULARLY WELCOME
FEATURE OF THE PRESENT SITUATION IS THAT WORLD TRADE SEEMS LIKELY
TO RISE BY A HEALTHY 8 PER CENT THIS YEAR AFTER FOUR YEARS OF
VIRTUAL STAGNATION.

3. THE UNDERLYING FACTORS BEHIND THE RECOVERY HAVE BEEN THE FIRM
EFFORTS MANY OF US HAVE MADE TO REDUCE INFLATION, CURB BUDGET DEFICIT
S

AND TO REMOVE THE RIGIDITIES THAT AFFECT SO MANY OF THE ECONOMIES.
WE MUST CONTINUE WITH THESE POLICIES, WITH RENEWED DETERMINATION.

4. IN THE UNITED KINGDOM, AS A RESULT OF THESE POLICIES, WE ARE
NOW IN THE FOURTH YEAR OF ECONOMIC RECOVERY, WHILE INFLATION
HAS REMAINED RELATIVELY LOW AT 5 PER CENT.

5. IN RECENT YEARS THE EMPHASIS OF POLICY IN MANY COUNTRIES,
INCLUDING THE UK, HAS BEEN ON FINANCIAL STABILISATION. AND WE HAVE
SEEN THE BENEFITS OF THAT STABILISATION. BUT WHILE MAINTAINING THIS
IMPROVE MACRO POLICY WE MUST NOW PLACE MORE EMPHASIS ON MICRO-
ECONOMIC AND STRUCTURAL PROBLEMS, WHICH ARE THE CAUSE OF THE
CONTINUING HIGH LEVEL OF UNEMPLOYMENT WHICH SO MANY OF US FACE TODAY.

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6. IMPROVED MICRO POLICIES INVOLVE DIFFICULT CHOICES -- JUST AS WITH IMPROVED MACRO POLICY.

THE UK IS DETERMINED TO CONTINUE TO OPERATE POLICY TOWARDS THE TWIN OBJECTIVES OF MICRO AND MACRO POLICY:

- A MACRO POLICY DESIGNED TO KEEP INFLATION LOW
- A MICRO POLICY DESIGNED TO IMPROVE PRODUCTIVE POTENTIAL AND ENSURE ADEQUATE EMPLOYMENT PROSPECTS IN THE FUTURE.

DIALOGUES

7. THE ISSUES RAISED BY RECOVERY HAVE REMINDED US ALL OVER AGAIN OF THE INTERDEPENDENCE OF THE FORTUNES OF DEVELOPING AND DEVELOPED COUNTRIES. WE SHARE AN INTEREST IN RE-EXAMING ASPECTS OF THE INTERNATIONAL MONETARY SYSTEM, THE ROLES OF MULTILATERAL INSTITUTIONS, PROBLEMS OF FLOWS OF RESOURCES, OF INVESTMENT AND DEBT, AND OF TRADE AND PROTECTIONISM.

8. THE LONDON ECONOMIC SUMMIT IN JUNE OF THIS YEAR RESPONDED POSITIVELY TO MANY DEVELOPING COUNTRIES' UNDERSTANDABLE REQUEST FOR A DIALOGUE ON THESE MATTERS.

9. AS SECRETARY REGAN HAS REMINDED US, THE LONDON ECONOMIC SUMMIT DECLARATION OF THE HEADS OF GOVERNMENT OF THE 7 MAJOR INDUSTRIALISED COUNTRIES EXPLICITLY ASKED THEIR FINANCE MINISTERS TO CONSIDER THE SCOPE FOR INTENSIFIED DISCUSSION OF INTERNATIONAL FINANCIAL ISSUES OF PARTICULAR CONCERN TO DEVELOPING COUNTRIES WITHIN THE DEVELOPMENT COMMITTEE OF THE BANK AND FUND. AT THE COMMONWEALTH FINANCE MINISTERS' MEETING IN TORONTO EARLIER THIS WEEK WE CONCLUDED THAT A SPECIAL MEETING OF THE DEVELOPMENT COMMITTEE SHOULD BE HELD NEXT SPRING FOR THIS PURPOSE.

10. I THEREFORE WELCOME SECRETARY REGAN'S RESPONSE TO THE LONDON SUMMIT INITIATIVE.

11. HE HAS PROPOSED AN ALTERNATIVE OF THE ORIGINAL PROPOSAL, UNDER WHICH THERE SHOULD BE A SPECIAL DISCUSSION IN THE INTERIM COMMITTEE AS WELL AS IN THE DEVELOPMENT COMMITTEE. CLEARLY THE FUND WILL NEED TO BE DEEPLY INVOLVED, WHATEVER HAPPENS, SINCE MANY OF THE ISSUES TO BE DISCUSSED FALL WITHIN ITS COMPETENCE. AND CLEARLY THE PAPERS ON THESE ISSUES WILL NEED TO BE PREPARED BY THE FUND.

12. BUT THE PRECISE QUESTION OF WHETHER WE NEED A SPECIAL MEETING OF THE INTERIM COMMITTEE AS WELL AS THE DEVELOPMENT COMMITTEE, OR WHETHER WE SHOULD BEGIN WITH A MEETING OF THE DEVELOPMENT COMMITTEE, WHICH WOULD THEN BE ABLE TO REFER TO THE INTERIM COMMITTEE ANY PROPOSALS ON MATTERS WHICH CLEARLY FALL WITHIN THE COMPETENCE OF THE FUND, IS SOMETHING ON WHICH IT WOULD BE FOOLISH TO TAKE A DOGMATIC POSITION. LET US SEE WHICH PROPOSAL COMMANDS THE GREATEST DEGREE OF ACCEPTANCE. WHAT IS IMPORTANT IS THAT THE DIALOGUE TAKES PLACE, AND DOES SO FIRMLY WITHIN THE FRAMEWORK OF OUR EXISTING INTERNATIONAL FINANCIAL INSTITUTIONS.

13. I NOW TURN TO THE QUESTION OF SDRS.

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14. I AM NOT PERSUADED OF THE CASE FOR AN ALLOCATION OF SDRS ON THE CRITERIA WE ARE REQUIRED TO APPLY TO THIS DECISION.

15. NOR AM I IMPRESSED BY ARGUMENTS THAT ARE SOMETIMES ADDUCED TO BOLSTER THE CASE WHICH RELY ON AN OUTDATED VIEW OF THE ROLE OF THE SDR IN THE SYSTEM.

16. MOREOVER, I DOUBT IF AN ALLOCATION WOULD HAVE A HELPFUL BEARING ON THE REAL PROBLEMS WE HAVE TO CONSIDER. IT COULD INSTEAD BE AN UNHELPFUL DISTRACTION.

17. LET ME EXPLAIN BRIEFLY WHY I REACH THESE CONCLUSIONS.

18. FIRST, THE QUESTION OF CRITERIA. IN AN EXCHANGE RATE SYSTEM WHERE THE MAJOR CURRENCIES FLOAT, THE REQUIREMENT FOR RESERVES IS LESS THAN IT USED TO BE. IT IS ALSO THE CASE -- AND THE DEBT PROBLEM ITSELF BEARS WITNESS TO THIS -- THAT OVER THE LAST DECADE POTENTIAL SOURCES OF LIQUIDITY FOR CREDITWORTHY BORROWERS HAVE INCREASED BEGIN SQUARE BRACKETS LAST WORD UNDERLINED END SQUARE BRACKETS. HOWEVER, EVEN WITHOUT REFERENCE TO THESE POINTS I SEE NO REASON TO BELIEVE THAT GLOBAL RESERVES ARE INADEQUATE. NON-GOLD RESERVES HAVE INCREASED BY 12 PER CENT SINCE THE END OF 1982. IN GLOBAL TERMS, PRESENT LEVELS RELATIVE TO IMPORTS ARE CLOSE TO THE AVERAGE OF THE 1970S. FINALLY, WE ARE ALSO REQUIRED TO TAKE A LONG-TERM VIEW. THE PROSPECT FOR THE PERIOD AHEAD IS THAT CENTRAL BANKS WILL HAVE THE OPPORTUNITY TO INCREASE THEIR HOLDINGS OF DOLLARS

19. SECOND, THE ROLE OF THE SDR. AN IMPORTANT ELEMENT OF THE ARGUMENT FOR AN ALLOCATION HAS THE FLAVOUR OF GIVING THE SDR THE BENEFIT OF THE DOUBT ON SOME GENERAL PHILOSOPHIC GROUNDS. BUT I THINK A FAIRER WAY OF LOOKING AT IT WOULD BE TO RECOGNISE THAT THE CIRCUMSTANCES WHICH LED US TO SEEK TO DEVELOP THE SDR NO LONGER EXIST. THE SYSTEM WE HAVE IS A MULTICURRENCY RESERVE SYSTEM. THAT IS ONE REASON WHY I WELCOME RECENT MOVES TO INTERNATIONALISE THE YEN.

20. THIRDLY, THE DISTRACTION POINT. AN ALLOCATION OF SDR WILL NOT SOLVE THE DEBT PROBLEM. IT WILL NOT SOLVE THE PROBLEM OF US INTEREST RATES. THERE ARE ISSUES HERE WHICH WE NEED TO TACKLE. IF DEBTOR COUNTRIES CAN RECOVER CREDITWORTHINESS, AND IF WE ARE SUCCESSFUL IN ENCOURAGING NEW KINDS OF CAPITAL FLOWS TO THEM, THIS WOULD DEAL WITH THE RESERVE AND OTHER PROBLEMS WITH WHICH THEY ARE FACED IN AN APPROPRIATE MANNER.

21. I NOW TURN TO THE QUESTION OF THE LEVEL OF ACCESS TO IMF RESOURCES. THIS IS THE MOST IMPORTANT OPERATIONAL DECISION WE HAVE TO CONSIDER TODAY.

22. IT IS TEMPTING SIMPLY TO KEEP THE EXISTING LIMITS. AND IN THE CASE OF THE CFF, GIVEN RECENT TRENDS IN COMMODITY PRICES, THIS DOES SEEM THE RIGHT CONCLUSION.

23. BUT AS TO ACCESS LIMITS PROPER, I BELIEVE THAT A MODEST CHANGE IS IN ORDER. IF WE WERE TO MAKE NO MOVEMENT AT ALL, WE WOULD BE FAILING TO RECOGNISE THAT WORLD ECONOMIC CONDITIONS HAVE IMPROVED. WE WOULD ALSO BE FAILING TO ACKNOWLEDGE THE AGREED TEMPORARY NATURE OF THE ENLARGED ACCESS FACILITY. CLEARLY, WE NEED TO KEEP ENLARGE ACCESS ARRANGEMENTS GOING FOR THE TIME BEING. BUT WE SHOULD ALSO BE TAKING THE FIRST STEP BACK TO A QUOTA-BASED FUND.

24. I DO BELIEVE, HOWEVER, THAT WE HAVE TO BE VERY CAUTIOUS ABOUT ANY REDUCTION IN THE CUMULATIVE LIMITS WE SET. IF WE SET THEM TOO LOW WE RULE OUT THE POSSIBILITY OF FOLLOW ON PROGRAMMES FOR COUNTRIES WHO REQUIRE ANOTHER YEAR OR TWO OF FUND SUPPORT.

25. THIS IS NOT TO SAY THAT I FAVOUR PROLONGED USE OF FUND RESOURCES. AS A GENERAL PRINCIPLE I BELIEVE THE OPPOSITE. WHAT I AM SPEAKING OF HERE, IN SUGGESTING MAINTENANCE OF GENEROUS CUMULATIVE LIMITS, IS HELPING THROUGH THE FINAL STAGE OF TOUCH BUT EFFECTIVE ADJUSTMENT PROGRAMES. I BELIEVE WE SHOULD ASK THE EXECUTIVE BOARD TO THINK ABOUT HOW BEST TO MAKE A CLEAR DISTINCTION BETWEEN THE TWO, AND I WELCOME THE MANAGING DIRECTOR'S STATEMENT THIS MORNING THAT HE INTENDS TO ADDRESS THIS ISSUE.

US BUDGET DEFICIT

26. I SPOKE EARLIER OF THE NEED FOR FURTHER ACTION IS THE RECOVERY IS TO BE SUSTAINED. THE MOST PRESSING ISSUE HERE IS THE HIGH LEVEL OF US AND CONSEQUENTLY WORLD INTEREST RATES. DURING THE PERIOD WHEN MONETARY GROWTH AND INFLATION WERE BEING REINED BACK FROM THE EXCESSES OF THE 1970S, SOME RISE IN INTEREST RATES WAS ALSO TO BE EXPECTED. BUT NOW THAT GREATER FINANCIAL STABILITY HAS BEEN ACHIEVED IN MOST MAJOR INDUSTRIAL COUNTRIES, WE MIGHT HAVE EXPECTED LOWER INTEREST RATES TO ENCOURAGE AND SUSTAIN THE REVIVAL OF INVESTMENT AND TIME ON WHICH GROWTH SO HEAVILY DEPENDS. THIS YEAR'S RISE IN INTEREST RATES, THEREFORE, IS PARTICULARLY UNHELPFUL.

27. A MAJOR FACTOR BEHIND THIS STATE OF AFFAIRS IS THE CONTINUING LARGE US BUDGET DEFICIT. THE RISE IN THE AMERICAN STRUCTURAL DEFICIT AT A TIME WHEN PRIVATE CREDIT DEMANDS ARE ALSO INCREASING HAS RAISED US DOMESTIC INTEREST RATES, PARTICULARLY REAL INTEREST RATES, AND RESULTED IN AN UNHEALTHY OVERVALUATION OF THE DOLLAR. BUT IS HAS ALSO TENDED TO INCREASE PRESSURE ON RATES IN THE REST OF THE WORLD, DESPITE THE EFFORTS OTHER GOVERNMENTS HAVE BEEN MAKING TO REDUCE THEIR OWN STRUCTURAL BUDGET DEFICITS.

28. I FEAR THAT THE BLUNT TRUTH IS THAT A RISING US STRUCTURAL BUDGET DEFICIT, FINANCED IN LARGE PART BY DRAWING ON THE SAVINGS OF THE REST OF THIS WORLD, AND ACCOMPANIED BY MASSIVE CURRENT EXTERNAL DEFICITS, IS UNHEALTHY AND UNSUSTAINABLE.

29. THE 'DOWNPAYMENT' MEASURES THAT THE ADMINISTRATION HAVE PREPARED TO REDUCE THE DEFICIT ARE WELCOME BUT IT MUST BE IN THE INTEREST OF THE US ITSELF, OTHER INDUSTRIAL COUNTRIES, AND THE DEVELOPING WORLD THAT FURTHER ACTION IS TAKEN AS SOON AS FEASIBLE TO PUT THE DEFICIT ON A CONVINCING DECLINING PATH.

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30. LET ME CONCLUDE THIS SECTION WITH TWO QUOTATIONS.

31. INCREASES IN OUR INTEREST RATES DIRECTLY ADD TO THE STRAIN ON THE EXTERNAL PAYMENTS OF HEAVILY INDEBTED DEVELOPING COUNTRIES, AND, OVER TIME, THE CAPITAL FLOWS AND TRADE IMBALANCE WILL NOT BE SUSTAINABLE, POSING THE RISK OF FURTHER FINANCIAL DISTURBANCES IN THE ABSENCE OF NEEDED POLICY ADJUSTMENT. ... WE CANNOT, IN MY JUDGEMENT, ESCAPE THE NEED FOR DECISIVE ACTION TO REDUCE OUR FEDERAL BUDGET DEFICIT.

32. MR PAUL VOLCKER, CHAIRMAN OF THE FEDERAL RESERVE BOARD, SPEAKING TO THE SENATE SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY IN JUNE OF THIS YEAR.

33. I AGREE WITH CHAIRMAN VOLCKER.

34. WITH RESPECT TO THE BUDGET DEFICITS, AS THINGS NOW STAND, DEFICITS NEXT YEAR WILL REMAIN IN THE SAME AREA AS CURRENTLY, AND UNACCEPTABLY LARGE THEREAFTER. THE IMPLICATIONS FOR FINANCIAL MARKETS AND THE ECONOMY BECOME MORE ADVERSE PRECISELY AS GROWTH IN THE PRIVATE SECTOR GENERATES MORE NEED FOR CREDIT AND CAPITAL. THAT OUTLOOK MUST BE CHANGED IN THE ONLY WAY IT CONSTRUCTIVELY CAN BE -- MOVING BEYOND THE WELCOME "DOWN PAYMENT" TO FURTHER SUBSTANTIVE ACTION ON THE BUDGET AS SOON AS FEASIBLE.

35. MR PAUL VOLCKER, SPEAKING TO THE SENATE SUBCOMMITTEE ON BANKING IN JULY OF THIS YEAR.

36. I AGREE WITH CHAIRMAN VOLCKER.

DEBT

37. I TURN NOW TO THE PROBLEM OF INTERNATIONAL DEBT.

38. THE CASE BY CASE APPROACH, WHICH WE HAVE ADOPTED -- AND RIGHTLY SO -- REPRESENTS A COHERENT STRATEGY. IT RESTS ON COMMON PRINCIPLES -- ABOVE ALL ON THE CENTRAL IMPORTANCE OF COUNTRIES TAKING MEASURES TO PUT THEIR FINANCES IN ORDER AND RESTORE THEIR CREDITWORTHINESS. BUT IT RECOGNISES THE INESCAPABLE FACT THAT EVERY DEBTOR COUNTRY IS INDIVIDUAL AND DIFFERENT. THEY ALL HAVE DIFFERENT RESOURCES AND ABILITIES, DIFFERENT KINDS OF SCALES OF DEBTS AND INTERNATIONAL FINANCIAL AND ECONOMIC DIFFICULTIES AND OPPORTUNITIES.

39. IT ALSO RECOGNISES THE NEED TO BUY TIME, IN THIS SITUATION TIME IS A VALUABLE COMMODITY, BORROWING COUNTRIES NEED TIME FOR NEW POLICIES TO WORK; BANKS NEED TIME TO ADJUST THEIR BALANCE SHEETS. AS SO OFTEN IN INTERNATIONAL AFFAIRS, PATIENCE IS A PRIME VIRTUE. THE EVIDENCE OF THE LAST YEAR IS THAT IN MANY COUNTRIES NEW POLICIES CARRIED THROUGH WITH GREAT COURAGE ARE TAKING EFFECT, AND THAT WE ARE SLOWLY MAKING REAL PROGRESS. MEANWHILE WE ALL OWE AN INCALCULABLE DEBT OF GRATITUDE TO THE MANAGING DIRECTOR FOR THE KEY ROLE HE HAD PLAYED WITH SUCH DISTINCTION IN BRINGING THIS ABOUT.

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40. BUT WE ALSO NEED TO USE THIS TIME WE HAVE BOUGHT TO DEVELOP NEW IDEAS ON HOW TO BRING GREATER STABILITY INTO THE FINANCIAL ENVIRONMENT OF DEBTOR COUNTRIES IN THE MEDIUM-TERM.

41. THE LONDON SUMMIT ALSO ADDRESSED THIS ISSUE. IT COMMENDED MULTI-YEAR RESCHEDULING IN APPROPRIATE CASES. IT ENCOURAGED CLOSER COOPERATION BETWEEN THE WORLD BANK AND THE FUND. IT COMMENDED THE ENCOURAGEMENT OF PRIVATE INVESTMENT, AND THE SEARCH FOR THE DEVELOPMENT OF OTHER LONG-TERM FORMS OF FINANCE TO SUPPLEMENT OR SUBSTITUTE FOR BANK LENDING.

42. ALL THESE APPROACHES NEED TO BE PURSUED WITH VIGOUR. BUT THE DEBT PROBLEM IS BOUND TO REMAIN A MATTER OF SERIOUS CONCERN SO LONG AS PRESENT LEVELS OF INTEREST RATES PERSIST.

CONCLUDING REMARKS

43. MR CHAIRMAN, I HAVE TOUCHED TODAY ON THE OPERATIONAL DECISIONS IMMEDIATELY BEFORE US. I HAVE SAID SOMETHING ABOUT WAYS IN WHICH I BELIEVE WE CAN MAKE MORE PROGRESS, OVER A RATHER LONGER TIME SCALE, IN AREAS OF PERSISTING CONCERN TO THE INTERNATIONAL COMMUNITY. WE WILL NOT SAY THE LAST WORD ON ANY OF THEM TODAY. BUT WE CAN CHART THE WAY FORWARD. AND WE CAN EXPLORE TOGETHER HOW TO BUILD UPON THOSE AND OTHER IDEAS IN THE TWO FURTHER MEETINGS WE HAVE IN VIEW IN COMING MONTHS.

ENDS

TEXT OF INTERIM COMMITTEE COMMUNIQUE MIFT.

FCO PASS DESKBY 260800Z MRS DIGGLE TREASURY.

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H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233 3415
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PLEASE NOTE EMBARGO

NOT FOR PUBLICATION, BROADCAST OR
USE ON CLUB TAPES BEFORE 15.30 HOURS
TODAY, TUESDAY 25 SEPTEMBER 1984

25 September 1984

THE CHANCELLOR OF THE EXCHEQUER'S SPEECH
TO THE IMF

Attached is the text of the speech to be delivered in Washington today by the Rt Hon Nigel Lawson MP, Chancellor of the Exchequer, at the Joint Annual Meeting of the International Monetary Fund and the International Bank for Reconstruction and Development.

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
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01-233 3415

I SHOULD LIKE AT THE OUTSET TO JOIN MY COLLEAGUES IN EXTENDING A VERY WARM WELCOME TO OUR TWO NEW MEMBERS — SAINT CHRISTOPHER AND NEVIS, AND MOZAMBIQUE.

A YEAR AGO MOST OF US SAW THREE MAIN EXTERNAL THREATS TO OUR NATIONAL ECONOMIES: UNCERTAINTY OVER THE PROSPECTIVE WORLD ECONOMIC RECOVERY, HIGH INTEREST RATES, THE INTERNATIONAL DEBT DIFFICULTIES. I WOULD LIKE TODAY TO LOOK AT EACH IN TURN.

BEFORE DOING SO I WILL, AS LAST YEAR, SAY SOMETHING ABOUT THE EXPERIENCE OF MY OWN COUNTRY.

THE UK ECONOMY

DEVELOPMENTS IN THE UK OVER THE PAST YEAR HAVE BEEN MUCH AS I FORESAW WHEN I SPOKE AT THIS MEETING LAST YEAR. WE ARE NOW IN THE FOURTH SUCCESSIVE YEAR OF STEADY RECOVERY. AS EXPECTED, THE PATTERN OF THE RECOVERY HAS CHANGED. FIXED INVESTMENT AND EXPORTS HAVE BOTH GROWN RAPIDLY OVER THE PAST YEAR WHILE CONSUMER SPENDING HAS GROWN MORE SLOWLY. IN PARTICULAR, MANUFACTURING INVESTMENT IN THE FIRST HALF OF 1984 WAS ABOUT 15 PER CENT UP IN REAL TERMS ON A YEAR AGO. AT THE SAME TIME THE INFLATION RATE HAS REMAINED BROADLY FLAT AT 5 PER CENT, A PATTERN WHICH HAS PERSISTED NOW FOR SOME 18 MONTHS.

FISCAL AND MONETARY POLICY HAVE DEVELOPED AS INTENDED. BOTH BROAD AND NARROW MEASURES OF MONEY ARE GROWING AT A RATE WELL WITHIN THEIR TARGET RANGES. AND WE ARE CONTINUING TO REDUCE THE BUDGET DEFICIT. LAST YEAR IT WAS OVER 3 PER CENT OF GDP. THIS YEAR WE BUDGETED FOR 2 AND A QUARTER PER CENT OF GDP AND PRESENT INDICATION SUGGEST THAT WE REMAIN BROADLY ON TARGET.

GROWTH LAST YEAR WAS 3 AND QUARTER PER CENT. THIS YEAR THE FALL IN COAL OUTPUT AS A RESULT OF THE CONTINUING MINERS STRIKE IS EQUIVALENT TO ALMOST 1 PER CENT OF GDP IN 1984, AND GROWTH THIS YEAR MAY THEREFORE BE CLOSER TO 2 PER CENT THAN THE 3 PER CENT PREVIOUSLY EXPECTED.

BY THE SAME TOKEN, GROWTH NEXT YEAR SHOULD BENEFIT BY ABOUT 1 PER CENT AS COAL OUTPUT RETURNS TO ITS NORMAL LEVEL. AS A RESULT, I WOULD EXPECT RECORDED GROWTH NEXT YEAR TO BE HIGHER THAN THIS YEAR.

WHILE NONE OF US CAN CLAIM ACTUALLY TO HAVE ABOLISHED THE BUSINESSCYCLE, THE POLICIES WHICH THE UK, IN COMMON WITH MANY OTHER INDUSTRIALISED COUNTRIES, HAS BEEN FOLLOWING FORM A SOUNDER BASIS FOR SUSTAINABLE GROWTH THAN WE HAVE KNOWN IN THE PAST.

SO FAR AS MY OWN COUNTRY IS CONCERNED, THAT IS BORNE OUT BY THE IMPORTANT DIFFERENCES BETWEEN THIS RECOVERY AND PREVIOUS RECOVERIES.

THERE HAS BEEN NO SIGNIFICANT STOCKBUILDING. THIS MEANS THERE IS MUCH LESS CHANCE OF A SHARP STOCKBUILDING CYCLE. THERE IS LITTLE THREAT FROM HIGHER INFLATION, WHICH SO OFTEN HAS BEEN AN IMPORTANT FACTOR IN CYCLICAL SLOWDOWN. IN ADDITION, THE DIFFERENT PHASING OF OUTPUT GROWTH IN THE US AND EUROPE MEANS THAT THE GROWTH OF WORLD TRADE SHOULD BE MORE EVEN. AND COMMODITY PRICES, INCLUDING OIL, ARE SHOWING WEAKNESS RATHER THAN THE RAPID GROWTH OF THE LAST TWO CYCLICAL UPSWINGS.

IN PREVIOUS CYCLES INFLATION HAS TENDED TO RISE AS SOON AS RECOVERY HAS BECOME WELL ESTABLISHED. AS A RESULT, MANY COMMENTATORS HAVE ARGUED THAT AN INFLATION UPTURN IN THE UK IS IMMINENT. WE TAKE A DIFFERENT VIEW. OUR ANALYSIS SUGGESTS THAT THE PRESSURES MAKING FOR HIGHER INFLATION ARE NOT STRONG. MONETARY GROWTH CONTINUES TO DECLINE, AND COMPETITIVE PRESSURES ARE LIKELY TO CONTINUE TO RESTRAIN PRICE INCREASES. THE UNDERLYING TREND OF INFLATION IS STILL DOWNWARD. THIS PERFORMANCE OF INFLATION DURING THE CURRENT RECOVERY HAS CONVINCINGLY REVERSED THE SECULAR UPWARD TREND OF THE LAST TWO DECADES.

THE ONE OUTSTANDING WORRY IS UNEMPLOYMENT, WHICH IS NOT ONLY FAR TOO HIGH BUT CONTINUES TO RISE.

NOT THAT NEW JOBS ARE NOT BEING CREATED. OVER THE YEAR TO LAST MARCH, THE NUMBER OF PEOPLE IN WORK IN THE UK HAS RISEN BY AROUND A QUARTER OF A MILLION--ABOUT DOUBLE THE RISE IN UNEMPLOYMENT OVER THE SAME PERIOD.

BUT WE OUGHT TO BE DOING BETTER THAN THIS. TO SOME EXTENT, OF COURSE, THE RISE IN UNEMPLOYMENT IS THE TEMPORARY CONSEQUENCE OF THE LONG OVERDUE SUCCESS OF BRITISH INDUSTRY IN MAKING ITSELF MORE COMPETITIVE BY CUTTING COSTS AND IMPROVING PRODUCTIVITY.

BUT THE HEART OF THE PROBLEM-- AND HERE THE CONTRAST WITH THE UNITED STATES IS PARTICULARLY STRIKING--HAS BEEN THE STEADY GROWTH IN REAL WAGES.

WE MUST NOT BE SEDUCED BY THE WONDERS OF HIGH-TECH INTO OVERLOOKING THE FACT THAT MANY OF THE JOBS OF THE FUTURE WILL BE IN LABOUR-INTENSIVE SERVICE INDUSTRIES WHICH ARE NOT SO MUCH LOW-TECH AS NO-TECH.

I SEE LITTLE PROSPECT OF REVERSING THE TREND OF UNEMPLOYMENT UNLESS WE CAN DECISIVELY MODERATE THE GROWTH OF REAL WAGES. AS THE MANAGING DIRECTOR PUT IT IN A SPEECH TO THE ECONOMIC AND SOCIAL COUNCIL OF THE UNITED NATIONS LAST JULY:

QUOTE THERE ARE NOW CLEAR INDICATIONS THAT IN SOME OF THE MAJOR INDUSTRIAL COUNTRIES, ESPECIALLY IN EUROPE, THE PRESENT COST OF LABOUR MAY BE INCOMPATIBLE WITH THE ATTAINMENT OF HIGH EMPLOYMENT GOALS. UNQUOTE.

THIS MEANS THAT IT HAS BECOME MORE IMPORTANT THAN EVER TO REMOVE RIGIDITIES IN THE LABOUR MARKET AND PRODUCT MARKETS ALIKE.

IN RECENT YEARS THE EMPHASIS OF POLICY IN MANY COUNTRIES, INCLUDING THE UK, HAS BEEN ON FINANCIAL STABILISATION. AND WE HAVE SEEN THE BENEFITS OF THAT STABILISATION. BUT WHILE MAINTAINING THIS POLICY INTACT WE NEED TO PLACE MORE EMPHASIS ON SUPPLY SIDE POLICY IN THE TRUE SENSE OF THAT MUCH-ABUSED TERM: IN DEALING WITH THE STRUCTURAL PROBLEMS WHICH ARE THE CAUSE OF THE CONTINUING HIGH LEVEL OF UNEMPLOYMENT WHICH SO MANY OF US FACE TODAY.

THE WORLD ECONOMY

IN THE INDUSTRIALISED WORLD AS A WHOLE, RECOVERY HAS IN GENERAL BEEN STRONGER EVEN THAN THE HOPES, LET ALONE THE FEARS, OF A YEAR AGO. THE IMF STAFF'S LATEST FORECAST FOR GROWTH THIS YEAR SHOWS A FURTHER UPWARD REVISION. AND ALMOST ALL MAJOR FORECASTERS EXPECT REASONABLE RATES OF GROWTH TO CONTINUE NEXT YEAR, AND WITH A LESS UNEVEN DISTRIBUTION.

THE POSITION OF MANY DEVELOPING COUNTRIES, AND I WILL COME BACK TO THIS, HAS ALSO STRENGTHENED. THE CURRENT ACCOUNT DEFICIT OF THE NON-OIL DEVELOPING COUNTRIES THIS YEAR IS EXPECTED TO BE ONLY DOLLARS 45 BILLION, LESS THAN HALF ITS LEVEL IN 1981. THIS IMPROVEMENT HAS REFLECTED IN MANY CASES CUT-BACKS IN IMPORTS AND NATIONAL INCOME. WE RECOGNISED AT THE LONDON SUMMIT THE SOCIAL AND POLITICAL HARDSHIPS THIS INVOLVES. BUT SUCH ADJUSTMENT IS PAYING THE WAY FOR RENEWED AND SUSTAINABLE FUTURE GROWTH. THE PROCESS MUST CONTINUE, BUT WE SHOULD BE LOOKING NOW FOR EMPHASIS ON THE POSITIVE ASPECTS OF MAINTAINING AND FINANCING HEALTHY GROWTH.

TRADE AND CAPITAL FLOWS

IN THE TRADE FIELD THERE IS AGREEMENT TO BEGIN PRELIMINARY CONSULTATIONS ON A NEW ROUND OF MULTILATERAL TRADE NEGOTIATIONS. WITH RECOVERY BEING SUSTAINED I HOPE WE NEED NOT WAIT FOR THAT NEGOTIATION BEFORE TAKING ACTION TO ROLL BACK PROTECTIONIST BARRIERS: NOT JUST TARIFFS BUT SUBSIDIES AND OTHER DISTORTIONS.

WITH AN OVERVALUED DOLLAR CAUSING IMPORTS TO FLOOD INTO THE UNITED STATES, WITH HIGH AND RISING UNEMPLOYMENT IN EUROPE, AND WITH THE CONTINUING HARDSHIP FACED BY MUCH OF THE DEVELOPING WORLD, THE PRESSURES FOR PROTECTIONISM ARE VERY STRONG INDEED. IT IS ESSENTIAL THAT WE RESOLVE ALL THE MORE STRONGLY TO RESIST THEM.

NOTHING COULD BE MORE SELF-DEFEATING THAN A WORLDWIDE DRIFT TO PROTECTIONISM. AND FEW THINGS WOULD BE MORE DAMAGING TO OUR BURGEONING RECOVERY.

THE PAST YEAR HAS ALSO SEEN PROGRESS IN PROMOTING THE FREE FLOW OF CAPITAL BETWEEN COUNTRIES. I HAVE PARTICULARLY IN MIND THE STEPS ANNOUNCED BY THE JAPANESE GOVERNMENT TO PROMOTE THE INTERNATIONAL USE OF THE YEN. THIS INVOLVES A CONTINUING PROGRAMME OF SPECIFIC MEASURES, AND WE WILL FOLLOW DEVELOPMENTS HERE WITH CLOSE INTEREST.

IN SHORT, IN THE FIRST OF OUR THREE MAIN AREAS OF CONCERN, THE FUTURE COURSE OF WORLD ECONOMIC ACTIVITY, WE HAVE A DISTINCTLY IMPROVED CLIMATE, AND THE MEDIUM-TERM PROSPECTS FOR WIDELY-SHARED RECOVERY ARE BETTER THAN FOR MANY YEARS PAST.

INTEREST RATES.

INTEREST RATES ON THE OTHER HAND REMAIN A DOMINANT CONCERN FOR MOST OF US, AND I MUST LINK THIS WITH THE SITUATION IN THE US. THE US ACCOUNTS FOR ONE-FIFTH OF WORLD GNP AND SOME 15 PERCENT OF WORLD TRADE. SO US POLICIES CANNOT SIMPLY BE JUDGED BY DOMESTIC CRITERIA, EVEN IN ECONOMIC TERMS, QUITE APART FROM THE RESPONSIBILITIES THAT ACCRUE TO THE UNITED STATES AS THE LEADER OF THE FREE WORLD.

ON THE DOMESTIC SIDE, THE US ACHIEVEMENT HAS BEEN REMARKABLE BY ANY POST-WAR STANDARDS. IN PARTICULAR THE CREATION OF OVER 6 MILLION NEW JOBS SINCE THE END OF 1962 OWES A GREAT DEAL TO THE FLEXIBILITY OF THE US LABOUR MARKET AND THE MODERATE INCREASES IN REAL LABOUR COSTS COMPARED WITH MOST OTHER LEADING INDUSTRIAL COUNTRIES IN RECENT YEARS.

SUCCESS IN THE CREATION OF NEW JOBS AND THE VIGOROUS GROWTH OF OUTPUT IN THE LAST TWO YEARS REFLECT THE ADMIRABLE STRENGTH AND RESILIENCE OF THE US ECONOMY. BUT THERE ARE OTHER FEATURES THAT REPRESENT A CAUSE FOR REAL CONCERN.

ALTHOUGH THE US BUDGET DEFICIT MAY BE LOWER AS A PROPORTION OF GDP THAN THAT OF SOME OTHER MAJOR INDUSTRIAL COUNTRIES, IT HAS GROWN VERY LARGE IN RELATION TO THE LEVEL OF NET DOMESTIC SAVINGS. AND ITS SHEER SIZE WEIGHS HEAVILY IN THE DEMAND FOR SAVINGS WORLDWIDE. AS THE RECOVERY STIMULATES A GROWING PARALLEL DEMAND FOR PRIVATE INVESTMENT, WITHOUT ANY MATCHING GROWTH OF DOMESTIC SAVINGS, WE SEE TWO EFFECTS. INTEREST RATES ARE HELD AT UNPRECEDENTED
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LEVELS IN REAL TERMS, AND THE NEEDS OF THE US ECONOMY PRE-EMPT A LARGE SHARE OF THE SAVINGS OF THE REST OF THE WORLD. /THE

THE NEED TO ATTRACT INCREASING CAPITAL INFLOWS FROM THE REST OF THE WORLD TO FINANCE THE BUDGET DEFICIT HAS AS ITS INEVITABLE COUNTERPART - FOR THE EXTERNAL ACCOUNTS HAVE TO BALANCE - A CURRENT ACCOUNT TRADE AND PAYMENTS DEFICIT OF GETTING ON FOR DOLLARS 100 BILLION A YEAR, AND STILL RISING: WHILE THE UNPRECEDENTED RATE OF INTEREST ON THE WORLD'S LEADING RESERVE CURRENCY HAS INEVITABLY LED TO A SHARP RISE IN THE VALUE OF THE DOLLAR IN TERMS OF OTHER CURRENCIES.

I COME FROM A COUNTRY THAT HAS EXPERIENCE FROM THE PAST OF THE ADVANTAGES - AND ALSO OF THE RISKS AND THE RESPONSIBILITIES - OF OPERATING A RESERVE CURRENCY. THE ABILITY TO BORROW ABROAD IN ONE'S OWN CURRENCY GIVES OPPORTUNITY AND TIME WHICH WOULD NOT OTHERWISE BE AVAILBALE, TO SOME EXTENT AT THE EXPENSE OF THE REST OF THE WORLD. BUT WE ALSO HAVE EXPERIENCE OF THE CONSEQUENCES THAT OCCUR WHEN THIS SPECIAL PRIVILEGE IS ABUSED.

IMBALANCES, IN THE BUDGET AND IN THE TRADE AND CURRENT ACCOUNTS, OF THE SIZE WE ARE NOW SEEING IN THE UNITED STATES CAN CONTINUE FOR MUCH LONGER THAN THEY COULD IN ANY OTHER COUNTRY. BUT THEY CANNOT BE SUSTAINABLE FOREVER.

AND MEANWHILE, THE PROBLEM OF INTERNATIONAL DEBT, TO WHICH I WILL TURN IN A MOMENT, IS GREATLY EXACERBATED.

THE US AUTHORITIES HAVE THEMSELVES POINTED THE WAY AHEAD WITH THEIR IMPORTANT QUOTE DOWN PAYMENT UNQUOTE DECISION. TIMELY REINFORCEMENT OF THAT APPROACH WILL BE CRUCIAL IF THE PROCESS OF ADJUSTMENT IS NOT TO END IN TEARS.

PERHAPS, HERE IN WASHINGTON, IT WOULD BE APPROPRIATE FOR ME TO CONCLUDE THIS SECTION OF MY SPEECH WITH SOME WORDS OF THOMAS JEFFERSON:

QUOTE

I PLACE ECONOMY AMONG THE FIRST AND MOST IMPORTANT OF REPUBLICAN VIRTUES, AND PUBLIC DEBT AS THE GREATEST OF THE DANGERS TO BE FEARED. TO PRESERVE OUR INDEPENDENCE, WE MUST NOT LET OUR LEADERS LOAD US WITH PERPETUAL DEBT. UNQUOTE +

OPEN SQUARE BRACKETS +

LETTER WRITTEN IN 1816 BY JEFFERSON TO WILLIAM PLUMER QUOTED IN THE 1984 SHANN MEMORIAL LECTURE GIVEN BY JOHN STONE, SECRETARY OF THE AUSTRALIAN TREASURY. + CLOSE SQUARE BRACKETS

INTERNATIONAL DEBT

I TURN NOW TO THE QUESTION OF INTERNATIONAL DEBT. I SUGGESTED LAST YEAR SOME IDEAS GOING BEYOND THE IMMEDIATE STRATEGY ADOPTED BY THE INTERNATIONAL COMMUNITY BUILT AROUND PROGRAMMES OF ADJUSTMENT. SOME OF THOSE IDEAS WERE CARRIED A STAGE FURTHER AT THE RECENT LONDON SUMMIT. I SHOULD LIKE TO SAY A LITTLE MORE ABOUT THEM NOW.

BORROWING OF THE WRONG KIND

I WILL NOT TODAY GO OVER ALL THE ORIGINS OF THE DEBT PROBLEM. BUT IMPORTANT ELEMENTS WERE: TOO MUCH BORROWING AND BORROWING OF THE WRONG KIND. BY BORROWING OF THE WRONG KIND I MEAN UNDUE RELIANCE ON BANK FINANCE.

IN RETROSPECT IT IS EASY TO SEE HOW THIS HAPPENED. FINANCING DIFFICULTIES WERE SUBSTANTIAL AND AROSE RELATIVELY SUDDENLY. THE PRIVATE BANKING SECTOR IS GENERALLY ABLE TO RESPOND MORE QUICKLY TO SUDDEN CHANGE. IT IS THEREFORE PERHAPS NOT SURPRISING THAT THE BANKS TOOK ON THE MAJOR ROLE IN THE RECYCLING PROCESS. INDEED, THE SUBSTANTIAL RECYCLING OF FUNDS THAT TOOK PLACE DURING THE SEVENTIES AND EIGHTIES WAS INITIALLY HELPFUL IN AVOIDING SEVERE DEFLATION IN DEVELOPING COUNTRIES AND PROVIDING THEM WITH TIME TO ADJUST. BUT, WITH THE BENEFIT OF HINDSIGHT, IT IS CLEAR THAT OVERSHOOTING IS A CHARACTERISTIC NOT MERELY OF THE FOREIGN EXCHANGE MARKET. THE PATTERNS AND SCALES OF FINANCING THAT RESULTED AND THE LACK OF CONDITIONALITY ATTACHING TO MOST OF THE FLOWS, MADE THE DEBTOR COUNTRIES AND THE INTERNATIONAL FINANCIAL SYSTEM HIGHLY VULNERABLE TO THE CHANGES IN THE ECONOMIC ENVIRONMENT THAT HAVE OCCURRED SINCE THE END OF THE 1970S.

THE UNHAPPY LEGACY OF THAT PERIOD WHICH WE NOW FACE IS A BURDEN OF LIABILITIES OF DEBTOR COUNTRIES WHICH PRESENT CONSIDERABLE PROBLEMS IN TERMS OF THEIR RELATIVE SIZE, THEIR MATURITY PROFILES AND THE ACCOMPANYING VULNERABILITY TO INTEREST RATE FLUCTUATIONS: AND FOR BANKS POTENTIALLY DESTABILISING DOUBTS AS TO THE TRUE VALUE OF A PART OF THEIR ASSETS.

DEBTOR COUNTRIES

SOME DEBTOR COUNTRIES HAVE ACHIEVED CONSPICUOUS SUCCESS IN SOME ASPECTS OF ADJUSTMENT - THE TURN ROUND IN THE BALANCE OF TRADE OF BOTH MEXICO AND BRAZIL ARE NOTABLE EXAMPLES OF WHAT CAN BE ACHIEVED. IF INESCAPABLY AT THE COST OF CONSIDERABLE PAIN AND SACRIFICE. BUT EVEN THOSE COUNTRIES WHICH HAVE TACKLED ADJUSTMENT IN THE MOST DETERMINED FASHION STILL HAVE SOME WAY TO GO. SOME COUNTRIES ARE AS YET ONLY A LITTLE WAY ALONG THE ADJUSTMENT ROAD: AND SOME COUNTRIES HAVE NOT YET MADE A START.

THE NEED FOR FURTHER ADJUSTMENT IS EVIDENT. MANY COUNTRIES STILL HAVE TO CONTEND, IN VARYING DEGREES, WITH HIGH RATES OF INFLATION AND SUBSTANTIAL BUDGET DEFICITS BEYOND THE SCOPE OF FINANCING BY DOMESTIC SAVINGS. SOME ARE STILL CLINGING TO OVERVALUED EXCHANGE RATES, ON THE MISTAKEN GROUNDS THAT THIS WILL MODERATE INFLATION - THE REAL EFFECT IS TO DAMAGE INTERNATIONAL TRADE PERFORMANCE AND DEPRESS AND DISTORT DOMESTIC PRODUCTION. THESE ARE NOT STABLE CONDITIONS. THEY DO NOT MAKE FOR REAL GROWTH OF PROSPERITY.

THE ESSENTIAL POINT, ON A LONGER PERSPECTIVE, IS THAT BORROWING COUNTRIES WILL NEED TO PLACE MORE EMPHASIS ON CHANGING THE STRUCTURE OF THEIR ECONOMIES TO REDUCE DISTORTIONS AND DISINCENTIVES. MORE CONSIDERATION NEEDS TO BE GIVEN TO WAYS IN WHICH THIS CAN BE ACHIEVED.

CONTINUING ADJUSTMENT IS NEEDED FOR BOTH INTERNAL AND EXTERNAL REASONS, IF THE FUTURE DEVELOPMENT OF THESE COUNTRIES IS TO BE PUT AGAIN ON A SOUND BASIS, AND IF THEY ARE TO RESTORE CONFIDENCE IN THEMSELVES AS WELL AS IN WORLD FINANCIAL MARKETS.

ONE OF THE TRAGEDIES IN MANY DEBTOR COUNTRIES - AND OTHER DEVELOPING COUNTRIES TOO - IS THAT THEY NOT ONLY HAVE DIFFICULTY IN ATTRACTING FOREIGN INVESTORS, BUT THEY HAVE LOST A HUGE VOLUME OF POTENTIAL INVESTMENT BY THE FLIGHT OF CAPITAL FROM THEIR OWN RESIDENTS.

DEBTOR COUNTRIES NEED TO ADOPT POLICIES THAT WILL RESTORE THE CONFIDENCE NOT MERELY OF THE OUTSIDE WORLD BUT ALSO - AND EQUALLY IMPORTANT - OF THEIR OWN PEOPLE. FOREIGN EXCHANGE CONTROLS ARE NOT - AND CANNOT BE - A SUBSTITUTE FOR RESTORING THAT CONFIDENCE. TO IMAGINE OTHERWISE IS AN ILLUSION.

PRIVATE FINANCIAL FLOWS

AS DEBT-SERVICING PROBLEMS EMERGED AMONG DEVELOPING COUNTRIES, BANKS THAT HAD LENT TO THEM FACED UNCERTAINTY ABOUT THE VALUE AND MATURITY OF A PROPORTION OF THEIR ASSETS. THEY HAVE RESPONDED TO THIS BY ESTABLISHING A HIGHER LEVEL OF PROVISIONS.

IT IS OF PRIME IMPORTANCE THAT THIS PROCESS CONTINUES; AND THAT BANKS BUILD UP AND MAINTAIN PROVISIONS TO ALLOW FOR THE PROBABILITY OF SOME LOSSES OF VALUE, EVEN WHERE THEY CANNOT WITH ANY CERTAINTY BE IDENTIFIED INDIVIDUALLY. THEY MUST ALSO CONTINUE THE PROCESS OF STRENGTHENING THEIR BALANCE-SHEETS IN OTHER WAYS, NOTABLY BY ADDING TO THEIR CAPITAL RESOURCES.

THERE ARE A NUMBER OF LESSONS FOR THE LONGER TERM. FOR THE INTERNATIONAL FINANCIAL SYSTEM AS A WHOLE IT CAN BE ARGUED THAT A BALANCE NEEDS TO BE MAINTAINED BETWEEN UNCONDITIONAL MARKET LENDING AT COMMERCIAL RATES AND CONCESSIONARY LENDING WHICH WILL, FOR THE MOST PART, BE CONDITIONAL. THE BANKING SYSTEM HAS UNDOUBTEDLY A ROLE TO PLAY BUT IT IS NOT APPROPRIATE FOR IT TO PLAY THE MAJOR ROLE THAT IT HAS IN RECENT YEARS IN FINANCING DEBTOR COUNTRIES' BALANCE OF PAYMENTS DEFICITS. AT THE LEVEL OF THE INDIVIDUAL BANK THE EVENTS OF RECENT YEARS PROVIDE AN ELOQUENT CASE FOR THE NEED TO MAINTAIN AN APPROPRIATELY DIVERSIFIED PORTFOLIO. BANKS AND THEIR SUPERVISORS ARE WELL SEIZED OF THIS ALTHOUGH IT WILL NOT BE QUICKLY ACHIEVED.

BANKS HAVE BEEN PREPARED TO PUT UP SUBSTANTIAL SUMS OF NEW MONEY IN QUOTE UNSPONTANEOUS UNQUOTE LENDING IN SUPPORT OF DEBTORS WHICH HAVE AGREED PROGRAMMES WITH THE IMF. THEY ARE SHOWING A WILLINGNESS TO ADAPT TO THE CHANGING NEEDS OF DEBTORS AT DIFFERENT STAGES OF ADJUSTMENT, AS WITNESS THE IMAGINATIVE AND LONGER-TERM PACKAGE RECENTLY NEGOTIATED FOR MEXICO. THIS CONSTRUCTIVE APPROACH WAS ADVOCATED FOR APPROPRIATE CASES AT THE LONDON SUMMIT.

/ BUT

BUT THE FACT REMAINS THAT IT IS NECESSARY, BOTH IN THE INTERESTS OF DEBTORS AND OF THE BANKS, THAT NON-BANK PRIVATE FLOWS SHOULD GRADUALLY BECOME MORE PROMINENT. THE LONDON SUMMIT ADDRESSED THIS ISSUE AND OUTLINED A STRATEGY TO CREATE A SOUNDER FINANCIAL FRAMEWORK FOR MEDIUM-TERM DEVELOPMENT IN THE PRESENT DEBTOR COUNTRIES. I HAVE MENTIONED MULTI-YEAR RESCHEDULING; LET ME RECALL NOW THREE OTHER IMPORTANT ELEMENTS.

FIRST, A STRONGER ROLE FOR THE WORLD BANK GROUP OF INSTITUTIONS, IN FOSTERING DEVELOPMENT OVER THE MEDIUM AND LONG-TERM, NOT LEAST AS A CATALYST FOR PRIVATE INVESTMENT.

SECOND, THE ENCOURAGEMENT OF PRIVATE INVESTMENT. I WELCOME THE EMPHASIS THE MANAGING DIRECTOR HAS GIVEN TO THE IMPORTANCE OF BORROWING COUNTRIES QUOTE TAKING STEPS TO DISMANTLE OR RELAX ADMINISTRATIVE OR OTHER OBSTACLES WHICH OFTEN APPLY TO INFLOWS OF DIRECT INVESTMENT UNQUOTE. THIS IS A MATTER TO WHICH I BELIEVE THE EXECUTIVE BOARD SHOULD ALWAYS PAY CLOSE ATTENTION BOTH IN ITS REGULAR SURVEILLANCE AND IN ITS EXAMINATION OF COUNTRY PROGRAMMES. AN IMPORTANT ADVANTAGE TO DEVELOPING COUNTRIES, ESPECIALLY DEBTORS, OF SEEKING PRIVATE DIRECT INVESTMENT IS THAT IT CAN SERVICE ITSELF AS, AND ONLY AS, IT CONTRIBUTES TO PROFITABLE OUTPUT. IN THIS CONTEXT, I HOPE WE SHALL BE ABLE TO BRING TO FRUITION A WORKABLE PLAN FOR THE INSURANCE OF PRIVATE OVERSEAS INVESTMENT.

THIRD, ENCOURAGING OTHER FORMS OF FINANCE THAT PROMISE TO BE MORE APPROPRIATE AND STABLE. FOR THE MOMENT, THE FINANCIAL POSITION OF MANY DEBTOR COUNTRIES REMAINS SO PRECARIOUS THAT THE PROVISION OF UNSPONTANEOUS BANK LENDING WILL HAVE TO CONTINUE TO PLAY A PART IN MEETING THEIR IMMEDIATE FINANCING NEEDS. BUT THE RECENT MEXICAN AGREEMENT SHOWS THAT A RETURN TO SPONTANEOUS LENDING IS A PRIZE WITHIN REACH. BEYOND THAT, DEBTOR COUNTRIES SHOULD BE GIVEN ENCOURAGEMENT TO FIND MEANS OF REDUCING THE RELATIVE BURDEN OF BANK DEBT BY OFFERING OPPORTUNITIES FOR MORE STABLE AND APPROPRIATE INVESTMENT - THE KINDS OF INVESTMENT THEY WILL SURELY IN ANY CASE NEED TO FOSTER IN SUPPORT OF THEIR INTERNAL DEVELOPMENT FOR MANY YEARS TO COME.

BETTER AND HEALTHIER COMMERCIAL WAYS OF FINANCING THE FUTURE NEEDS OF DEVELOPING COUNTRIES COULD BE FOUND IN PRIVATE INVESTMENT, DIRECT AND PORTFOLIO, AND IN LONGER-TERM MARKETABLE INSTRUMENTS. I WOULD LIKE TO SEE BANKS POSITIVELY ENCOURAGING DEVELOPMENTS OF THESE KINDS. MANY OF THEM COULD DOUBTLESS FIND AN ACTIVE ROLE AS AGENTS IN PLACING FINANCIAL INSTRUMENTS THAT COMPLEMENTED, OR IN SOME CASES REDUCED, THE BANKS' OWN LENDING, TO THIS END DEVELOPING A MORE DIRECT RELATIONSHIP BETWEEN SOME OF THEIR PRESENT DEPOSITORS AND THE ULTIMATE BORROWERS.

THE DEVELOPMENT OF SUCH DIFFERENT FORMS OF FINANCING WILL TAKE TIME AND IS LIKELY TO RELATE TO NEW MONEY RATHER THAN THE DIRECT MARKETING OF EXISTING DEBT. BUT THE ACTION ALREADY BEING TAKEN, WITH ADJUSTMENT BOLSTERED BY RESCHEDULING, HAS BOUGHT TIME AND IS HELPING TO CREATE A SITUATION WHERE SOME DEBTORS AT LEAST MAY BEGIN TO CONTEMPLATE RETURNING TO THE BOND MARKET AND WHERE OUTSIDE INVESTORS MAY BE WILLING TO LOOK AGAIN AT PARTICIPATIONS IN LOCAL RESOURCES AND ASSETS. BANKS AND OTHER FINANCIAL INSTITUTIONS SHOULD BE ENCOURAGED TO DEVISE NEW INSTRUMENTS TO BRING STABLE CAPITAL TO COUNTRIES WHOSE UNDERLYING RESOURCES IN MANY CASES ARE SO ABUNDANT.

THE LESSON FOR GOVERNMENTS

THE KINDS OF FUTURE FINANCING FLOWS I AM ADVOCATING ARE FOR COMMERCIAL MARKETS TO DEVELOP. THEY ARE NEEDED TO MOBILIZE IN UP-TO-DATE WAYS THE KIND OF FINANCING WHICH HAS BEEN BASED ON PRIVATE RESOURCES IN THE PAST. GOVERNMENTS OF HOST COUNTRIES CAN DO MUCH BY CREATING CONFIDENCE AND A HOSPITABLE CLIMATE. INTERNATIONAL INSTITUTIONS CAN PLAY A VALUABLE ENCOURAGING ROLE, WHICH IS WHY I WARMLY WELCOME THE EFFORTS, FOR EXAMPLE, OF THE WORLD BANK TO PROMOTE JOINT VENTURES AND CO-FINANCING, AND THE IDEAS THE IFC HAS BEEN NURTURING FOR THE DEVELOPMENT OF UNIT AND INVESTMENT TRUST OUTLETS IN SOME DEVELOPING COUNTRIES.

GOVERNMENTS OF CREDITOR COUNTRIES CAN AND SHOULD OFFER ENCOURAGEMENT. THEY ARE ALSO DIRECTLY INVOLVED WITH DEBTOR COUNTRIES, LARGELY THROUGH THEIR VARIOUS EXPORT CREDIT AGENCIES, AND ON A LARGE SCALE. THEY HAVE SHOWN READINESS, THROUGH THE PARIS CLUB, TO NEGOTIATE RESCHEDULING ARRANGEMENTS, AND WILL BE PREPARED TO EXTEND THIS APPROACH TO MULTI-YEAR AGREEMENTS WHERE APPROPRIATE, IN PARALLEL WITH NEGOTIATIONS BY COMMERCIAL BANKS. THE UK HAS TAKEN THE INITIATIVE IN PUSHING FORWARD CONSIDERATION OF THE TECHNICAL ISSUES THAT ARISE.

IN THE PAST THE UNITED KINGDOM IN COMMON WITH MANY OTHERS HAS NORMALLY SUSPENDED PROVISION OF OFFICIAL EXPORT COVER TO COUNTRIES WHICH HAVE RESCHEDULED DEBT. WE HAVE REVIEWED THIS POLICY AND SHOULD SHORTLY BE READY IN APPROPRIATE CASES TO MAINTAIN COVER OR RESUME IT AT AN EARLIER STAGE TO SUPPORT CREDIT FOR GOODS WHICH WOULD CONTRIBUTE TO THE ECONOMIC RECOVERY OF THE DEBTOR COUNTRY. IN THIS AREA WE SEE A CASE FOR SOME HARMONISATION OF APPROACH AMONGST INDUSTRIAL COUNTRIES GENERALLY AND I WELCOME THE DISCUSSIONS NOW TAKING PLACE TO THIS END.

BUT BY FAR THE MOST IMPORTANT CONTRIBUTION WHICH GOVERNMENTS OF THE MAJOR CREDITOR COUNTRIES CAN MAKE LIES IN THEIR OWN GENERAL ECONOMIC AND FINANCIAL POLICIES. THE BIGGEST SINGLE CONTRIBUTION SO FAR TOWARDS EASING THE DEBT PROBLEM HAS BEEN THE RECOVERY OF WORLD ECONOMIC ACTIVITY AND, ESPECIALLY DURING THE PAST YEAR, THE RESUMPTION OF MORE VIGOROUS GROWTH OF WORLD TRADE. THE BIGGEST SINGLE CONTRIBUTION WHICH COULD BE MADE OVER THE NEXT YEAR OR SO WOULD BE DEVELOPMENTS OF US POLICIES WHICH COULD LEAD TO LOWER DOLLAR AND WORLD INTEREST RATES.

THE CASE BY CASE APPROACH

IT IS TEMPTING, OF COURSE, TO SEEK NOW A RADICAL NEW APPROACH TO INTERNATIONAL DEBT. HOWEVER, I DO NOT BELIEVE THAT THAT IS THE WAY FORWARD. THERE IS NO SUCH RADICAL ALTERNATIVE WHICH CAN SATISFACTORILY RESOLVE WHAT IS CLEARLY A HIGHLY COMPLEX PROBLEM. RATHER WE HAVE TO PERSEVERE WITH THE PRESENT APPROACH, VARYING IT AS NECESSARY TO MEET THE PARTICULAR CIRCUMSTANCES AS THEY ARISE. I REMAIN FIRMLY OPPOSED TO THE QUOTE GLOBAL SOLUTIONS UNQUOTE TO THE DEBT PROBLEM WHICH ARE CANVASSED FROM TIME TO TIME. THESE INVARIABLY - IF NOT ALWAYS EXPLICITLY - INVOLVE NEW AND INFLATIONARY METHODS OF FINANCING, OR THE ASSUMPTION BY THE TAXPAYERS OF CREDITOR COUNTRIES OF THE OBLIGATIONS OF THE DEBTOR COUNTRIES OR THE RISKS OF THE BANKS.

THERE IS NO SENSIBLE ALTERNATIVE TO THE CASE-BY-CASE APPROACH WHICH WE HAVE BEEN PURSUING.

CONTRARY TO WHAT IS ALLEGED BY ITS CRITICS, IT REPRESENTS A COHERENT STRATEGY.

IT RESTS ON COMMON PRINCIPLES - ABOVE ALL ON THE CENTRAL IMPORTANCE OF COUNTRIES TAKING MEASURES TO PUT THEIR FINANCES IN ORDER AND RESTORE THEIR CREDITWORTHINESS. BUT IT RECOGNISES THE INESCAPABLE FACT THAT EVERY DEBTOR COUNTRY IS INDIVIDUAL AND DIFFERENT. THEY ALL HAVE DIFFERENT RESOURCES AND ABILITIES, DIFFERENT KINDS AND SCALES OF DEBTS AND INTERNATIONAL FINANCIAL AND ECONOMIC DIFFICULTIES AND OPPORTUNITIES.

AND THE CASE-BY-CASE APPROACH ALSO RECOGNISES THE NEED TO BUY TIME. BORROWING COUNTRIES NEED TIME FOR THE PROCESS OF ADJUSTMENT TO WORK. BANKS NEED TIME TO GET THEIR BALANCE SHEETS IN ORDER. THIS IS A SITUATION ON WHICH TIME - PROVIDED IT IS PUT TO GOOD USE - IS AN INVALUABLE COMMODITY.

THE LONDON INITIATIVE

AT OUR MEETINGS OVER THE PAST WEEKEND WE WERE ABLE WITHIN THE INTERIM COMMITTEE TO REACH SATISFACTORY OPERATIONAL DECISIONS WHICH WILL PROVIDE CONSTRUCTIVE GUIDANCE TO THE WORK OF THE EXECUTIVE BOARD OF THE FUND IN THE COMING MONTHS.

BUT THE MOST IMPORTANT OUTCOME OF OUR DELIBERATIONS IN THE INTERIM AND DEVELOPMENT COMMITTEES DERIVES FROM THE PROPOSAL CONTAINED IN THE ECONOMIC DECLARATION AT THE END OF THE LONDON SUMMIT LAST JUNE. IT WAS THEN AGREED, BY THE SEVEN NATIONS TAKING PART, THAT FINANCE MINISTERS SHOULD SET UP AN INTENSIVE DISCUSSION OF INTERNATIONAL FINANCIAL ISSUES OF PARTICULAR CONCERN TO DEVELOPING COUNTRIES WITHIN THE FRAMEWORK OF THE ESTABLISHED INTERNATIONAL FINANCIAL INSTITUTIONS.

THIS INITIATIVE RECOGNISED THE CLOSE INTERDEPENDENCE OF DEVELOPING AND DEVELOPED COUNTRIES. IT REFLECTED THE INTEREST THEY SHARE IN A RE-EXAMINATION, IN A MEDIUM-TERM FRAMEWORK, OF ASPECTS OF THE INTERNATIONAL MONETARY SYSTEM, OF EXTERNAL INDEBTEDNESS, THE ROLES OF MULTILATERAL INSTITUTIONS, INTERNATIONAL CAPITAL FLOWS AND INVESTMENT, AND TRADE POLICIES AND PROTECTIONISM. THE CONCERNS EXPRESSED IN THE LONDON DECLARATION HAVE BEEN ECHOED IN OTHER INTERNATIONAL FORA INCLUDING THE RECENT MEETING OF COMMONWEALTH FINANCE MINISTERS IN TORONTO.

AS HOST COUNTRY AT THE LONDON SUMMIT, IT IS THEREFORE OF PARTICULAR SATISFACTION TO THE UNITED KINGDOM THAT AT THE MEETINGS THAT HAVE JUST BEEN CONCLUDED, THE INTERIM AND DEVELOPMENT COMMITTEES HAVE RESPONDED BY DECIDING TO SET TIME ASIDE NEXT SPRING FOR DISCUSSIONS COVERING THE BROAD AREAS I HAVE OUTLINED.

I AM SURE THAT THIS IS THE MOST CONSTRUCTIVE WAY OF MEETING THE VERY UNDERSTANDABLE REQUEST OF DEVELOPING COUNTRIES THROUGHOUT THE WORLD FOR A DIALOGUE WITH THE INDUSTRIALISED NATIONS.

CONCLUDING REMARKS

TWO YEARS AGO SAW THE START OF GLOBAL ECONOMIC RECOVERY. THIS YEAR WE CAN REASONABLY CLAIM THAT IT IS WELL ESTABLISHED. IN THE COMING YEAR THE TASK BEFORE US WILL BE TO SUSTAIN IT BY MAKING PROGRESS IN THE FOLLOWING AREAS:

WE NEED TO:

- PUT OUR OWN HOUSES IN ORDER BY SECURING STABLE MONETARY CONDITIONS AND REDUCED BUDGET DEFICITS;
- PRESS FORWARD WITH SUPPLY SIDE POLICIES TO IMPROVE PRODUCTIVE POTENTIAL AND EMPLOYMENT;
- RESIST THE FORCES OF PROTECTIONISM AND MOVE TOWARDS A NEW ROUND OF MULTILATERAL TRADE NEGOTIATIONS;
- MAINTAIN THE MOMENTUM OF ECONOMIC ADJUSTMENT, WHERE IT IS STILL NEEDED;
- DEVELOP NEW WAYS OF FINANCING THE FUTURE NEEDS OF DEVELOPING COUNTRIES AND RELAX OBSTACLES TO FLOWS OF PRIVATE CAPITAL.

AND LET US IN ALL THESE ENDEAVOURS RECOGNISE THE RESPONSIBILITIES WHICH FLOW FROM THE INTERDEPENDENCE OF OUR ECONOMIES, AN INTERDEPENDENCE OF WHICH THE FUND AND THE BANK ARE SO VALUABLE AN INSTITUTIONAL EXPRESSION.

BOARDS OF GOVERNORS • 1985 ANNUAL MEETINGS • SEOUL, REPUBLIC OF KOREA

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL MONETARY FUND

Press Release No. 34

October 9, 1985

HOLD FOR RELEASE
UNTIL DELIVERY

Statement by Mr. IAN STEWART, M.P.,
Economic Secretary and Governor of the Fund
for the UNITED KINGDOM, at the
Joint Annual Discussion

I offer warm thanks to President Chun Doo Hwan and the people of the Republic of Korea for the generous welcome we have received in Seoul, for the opportunity many of us have had to see for the first time this increasingly prosperous country, and for the excellent arrangements made for our Annual Meetings.

We always owe a great debt to the President of The World Bank and the Managing Director of the International Monetary Fund, but I should like to place on record, on this occasion in particular, our appreciation of the great contribution that has been made by Mr. Clausen during such a critical period for the Bank.

At the outset, I should also like to join my colleagues in extending a very warm welcome to Tonga as a new member of the Bank and Fund.

I speak today in place of the Governor of the Fund for the United Kingdom, Mr. Nigel Lawson. He has asked me to convey to you, Mr. Chairman, to his fellow Governors and to the heads of the institutions whose Annual Meetings these are, his regret at being unable to be present today, because the date of the Meetings, being rather later than usual, unfortunately clashes with the annual conference of the British Government Party.

After commenting briefly on the world economic outlook I want to concentrate on the main risks to the continuation of the present healthy recovery in the world and to the further progress of our individual economies. Those main risks are the growing threat of protectionism and the danger of mismanagement of debt.

The World Economy

Although experience in individual countries was uneven, the world economy as a whole in 1984 showed remarkable strength. Growth in the seven major industrial countries together was over 5 percent. The

volume of world trade rose almost 9 percent and imports of OECD countries rose 12 percent. This rapid recovery was achieved without the renewal of inflation which has often accompanied recovery in the past. In OECD countries, on average, inflation was around 5 percent in 1984, with expectations of a further fall this year.

The recovery in industrial countries has helped to support the remarkable adjustment efforts of many developing countries grappling with the heavy burden of debt incurred in earlier years. The aggregate current account deficits of developing countries fell from \$100 billion in 1982 to around \$40 billion in 1984 and are expected to remain around \$40 billion this year. The severe cutback in imports which many had to accept are now being succeeded by a balanced expansion of their trade.

The pace of recovery in 1984 could not be expected to be sustained. The U.K. assessment is similar to that of the Fund. We expect economic growth in the major industrial countries to continue at around 3 percent per year, a rate in line with longer-term productivity trends. We believe that the strategy of sound finance to which the major industrial countries have committed themselves provides a firm foundation for sustained growth without renewed inflation.

The U.K. economy itself is now in its fifth successive year of steady growth. Since the trough of the recession in the first half of 1981, the GDP of the United Kingdom has grown at an average rate of just over 3 percent per year. The recovery has owed much to our success in bringing down inflation in a framework of sound fiscal and monetary policies, in liberalizing markets, and in encouraging enterprise. It has been a well-balanced upswing. Since 1981 investment has grown twice as fast as consumption. Domestic demand has broadly matched the growth of domestic output, so that growth has not relied excessively on exports. Throughout this period we have been running current account surpluses, although not at an excessive level that could cause difficulties for others. These surpluses, based on exports of North Sea oil, have financed a corresponding capital outflow, unencumbered by any form of exchange control. Oil is a nonrenewable asset and it clearly makes sense to replace its foreign currency earning capacity in part by investing in assets overseas. As a result, the United Kingdom's net overseas assets have risen from \$25 billion in 1979 to \$85 billion, at the last count.

Regrettably, like most other European countries, the United Kingdom has continued to suffer from high levels of unemployment. Rigidities in the labor market remain a problem; but it has to be said, too, that management has not always been quick enough to adapt to the improvements that have taken place. Nevertheless, employment levels have been rising, and unemployment would have fallen if it had not been for a rapid expansion of the work force.

In the industrial world as a whole, growth is becoming more balanced between the different countries. But major imbalances of other kinds remain, notably those arising from the size of the U.S. budget deficit in relation to its domestic savings ratio. Partly as a result of this, we have seen large and disturbing movements in the relative values of currencies, with inevitable but undesirable effects on trade performance. This is the background to the first of the main threats to our continued progress.

Protectionism

The rise of protectionist pressures is the major and most immediate danger to the world economy. Protectionist sentiment has been increasing in Europe, and even more so in the United States. The extent of these pressures is reflected in the long catalogue of measures under discussion in the U.S. Congress. We welcome and applaud the way in which the U.S. Administration has resisted such proposals and its determination to continue to do so.

We cannot remind ourselves too often of the damage done by an escalation of barriers to international trade, the effect of which is to reduce growth in industrial countries, to limit employment opportunities, and to deprive developing countries of export markets which are vital to their prospects, especially for those grappling with the problems of debt.

This was why the United Kingdom, along with Germany, France, and Japan, responded positively to the initiative taken last month by the Governor for the United States, Secretary Baker. The five countries together committed themselves at their meeting on September 22 to continue to pursue and reinforce policies which are already bringing about steady growth and declining inflation, to resist the forces of protectionism, and to take such action as might be necessary to secure an early adjustment in the exchange rate between the dollar and other major currencies.

But resisting new protectionist pressures, although of the first importance, is not enough. We urgently need more progress in rolling back long-established barriers and in extending the scope of the open trading system. The best guarantee we have against the erosion of free trade is to make further progress in the multilateral context of GATT. This is in the interests of all of us--developing and industrial countries alike. We should all be concerned about the way nontariff barriers and other discriminatory practices have grown up, precisely when multilateral action in successive GATT rounds has reduced formal tariff barriers. Such measures are as harmful to the developing countries as to the industrial world.

We all have much to gain from freer trade--just as we all have something to contribute. For this reason the United Kingdom strongly supports the proposed new round of trade negotiations. A good start was made at the special GATT meeting last week. When the Contracting Parties meet in November, and in the negotiations which I hope will follow, my Government will support the broadest possible agenda.

We need also to look behind the present imbalances of trade which have given rise to protectionist pressures, to get at and to eliminate the root causes. If I refer in particular to the United States and Japan it is because their major influence in the world economy means that their policies cannot be judged solely by domestic criteria.

As in other industrial countries, U.S. monetary policy must be aimed at avoiding a resurgence of inflation. But it is also important that U.S. interest rates should remain at relatively low levels. The best chance of securing these two things is through significant reductions in the Federal budget deficit. We welcome the recognition of this by the U.S. Administration, and their recognition that the measures in the 1986 budget resolution can be seen only as a first step.

A better balance in the external trade of the United States must inevitably imply a reduction in the net exports of other countries to the United States. There is no need for this to mean recession for the world economy. Other major industrial countries are now showing a stronger recovery. Their performance can be helped to some extent by the impact of a lower dollar on their domestic costs and by the prospect of a gradual reduction in interest rates.

Japan has a particularly important contribution to make to the process of adjustment. Although Japanese growth and inflation performance have been enviable, they have relied too heavily on external demand. The recent appreciation of the yen exchange rate, particularly against the dollar, will help. The announced intentions of the Japanese authorities to liberalize their financial markets and promote opportunities for increased imports are very much to be welcomed, but they need to be implemented and made effective quickly. And some further encouragement to domestic consumption can surely be afforded in a country with so high a domestic savings ratio.

There has been much talk, at these and earlier Annual Meetings, in the Interim and Development Committees, in the Group of Ten, and elsewhere, of the need for better policy coordination and mutual surveillance among our countries. The agreement reached last month by the United States, Japan, Germany, France, and the United Kingdom marks an important advance in international economic cooperation.

Management of International Debt

These are the fourth successive Annual Meetings at which the problems of international debt have dominated our agenda. The international community can fairly take some legitimate satisfaction from the efforts which have been made over the past three years by all concerned--borrowing countries, creditor countries, commercial banks, the Bank, and the Fund alike. But though the sense of crisis of the early stages has eased, debt burdens remain a threat to the world economy and to the international banking system.

It was clear at the outset that the debt problems would not be solved quickly. It was bound to take a considerable time for individual debtor countries to recover, and longer still for the group of major borrowing countries as a whole.

It is worth reminding ourselves that the process of adjustment does not require the elimination of all external debt, or anything like that. It is natural that capital should flow from industrial to developing countries, and that developing countries should in consequence be fairly substantial net debtors, supplementing their domestic saving by external borrowing. The problems arise, as in the 1970s, when borrowers and lenders overestimate the capacity of the borrowing countries to service debt, particularly when this is coupled with the unproductive use of some of the proceeds.

During these past years, the immediate need has been met by the case-by-case strategy which has been followed. The wide differences between countries meant that the problems of each of them had to be considered separately on their merits. In all cases, there had to be a considerable adjustment in the domestic economies of the indebted countries, and the task during these years has been to get that process started. At the same time, there was need for creditors--private and official alike--to roll over outstanding debt and add some new financing to help ease the burdens. This approach was embodied in the London summit communiqué in 1984 which, with its encouragement of multiyear rescheduling, also made a start in tackling the longer-term aspects of the problem.

We now need to carry this approach further. I listened with particular interest yesterday to ideas put forward by the U.S. Governor, Mr. Baker. I welcome the lead the United States is now giving on these problems. There are difficulties to be overcome; but the objectives--the adoption of the right economic policies by the debtor countries, a continuing central role for the Fund, and a more prominent role for The World Bank and other development banks, and increased lending by the private banks in support of economic adjustment programs--are ones which we fully support. These three elements are interdependent; they require the cooperation of all parties concerned; and each element is indispensable to the resolution of the debt problem.

The need for continued adjustment cannot be avoided. Difficult and painful as the initial process inevitably is (and some debtor countries have tried harder than others), it can be at least as difficult to sustain it over a period of years. Many countries have had to accept a reduction in living standards and must still contemplate a period of restraint as they establish a sounder basis for growth. But this is the contribution which debtor countries must make and without which the necessary finance will not be forthcoming and could not be effective.

The part played by the Fund remains essential. Fund-supported adjustment programs have often been unfairly characterized as simply meaning cuts in budget deficits and imports. Correcting unsound fiscal and monetary policies is certainly a necessary element of such programs, but adjustment also involves structural reforms aimed at improving future performance. The Fund has thus rightly sought realistic exchange rates and pricing policies to ensure that scarce resources are not wasted. The Republic of Korea is a practical and highly instructive model of how a developing country can combine adjustment with growth and make productive use of capital inflows.

As part of this longer-term strategy for debt, the United Kingdom would support a larger and more effective role for The World Bank and its affiliates over the next few years. The Bank is already providing fast-disbursing loans in support of broad policy reform. While project financing should continue to be the main focus of the Bank's activities, lending linked with improved economic policies has the potential for greatly increasing the efficiency and growth of debtor economies. It is an approach which I believe should be further strengthened and expanded. Increased lending by the Bank, if it can be matched by improved policies and performance by borrowers, should help to encourage additional bank financing and private investment in their economies. The United Kingdom will look sympathetically at the need for the Bank to add to its resources as its lending program expands.

The third element is financing from the private sector, particularly the commercial banks. Decisions on lending must remain matters for judgment by the commercial banks themselves and for negotiation with individual debtor countries. But in making their judgments the banks will certainly be looking for some assurance from the commitment of debtor countries to sound economic policies and from the part which the Fund, and we hope increasingly the Bank, will be playing.

There have been valuable discussions about these problems here at Seoul, in the Interim and Development Committees, and the decisions taken reflect our common concerns.

In view of the uncertainties remaining in the world economy and the difficulties some debtor nations continue to face, I am glad that the Interim Committee has decided to renew the policy on enlarged access for 1986 with only marginal changes.

Particularly welcome, too, are the principles on which we have agreed regarding the future use of the Fund's Trust Fund reflows. These apply primarily to the poorest countries (above all those in Africa) and I am glad to pay tribute to the helpful decisions by China and India not to exercise their right to draw on the Trust Fund until 1991.

I was also very pleased to hear of the decision in principle taken in the Executive Board here in Seoul to make available a drawing of SDR 300 million under the emergency assistance facility to give the Government and people of Mexico some special help toward rebuilding after the tragedy of the recent earthquake.

Finally, I welcome the text of the Convention for a Multilateral Investment Guarantee Agency which, despite many difficulties, has now emerged from the work of the Executive Board of the Bank.

I conclude by emphasizing three vital contributions which the industrial countries must make. First, to sustain the noninflationary growth of the world economy. Second, to allow the free export of investment capital to developing countries. Third, to resist protectionist pressures and keep their markets open to the exports of the developing countries and of each other.

CHANCELLOR'S SPEAKING NOTE FOR THE INTERIM COMMITTEE
SUNDAY, SEPTEMBER 28, 1986

THE LAST FEW DAYS HAVE SEEN AN ALMOST UNHEALTHY PREOCCUPATION, IN THE MARKETS AND IN THE PRESS, WITH VERY SHORT-TERM CONCERNS. IT IS TIME TO REVERT TO A LONGER PERSPECTIVE. AND THE FIRST THING TO DO IS TO RECOGNISE THE ACHIEVEMENTS OF RECENT YEARS, AND THE REASONS FOR THEM.

THE ACHIEVEMENTS ARE SIGNIFICANT. INFLATION HAS BEEN DECISIVELY REDUCED AND WE HAVE HAD SUSTAINED GROWTH OF OUTPUT.

THE MAIN REASON FOR THESE SUCCESSES HAS BEEN A FUNDAMENTAL CHANGE IN THE APPROACH TO ECONOMIC POLICY, AND THIS HAS TWO MAIN ASPECTS.

FIRST, MONETARY AND FISCAL POLICIES HAVE BEEN DIRECTED TOWARDS THE CONTROL OF INFLATION. AND THE PROBLEM OF POOR OUTPUT GROWTH HAS BEEN TACKLED BY POLICIES TO IMPROVE THE SUPPLY PERFORMANCE OF THE ECONOMY. HAVING LEARNT FROM THE MISTAKES OF THE SEVENTIES, MONETARY AND FISCAL POLICIES HAVE NOT BEEN PERVERTED IN A VAIN ATTEMPT TO FINE TUNE REAL OUTPUT. NOR HAVE MICRO-ECONOMIC POLICIES BEEN USED--OR I SHOULD SAY ABUSED--TO SUPPRESS THE SYMPTOMS OF INFLATION.

SECOND, POLICIES HAVE BEEN SET FIRMLY IN A MEDIUM-TERM CONTEXT. GOVERNMENTS HAVE SET THEIR FACE AGAINST CHANGING COURSE IN RESPONSE TO EVERY SHORT-TERM FLUCTUATION.

OVER THE LAST YEAR, THESE POLICIES HAVE ONCE AGAIN SHOWN THEIR WORTH. THE WORLD HAS HAD TO COPE WITH MASSIVE CHANGES IN RELATIVE PRICES--IN EXCHANGE RATES, IN THE PRICE OF OIL, AND IN OTHER COMMODITY PRICES. ON THE WHOLE IT HAS COPED WELL. THE ASSURANCE

3.

PROVIDED BY A SOUND MEDIUM-TERM STRATEGY HAS STOOD US
IN GOOD STEAD.

BY ANY STANDARD THE CHANGES WE HAVE SEEN HAVE
BEEN ENORMOUS. AND IT IS INEVITABLE THAT THERE HAVE
BEEN DISAPPOINTMENTS. THE FRUSTRATION THAT HAS EMERGED
IN SOME QUARTERS IN RECENT WEEKS HAS INEVITABLY
INCREASED THE ATTENTION PAID TO SHORT-TERM
DEVELOPMENTS. IN THIS CLIMATE IT IS EASY TO FORGET
THAT IT IS THE MEDIUM-TERM THAT MATTERS.

FOR EXAMPLE, CONSIDER THE EFFECTS OF OIL PRICE
CHANGES ON ECONOMIC ACTIVITY. SO FAR WE HAVE SEEN
PREDOMINANTLY THE NEGATIVE EFFECTS; IN PARTICULAR
THOSE COUNTRIES WHOSE INCOME HAS BEEN REDUCED HAVE
RAPIDLY REDUCED THEIR IMPORTS. AND AS A RESULT THE
EXPORTS OF THE INDUSTRIAL COUNTRIES AND SOME OTHERS
HAVE BEEN WEAK. BUT IN TIME THE BENEFICIAL EFFECTS OF
CHEAPER OIL FOR THE WORLD AS A WHOLE WILL EMERGE.
DOMESTIC DEMAND IN THE INDUSTRIALISED COUNTRIES IS

ALREADY SHOWING SIGNS OF GROWING MORE RAPIDLY AND I EXPECT IT TO STRENGTHEN FURTHER. AND WITH THAT STRENGTHENING OF DOMESTIC DEMAND WE ARE SEEING A MORE RAPID GROWTH OF IMPORTS TO THE INDUSTRIALISED COUNTRIES, WHICH IN TURN SHOULD IMPROVE THE POSITION OF THE REST OF THE WORLD. I SHARE THE VIEW THAT THE WORLD ECONOMY WILL STRENGTHEN OVER THE NEXT YEAR.

SIMILARLY WE CANNOT EXPECT EXCHANGE RATE CHANGES INSTANTANEOUSLY TO RESOLVE THE PROBLEM OF CURRENT ACCOUNT IMBALANCES. BUT IT WOULD BE A MISTAKE TO CONCLUDE THAT WE NEED FURTHER LARGE DOLLAR DEPRECIATION SIMPLY BECAUSE WE HAVE NOT YET SEEN ANY IMPROVEMENT IN THE US CURRENT ACCOUNT. SO FAR WE HAVE SEEN SOME OF THE FAMILIAR ADVERSE EFFECTS OF CURRENCY REALIGNMENTS. THE TERMS OF TRADE EFFECTS COME THROUGH MUCH MORE RAPIDLY THAN THE EFFECTS ON THE VOLUME OF EXPORTS AND IMPORTS; BUT THERE ARE NOW SIGNS OF IMPROVED PERFORMANCE. THE CUMULATIVE EFFECTS OF THE EXCHANGE RATE CHANGES THAT HAVE OCCURRED SINCE THE

PLAZA AGREEMENT A YEAR AGO WILL MAKE A SIGNIFICANT CONTRIBUTION TO THE RESOLUTION OF THE PAYMENTS IMBALANCES THAT THREATEN CONTINUED STEADY OUTPUT GROWTH.

THIS IS NOT TO ARGUE THAT EXCHANGE RATE CHANGES ALONE CAN RESOLVE THE PROBLEM OF LARGE PAYMENTS IMBALANCES. IF WE ARE TO ACHIEVE THE NECESSARY LONG-TERM CORRECTION, DOMESTIC DEMAND IN OTHER INDUSTRIALISED COUNTRIES WILL HAVE TO GROW MARKEDLY FASTER THAN IN THE USA.

ALREADY WE CAN SEE SIGNS THAT THIS IS HAPPENING, FOR EXAMPLE IN GERMANY WHERE DOMESTIC DEMAND ROSE BY 3½ PER CENT IN REAL TERMS IN THE FIRST HALF OF THE YEAR. IT IS IMPORTANT THAT THIS IS SUSTAINED.

IN JAPAN, DOMESTIC SAVINGS HAVE LONG EXCEEDED DOMESTIC INVESTMENT, WITH THE RESULT THAT CAPITAL HAS BEEN INVESTED ABROAD, AND THE COUNTERPART HAS BEEN A

CURRENT ACCOUNT SURPLUS. IN GENERAL, I WELCOME THE MEASURES ANNOUNCED BY THE JAPANESE GOVERNMENT LAST WEEK--THOUGH I REMAIN CONCERNED THAT SUBSIDIES TO JAPANESE INDUSTRY MAY BE USED TO COUNTERACT THE APPRECIATION OF THE YEN. MOREOVER, THE JAPANESE GOVERNMENT HAS YET TO TAKE ACTION TO REDUCE THE DISTORTING EFFECTS OF INCENTIVES TO SAVINGS, ESPECIALLY THROUGH THE TAX SYSTEM, IN LINE WITH THE RECOMMENDATIONS OF THE GOVERNMENT'S MAEKAWA COMMISSION.

IN THE UNITED STATES, IT IS AGREED ON ALL SIDES THAT THE FISCAL DEFICIT REMAINS TOO HIGH. PROGRESS IN THE CURRENT YEAR HAS BEEN DISAPPOINTING, AND WELL SHORT OF WHAT WAS ENVISAGED IN THE PLAZA COMMUNIQUE. BUT THERE IS A BETTER PROSPECT OF A LOWER US DEFICIT NEXT YEAR. THAT IS A STEP IN THE RIGHT DIRECTION. IT IS VITAL THAT THIS PROGRESS IS MAINTAINED AND IMPROVED OVER A NUMBER OF YEARS.

I AM CONVINCED THAT THAT SORT OF PERSISTENCE REMAINS THE KEY TO SUCCESSFUL ECONOMIC MANAGEMENT. THE IMPORTANT THING IS NOT THE PRECISE MOVEMENT OF THIS OR THAT INDICATOR OVER A WEEK OR A MONTH OR A QUARTER. IT IS TO MAKE SURE WE HAVE THE RIGHT POLICIES IN PLACE AND TO STICK TO THEM.

THE IMPRESSIVE CONSENSUS WHICH HAS BEEN EMERGING IN MACRO-ECONOMIC POLICY HAS BEEN A CONSISTENT THEME OF THESE MEETINGS OVER THE LAST FEW YEARS. AND IT HAS BEEN BACKED BY INCREASING COOPERATION BETWEEN OUR COUNTRIES.

WE HAVE SEEN THAT OVER THIS LAST YEAR.

- AT THE PLAZA A YEAR AGO, WE RESOLVED TO BRING ABOUT A MAJOR ADJUSTMENT OF EXCHANGE RATES. EVERYONE AGREED THEY HAD GOT OUT OF LINE. NOW WE HAVE BROKEN THE BACK OF THE PROBLEM. AND WE HAVE DONE IT IN AN ORDERLY WAY.

- THEN AT THE TOKYO SUMMIT, WE RESOLVED TO IMPROVE THE PROCESS BY WHICH WE WORK TOWARDS GREATER CONSISTENCY IN OUR ECONOMIC POLICIES. NOW, AT THESE MEETINGS, WE ARE BENEFITING FROM THE ENHANCED USE OF AGREED INDICATORS. AND I AM SURE WE MUST BUILD ON THAT FURTHER.

ONE OF THE MAJOR PROBLEMS WE AND IN PARTICULAR THE DEVELOPING COUNTRIES ARE HAVING TO CONTINUE TO GRAPPLE WITH IS INTERNATIONAL DEBT. FOR SOME COUNTRIES, ESPECIALLY OF COURSE THE OIL IMPORTERS, DEVELOPMENTS OVER THE PAST YEAR HAVE BEEN FAVOURABLE. I WOULD LIKE TO PAY TRIBUTE TO THE EFFORTS OF THE FUND AND THE BANK IN RESPONDING TO THE INITIATIVE LAUNCHED A YEAR AGO BY SECRETARY BAKER TOWARDS THE RESOLUTION OF THE DEBT PROBLEM. A NUMBER OF COUNTRIES HAVE MADE REAL PROGRESS OVER THE PAST YEAR IN ADOPTING POLICIES WHICH SHOULD AT LEAST PROVIDE THE BASIS FOR RECOVERY AND RETURNING IN DUE COURSE TO NORMAL MARKET BORROWING.

HOWEVER, FOR ONE OR TWO OF THE MAJOR DEBTORS, DEVELOPMENTS OVER THE PAST YEAR HAVE MADE THINGS WORSE. MEXICO AND NIGERIA ARE PARTICULARLY ON OUR MINDS AT THIS TIME. THE GOVERNMENTS OF BOTH THESE COUNTRIES HAVE TAKEN IMPORTANT STEPS IN RECENT MONTHS AND IT IS HEARTENING THAT BOTH WERE ABLE TO REACH AGREEMENT WITH THE FUND. THE MEXICAN SITUATION HAS NOW REACHED A CRITICAL STAGE IN THE NEGOTIATIONS BETWEEN THE MEXICAN GOVERNMENT AND THE COMMERCIAL BANKS. IT IS OF THE FIRST IMPORTANCE THAT THESE NEGOTIATIONS ARE SUCCESSFULLY RESOLVED.

THE HEAVILY INDEBTED COUNTRIES WOULD BE GREATLY HELPED BY ADDITIONAL DIRECT INVESTMENT AND BY INCREASED EXPORTS. THE DEBTOR COUNTRIES HAVE A PART TO PLAY IN OPENING UP THEIR ECONOMIES FURTHER TO INWARD INVESTMENT--I AM SURE UK INVESTORS, WHO HAVE BEEN SECOND ONLY TO UNITED STATES' INVESTORS IN DEVELOPING COUNTRIES, WOULD RESPOND. THE DEVELOPED COUNTRIES, OF COURSE, HAVE THEIR PART TO PLAY BY ENSURING GROWING

MARKETS FOR DEVELOPING-COUNTRY EXPORTS, WHICH IN TURN REQUIRES THAT WE SUCCESSFULLY RESIST THE PROTECTIONIST PRESSURES IN OUR COUNTRIES AND ACHIEVE SUCCESS WITH OUR MACRO-ECONOMIC AND MICRO-ECONOMIC POLICIES.

THE CONSENSUS IN MACRO-ECONOMIC POLICY, WHICH WE ARE STEADILY CONSOLIDATING, IS NOW BEING EXTENDED INTO THE MICRO-ECONOMIC SPHERE. GOVERNMENTS OF LEFT AND RIGHT, THROUGHOUT THE WORLD, ARE COMING TO RECOGNISE THE BENEFITS OF THE MARKET ECONOMY.

THE MOST CONSPICUOUS EXAMPLE IS, OF COURSE, THE WIDESPREAD ADOPTION OF THE POLICY OF PRIVATISATION. ANOTHER IS THE MOVE TO REFORM AND REDUCE TAXES. IT IS IN WAYS LIKE THESE THAT WE CAN MAKE OUR ECONOMIES MORE EFFICIENT.

I AM ENCOURAGED THAT, IN ALL THIS, THE CORPORATIST TIDE IS AT LAST BEING TURNED. THERE IS MUCH TO BE DONE, BUT SLOWLY AND SURELY, WE ARE PUTTING

THE EMPHASIS BACK ON THE PROPER FUNCTIONING OF FREE MARKETS--WHERE, INDEED, IT SHOULD ALWAYS HAVE BEEN.

AND THAT IS BEING REFLECTED AT THE INTERNATIONAL LEVEL TOO. EIGHTEEN MONTHS AGO, AT THE BONN SUMMIT, I VIVIDLY REMEMBER THAT WE AGREED ON ALMOST EVERYTHING EXCEPT A STARTING DATE FOR A NEW GATT ROUND. EVEN WITHIN THE LAST FEW WEEKS, THERE HAS BEEN THE GRAVEST UNCERTAINTY WHETHER GOVERNMENTS HAD THE WILL TO RISE TO THE CHALLENGE. BUT HERE THERE HAS BEEN A REAL BREAKTHROUGH. THE WORLD IS NOW COMMITTED TO A GENUINE ATTEMPT TO BRING DOWN TRADE BARRIERS RIGHT ACROSS THE BOARD, IN INDUSTRY AND AGRICULTURE, GOODS AND SERVICES. IT IS VITAL THAT WE NOW CARRY THIS THROUGH TO A SUCCESSFUL CONCLUSION.

THE US ADMINISTRATION HAS ALL ALONG SEEN AN INTERNATIONAL TRADE AGREEMENT AS THE BEST POSSIBLE WEAPON AGAINST BIPARTISAN PROTECTIONIST PRESSURE IN CONGRESS. NOW THAT PUNTA DEL ESTE HAS GIVEN THE

ADMINISTRATION THAT WEAPON, WE EXPECT THEM TO BE
SUCCESSFUL IN RESISTING THOSE PRESSURES.

EXTRACTS FROM THE STATEMENT BY MR. NIGEL LAWSON,
PRESIDENT OF THE COUNCIL OF EUROPEAN COMMUNITIES
TO THE INTERIM COMMITTEE MEETING ON
SEPTEMBER 28, 1986

[TRIBUTE TO LAROSIERE]

I HAVE THE HONOUR OF ADDRESSING THIS MEETING ON BEHALF OF THE MEMBER STATES OF THE COMMUNITY, WHICH SINCE THE START OF THE YEAR INCLUDES SPAIN AND PORTGUAL. I WILL GIVE YOU THE MAIN POINTS NOW: A FULL TEXT OF THE STATEMENT WILL BE PLACED ON THE RECORD.

ECONOMIC ACTIVITY IN MOST INDUSTRIALISED COUNTRIES, PARTICULARLY INDUSTRIAL PRODUCTION, HAS BEEN SOMEWHAT SLUGGISH SINCE THE FINAL QUARTER OF 1985. WHILE THIS IS DISAPPOINTING, IT IS LIKELY TO PROVE A TRANSITIONAL PHASE AS THE WORLD ECONOMY ADJUSTS TO THE MAJOR SHIFTS IN RELATIVE PRICES WHICH HAVE OCCURRED OVER THE PAST YEAR OR SO.

- THE NEEDS OF POOR COUNTRIES ELSEWHERE IN THE WORLD MUST NOT BE FORGOTTEN, FROM THE HIGH POPULATION COUNTRIES OF SOUTH AND EAST ASIA, TO THE SMALL PACIFIC ISLANDS WHERE THE BANK SHOULD LOOK TO THE NEEDS OF AN EXPANDING MEMBERSHIP.

- THERE IS GROWING CONCERN WORLD WIDE, AND NOT LEAST IN BRITAIN ABOUT THE IMPLICATIONS OF DEVELOPMENT FOR THE ENVIRONMENT. ECONOMIC DEVELOPMENT MUST TAKE INTO ACCOUNT THE PROTECTION OF NATURAL RESOURCES. [HERE THE BANK HAS A BIG RESPONSIBILITY, AND MUST MAKE SURE, PERHAPS BETTER THAN IN THE PAST, THAT ITS PRACTICE FULLY RESPECTS ITS PRECEPTS.]

THERE IS A REASONABLE EXPECTATION THAT ECONOMIC ACTIVITY IN INDUSTRIAL COUNTRIES WILL PICK UP AS DOMESTIC DEMAND RESPONDS TO LOWER NOMINAL INTEREST RATES AND HIGHER REAL INCOMES. AND INDEED SIGNS OF A PICK-UP OF ACTIVITY IN A NUMBER OF EUROPEAN COUNTRIES ARE APPARENT.

BUT IN MANY COUNTRIES GOVERNMENT DEFICITS NEED TO BE REDUCED FURTHER. THE UNITED STATES HAS A MAJOR ROLE TO PLAY HERE BECAUSE OF THE SIZE OF THE FEDERAL GOVERNMENT DEFICIT AND BECAUSE OF THE CONTRIBUTION WHICH ITS CORRECTION CAN MAKE TO REDUCING CURRENT ACCOUNT IMBALANCES. IT IS CRUCIAL THAT JAPAN SHOULD MAKE ITS CONTRIBUTION BY IMPLEMENTING RAPIDLY THE RECOMMENDATIONS OF THE MAEKAWA COMMISSION DESIGNED TO REDUCE THE EXPORT-ORIENTED NATURE OF THE JAPANESE ECONOMY AND TO INCREASE ITS OPENNESS TO IMPORTS, THUS SUSTAINING A FASTER RISE IN DOMESTIC DEMAND. THE COMMUNITY COUNTRIES ARE ALSO AWARE OF THE NEED TO CONTRIBUTE TO THE CORRECTION OF EXISTING IMBALANCES AND TO THE

MAINTENANCE OF SUSTAINED GROWTH OF WORLD DEMAND AND TRADE.

THE EC MEMBER STATES WELCOME THE STEPS THAT HAVE BEEN TAKEN OVER THE PAST YEAR TO IMPROVE INTERNATIONAL POLICY COORDINATION.

OVER THE LAST YEAR CHANGES IN THE WORLD ECONOMY HAVE PROBABLY HAD, ON BALANCE, A BENEFICIAL EFFECT ON THE DEBT PROBLEM, ALTHOUGH THE SITUATION OF SOME COUNTRIES HAS SERIOUSLY DETERIORATED.

THESE DEVELOPMENTS OVER THE PAST YEAR--PARTICULARLY THE FALL IN OIL PRICES--UNDERLINE THE FACT THAT THE CASE-BY-CASE APPROACH TO THE DEBT PROBLEM IS THE MOST APPROPRIATE STRATEGY; EACH COUNTRY FACES DIFFERENT PROBLEMS AND NEEDS TO LOOK FOR DIFFERENT SOLUTIONS.

THE FORTHCOMING GATT ROUND PROVIDES THE MOST COMPREHENSIVE OPPORTUNITY FOR MULTILATERAL NEGOTIATIONS ON THE OPENING OF MARKETS SINCE THE

TOKYO ROUND A DECADE AGO. THE EUROPEAN COMMUNITY WILL ENTER THESE TALKS WITH THE OBJECTIVES OF CONSOLIDATING AND FURTHER DEVELOPING THE OPEN TRADING SYSTEM. THE EC IS COMMITTED TO AN EARLY LAUNCH OF NEGOTIATIONS--AND WELCOMES THE PROGRESS MADE AT THE SEPTEMBER GATT MINISTERIAL MEETING IN URUGUAY.

THE FUND CONTINUES TO HAVE A CENTRAL ROLE IN THE ADJUSTMENT PROCESS AND THE COUNTRIES OF THE COMMUNITY STAND FULLY BEHIND IT IN ITS WORK.

IN VIEW OF THE SERIOUS PAYMENTS DIFFICULTIES THAT MANY FUND MEMBERS CONTINUE TO FACE, THE EC MEMBER STATES FAVOUR A DECISION BY THE INTERIM COMMITTEE TO MAINTAIN THE POLICY OF ENLARGED ACCESS FOR ANOTHER YEAR AND TO KEEP THE ACCESS LIMITS UNCHANGED FOR 1987.

THE COMMUNITY COUNTRIES ATTACH THE GREATEST IMPORTANCE TO THE INTEGRITY OF THE FUND'S INCOME POSITION AND URGE THOSE COUNTRIES IN ARREARS TO THE FUND TO CLEAR THEM SPEEDILY.

THE MEMBER STATES OF THE COMMUNITY ARE PREPARED TO PARTICIPATE CONSTRUCTIVELY IN THE DISCUSSIONS ON THE NINTH QUOTA REVIEW.

ON BEHALF OF THE MEMBER STATES OF THE COMMUNITY, I WOULD LIKE TO CONGRATULATE MR. BARBER CONABLE ON HIS APPOINTMENT AS PRESIDENT OF THE WORLD BANK AND WELCOME HIM TO OUR REGULAR DISCUSSIONS AT THESE MEETINGS. HE BRINGS TO THE JOB A WEALTH OF RELEVANT EXPERIENCE. HIS APPOINTMENT COMES AT A TIME WHEN THE WORLD BANK IS EMBARKING ON IMPORTANT NEW DEVELOPMENTS.

WE RECOGNISE THAT THE BANK REQUIRES SUFFICIENT RESOURCES TO ENABLE IT TO FULFIL ITS ROLE IN TACKLING THE PROBLEMS OF MAJOR MIDDLE-INCOME DEBTOR COUNTRIES. WE ARE THEREFORE READY TO SUPPORT A SUBSTANTIAL INCREASE IN ITS CAPITAL.

WE LOOK FORWARD TO VERY EARLY FINALISATION OF AN EIGHTH IDA REPLENISHMENT, WITH EXTRA VOLUNTARY CONTRIBUTIONS, OF \$12 BILLION.

WE WELCOME THE ROLE OF THE INTERNATIONAL FINANCE CORPORATION IN SUPPORT OF PRIVATE INVESTMENT AND ENTERPRISE IN THE DEVELOPING COUNTRIES.

GOOD PROGRESS HAS ALSO BEEN MADE WITH MIGA. MORE THAN 35 COUNTRIES HAVE NOW SIGNED THE CONVENTION AND A FEW DAYS AGO THE PREPARATORY COMMITTEE AGREED THE INTERNAL REGULATIONS AND OPERATIONS GUIDELINES. WE HOPE THAT THE AGENCY CAN BE ESTABLISHED QUICKLY, AND BEGIN TO PLAY ITS PART IN SUPPORTING AND PROMOTING PRIVATE DIRECT INVESTMENT.

I NOW COME TO MY REMARKS IN MY CAPACITY AS UK MEMBER.



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*Nigel
Eofin b/gd of
30 September 1986
(communiqués & speeches)*

THE CHANCELLOR OF THE EXCHEQUER'S SPEECH TO THE IMF

Attached is the text of the speech delivered in Washington today by the Rt Hon Nigel Lawson MP, Chancellor of the Exchequer, at the Joint Annual Meeting of the International Monetary Fund and the International Bank for Reconstruction and Development.

p7

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EMBARGOED UNTIL 4 PM WASHINGTON TIME, SEPTEMBER 30, 1986
BOARD OF GOVERNORS 1986 ANNUAL MEETINGS, WASHINGTON DC

STATEMENT BY THE RT.HON. NIGEL LAWSON MP
CHANCELLOR OF THE EXCHEQUER
GOVERNOR OF THE FUND FOR THE UNITED KINGDOM AT THE
JOINT ANNUAL MEETINGS

MR. CHAIRMAN, I HAVE THE HONOUR OF ADDRESSING THIS MEETING AS PRESIDENCY OF THE EUROPEAN COMMUNITY WHICH SINCE THE START OF THE YEAR HAS FOR THE FIRST TIME COMPRISED TWELVE NATIONS, WITH THE WELCOME INCLUSION OF SPAIN AND PORTUGAL. THE BANK AND FUND HAVE ALSO ACQUIRED TWO NEW MEMBERS--POLAND AND KIRIBATI--AND I WELCOME THEM, TOO.

I SHALL DEPOSIT THE FULL TEXT OF MY PRESIDENCY SPEECH WITH THE SECRETARIAT, BUT I SHOULD LIKE TO MAKE SOME OF THE MAIN POINTS HERE, BEFORE I TURN TO MY REMARKS AS UK GOVERNOR.

ECONOMIC ACTIVITY IN MOST INDUSTRIALISED COUNTRIES, PARTICULARLY INDUSTRIAL PRODUCTION, HAS BEEN SOMEWHAT SLUGGISH SINCE THE FINAL QUARTER OF 1985. WHILE THIS IS DISAPPOINTING, IT IS LIKELY TO PROVE A TRANSITIONAL PHASE AS THE WORLD ECONOMY ADJUSTS TO THE MAJOR SHIFTS IN RELATIVE PRICES WHICH HAVE OCCURRED OVER THE PAST YEAR OR SO.

THERE IS A REASONABLE EXPECTATION THAT ECONOMIC ACTIVITY IN INDUSTRIAL COUNTRIES WILL PICK UP AS DOMESTIC DEMAND RESPONDS TO LOWER NOMINAL INTEREST RATES AND HIGHER REAL INCOMES. AND INDEED, SIGNS OF A PICK-UP OF ACTIVITY IN A NUMBER OF EUROPEAN COUNTRIES ARE APPARENT.

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GOOD PROGRESS HAS ALSO BEEN MADE WITH MIGA - THE MULTILATERAL INVESTMENT GUARANTEE AGENCY. MORE THAN 35 COUNTRIES HAVE NOW SIGNED THE CONVENTION AND A FEW DAYS AGO THE PREPARATORY COMMITTEE AGREED THE INTERNAL REGULATIONS AND OPERATIONS GUIDELINES. WE HOPE THAT THE AGENCY CAN BE ESTABLISHED QUICKLY, AND BEGIN TO PLAY ITS PART IN SUPPORTING AND PROMOTING PRIVATE DIRECT INVESTMENT.

LET ME NOW MAKE SOME ADDITIONAL REMARKS IN MY CAPACITY AS GOVERNOR FOR THE UNITED KINGDOM.

AT PREVIOUS ANNUAL MEETINGS I HAVE HAD OCCASION TO REMARK ON THE ENCOURAGING CONSENSUS THAT HAS GROWN UP THROUGH THE WORLD ON THE MONETARY AND FISCAL POLICIES NECESSARY TO SECURE SUSTAINABLE NON-INFLATIONARY ECONOMIC GROWTH.

WHAT IS NEW IS THAT THE CONSENSUS OVER MACRO-ECONOMIC POLICY HAS BEEN EXTENDED INTO THE MICRO-ECONOMIC SPHERE. GOVERNMENTS OF ALL POLITICAL PERSUASIONS, THROUGHOUT THE WORLD, ARE INCREASINGLY COMING TO RECOGNISE THAT SOUND MACRO-ECONOMIC POLICIES NEED TO BE ACCOMPANIED BY THE LIBERATION OF MARKET FORCES:

- PRIVATISATION
- DEREGULATION
- TAX REDUCTION

ALL HAVE BECOME PART OF THE NEW WORLD CONSENSUS.

FREE MARKETS, TRADE AND PROTECTIONISM

NOWHERE IS THE PROPER FUNCTIONING OF FREE MARKETS MORE IMPORTANT THAN AT THE INTERNATIONAL LEVEL. WE HAVE SEEN AT PUNTA DEL ESTE A REAL BREAKTHROUGH. THE WORLD IS NOW COMMITTED TO A GENUINE ATTEMPT TO BRING DOWN TRADE BARRIERS RIGHT ACROSS THE BOARD, IN INDUSTRY AND AGRICULTURE, GOODS AND SERVICES. IT IS VITAL THAT WE NOW CARRY THIS THROUGH TO A SUCCESSFUL CONCLUSION.

I KNOW THAT THE US ADMINISTRATION IS DEEPLY CONCERNED ABOUT THE STRENGTH OF BIPARTISAN PROTECTIONIST PRESSURE IN CONGRESS. WE ALL SHARE THAT CONCERN. BUT EQUALLY, IT IS RIGHT TO POINT OUT THAT OVER THE PAST YEAR ALONE WE HAVE SEEN THREE IMPORTANT ACHIEVEMENTS IN THE INTERNATIONAL SPHERE, EACH OF WHICH WILL STRENGTHEN THE OPEN TRADING SYSTEM:

- (I) SINCE THE PLAZA AGREEMENT, THERE HAS BEEN A MAJOR REALIGNMENT OF EXCHANGE RATES TO MUCH MORE REALISTIC AND SUSTAINABLE PARITIES;
- (II) AT THE TOKYO ECONOMIC SUMMIT IN JUNE, WE RESOLVED TO IMPROVE THE PROCESS BY WHICH WE WORK TOWARDS GREATER CONSISTENCY IN OUR ECONOMIC POLICIES;
- (III) AND FOLLOWING THE GATT MINISTERIAL MEETING AT PUNTA DEL ESTE EARLIER THIS MONTH, WE ARE ON THE ROAD TO A WORLDWIDE COMPREHENSIVE REDUCTION OF TRADE BARRIERS ON BOTH GOODS AND SERVICES.

ARMED WITH THESE ACHIEVEMENTS, IT IS NOT UNREASONABLE TO EXPECT THE UNITED STATES ADMINISTRATION TO OVERCOME PROTECTIONIST PRESSURES FROM WITHIN ITS OWN SHORES.

ONE AREA OF THE WORLD ECONOMY WHERE MARKET FORCES ARE STILL CONSPICUOUSLY CRIBBED, CABINED AND CONFINED, IS AGRICULTURE. AS A RESULT, WE HAVE PERVERSE AGRICULTURAL POLICIES THROUGHOUT THE WORLD WHICH MAY WELL PRESENT THE GREATEST CHALLENGE OF THE NEXT DECADE. WE ENCOURAGE PRODUCTION IN HIGH COST OECD COUNTRIES AND DISCOURAGE IT IN DEVELOPING COUNTRIES WHICH HAVE A COMPARATIVE ADVANTAGE. WE CONTINUE TO ARRANGE THAT THE TAXPAYERS OF THE WESTERN WORLD FINANCE FOOD AID TO THE SOVIET UNION.

LOW WORLD PRICES FOR AGRICULTURAL EXPORTS, AS A RESULT OF INDUSTRIAL COUNTRIES' SUBSIDIES, REPRESENT A MAJOR LOSS FOR DEVELOPING COUNTRIES, AND ARE PARTICULARLY SERIOUS FOR MANY DEBTORS. THE SUMS INVOLVED ARE ENORMOUS. THIS YEAR'S WORLD DEVELOPMENT REPORT SHOWS THAT WORLDWIDE LIBERALISATION--AND THAT IS AFTER ALLOWING FOR LOSSES TO PRODUCERS--COULD PRODUCE OVERALL GAINS IN THE REGION OF \$20 BILLION FOR

DEVELOPING COUNTRIES, AND UP TO \$50 BILLION FOR OECD COUNTRIES.

LET THERE BE NO DOUBT: THE POTENTIAL GAINS FROM BETTER PRICING POLICIES AND TRADE LIBERALISATION ARE VAST, AND INFINITELY LARGER THAN ANY FEASIBLE INCREASE IN AID. THE UNITED KINGDOM CERTAINLY NEEDS NO CONVINCING THAT MAJOR CHANGES IN AGRICULTURAL POLICIES ARE NEEDED BY INDUSTRIAL AND DEVELOPING COUNTRIES ALIKE.

AT THIS YEAR'S SUMMIT IN TOKYO, THE MAIN INDUSTRIALISED COUNTRIES AGREED THAT INTERNATIONAL COOPERATION WAS NEEDED TO BRING AGRICULTURAL PRODUCTION INTO LINE WITH DEMAND AND TO TACKLE SUBSIDIES. WHAT WE NEED IS MULTILATERAL DISARMAMENT AMONG THE SUBSIDISERS. CLEARLY, IT CANNOT BE ACHIEVED OVERNIGHT. BUT EQUALLY, A START HAS TO BE MADE WITHOUT DELAY. I AM PLEASED THAT THE DEVELOPMENT COMMITTEE HAS ADOPTED MY PROPOSAL THAT THIS VITAL ISSUE SHOULD BE DISCUSSED AT ITS NEXT MEETING.

THE UK ECONOMY

FINALLY, LET ME SAY SOMETHING ABOUT THE EXPERIENCE OF MY OWN COUNTRY THIS YEAR.

IN GENERAL, DEVELOPMENTS IN THE UNITED KINGDOM HAVE MIRRORED THE PATTERN OF THE INDUSTRIALISED WORLD AS A WHOLE.

DOMESTIC DEMAND HAS BEEN AS BUOYANT AS I SUGGESTED AT THE TIME OF THE BUDGET IN MARCH. BUT IN LINE WITH THE SLUGGISHNESS OF WORLD TRADE GENERALLY, AS A RESULT OF WEAKNESSES IN A NUMBER OF MARKETS (PARTICULARLY THOSE AFFECTED BY THE SHARP FALL OF THE OIL PRICE), EXPORTS HAVE BEEN FLATTER THAN I EXPECTED THEN.

AS A RESULT, OVERALL OUTPUT GROWTH THIS YEAR WILL BE LESS THAN I ENVISAGED IN MARCH.

THIS SLOWDOWN COMES AFTER FOUR YEARS OF STEADY GROWTH OF ABOUT 3 PER CENT A YEAR, THE LONGEST PERIOD WE HAVE KNOWN FOR A CONSIDERABLE TIME.

THE IMPORTANT QUESTION IS WHETHER IT REPRESENTS THE BEGINNING OF THE END OF THE CYCLICAL UPSWING THAT STARTED IN THE UK IN 1981, OR WHETHER IT IS MERELY A SHORT PAUSE IN THAT UPSWING.

EEEEEEEEEEEEEEEEEEEEEEEE

SOME MONTHS AGO I VENTURED THE VIEW THAT WHAT WE WERE EXPERIENCING WAS MERELY A SHORT PAUSE BEFORE THE BENEFICIAL EFFECTS OF LOWER OIL PRICES ON WORLD AND UK ACTIVITY CAME THROUGH.

I SEE NO REASON TO CHANGE THAT JUDGMENT, INDEED, THERE ARE ALREADY SIGNS OF A PICK-UP OF EXPORTS, AND WITH CONTINUED STRENGTH OF DOMESTIC DEMAND THERE IS EVERY PROSPECT OF FASTER GROWTH NEXT YEAR.

BUT WITHIN THIS OVERALL ECONOMIC GROWTH, THERE HAVE BEEN PROFOUND CHANGES IN THE PATTERN OF THE ECONOMY, ASSOCIATED WITH CHANGES IN THE PATTERN OF WORLD SUPPLY AND DEMAND, AND THE NEED FOR BRITISH INDUSTRY TO RESTRUCTURE ITSELF TO MEET THOSE CHANGES.

IN PARTICULAR, THERE HAS BEEN A LONG-ESTABLISHED TREND FOR SERVICES AND OIL TO GROW FASTER THAN MANUFACTURING.

BUT EVEN WITHIN MANUFACTURING--WHICH OVERALL ACCOUNTS FOR ROUGHLY A QUARTER OF GDP--PERFORMANCE WAS BEEN FAR FROM UNIFORM.

IN SOME INDUSTRIES--MOSTLY THE METAL-USING INDUSTRIES, TEXTILES, AND CLOTHING--OUTPUT IS STILL BELOW THE PRE-RECESSION PEAK OF 1979.

BUT IN OTHER IMPORTANT MANUFACTURING INDUSTRIES--SUCH AS CHEMICALS, FOOD AND ENGINEERING--OUTPUT IS WELL ABOVE THE PRE-RECESSION LEVEL.

AT THE SAME TIME, INFLATION HAS FALLEN RAPIDLY AND THE UNDERLYING RATE MAY NOW BE AROUND 3½ PER CENT. I DO NOT EXPECT TO SEE MUCH CHANGE IN THAT FIGURE OVER THE COMING MONTHS.

IN COMMON WITH OTHER COUNTRIES, WE HAVE TO ACCEPT THAT THE SHARP FALL IN THE OIL PRICE AND MOST OTHER COMMODITY PRICES MEANS THAT THE UNDERLYING RATE OF INFLATION IS NOT QUITE AS LOW AS THAT CURRENTLY RECORDED IN THE LATEST FIGURES. BUT GIVEN THE CONTINUED PURSUIT OF POLICIES OF SOUND MONEY, LOW INFLATION CAN BE SUSTAINED AND EVENTUALLY ELIMINATED ALTOGETHER.

AS THE FIFTH LARGEST OIL PRODUCING NATION IN THE WORLD--EVEN THOUGH IT IS ONLY SOME 5 PER CENT OF OUR

GDP - THE UK ECONOMY HAS BEEN AFFECTED MORE THAN MOST BE THE COLLAPSE OF THE OIL PRICE.

THIS IS REFLECTED MOST NOTABLY IN THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS WHERE THE SIZEABLE CONTRIBUTION OF THE NORTH SEA TO OUR EXPORT EARNINGS HAS BEEN HALVED.

THIS MEANS THAT NON-OIL EXPORTS, BOTH VISIBLE AND INVISIBLE, WILL HAVE TO RISE TO MAKE GOOD THE DROP IN OIL EXPORTS.

THE NEED FOR THIS TO TAKE PLACE -- ALTHOUGH NOT OF COURSE ITS IMMINENCE -- WAS ALWAYS FORESEEN.

AS I EXPLAINED IN A SPEECH I MADE AT CAMBRIDGE SOME THREE YEARS AGO, A LOWER REAL EXCHANGE RATE WOULD BE PART OF THE MECHANISM THAT WOULD LEAD TO THE NECESSARY IMPROVEMENT IN THE NON-OIL BALANCE.

SINCE THE OIL PRICE HALVED, WE HAVE DULY EXPERIENCED A SUBSTANTIAL BUT ON THE WHOLE ORDERLY FALL IN THE EXCHANGE RATE.

INEVITABLY, IT WILL TAKE TIME TO HAVE ITS FULL EFFECT ON THE CURRENT ACCOUNT.

MOREOVER, WE HAVE DELIBERATELY FOLLOWED A PRUDENT POLICY WITH REGARD TO NORTH SEA OIL, AND A HIGH PROPORTION OF THE REVENUE HAS BEEN INVESTED ABROAD TO GIVE A PERMANENT INFLOW OF FOREIGN CURRENCY INCOME.

THE UK'S NET OVERSEAS ASSETS HAVE RISEN FROM £12 BILLION, OR UNDER 7 PER CENT OF GDP, IN 1979 TO SOME £80 BILLION, OR 23 PER CENT OF GDP, BY THE END OF 1985. OUR NET OVERSEAS ASSETS ARE NOW SECOND ONLY TO THOSE OF JAPAN.

THE INCOME FROM THESE ASSETS WILL PROVIDE A USEFUL OFFSET TO A LOWER CONTRIBUTION FROM THE NORTH SEA.

IN THE EARLY STAGES FOLLOWING THE FALL IN OIL PRICES, THE UK WAS OFTEN ENCOURAGED TO JOIN IN A PROGRAMME TO RESTRICT OIL OUTPUT AND RAISE PRICES. WE HAVE ALWAYS HAD THE FREEST OIL PROVINCE IN THE WORLD, IN

WHICH IT IS UP TO COMPANIES, NOT GOVERNMENT, TO DECIDE HOW MUCH TO PRODUCE. I HAVE NEVER BELIEVED IT WOULD BE IN THE INTERESTS OF THE UK OR THE WORLD FOR US TO DEPART FROM THAT POLICY. AND I AM GLAD TO SAY THAT SINCE THE SPRING INTERIM COMMITTEE MEETING OUR POSITION HAS BEEN MORE WIDELY UNDERSTOOD AND ACCEPTED.

A BIGGER WORRY IS UNEMPLOYMENT, WHICH NOT ONLY REMAINS FAR TOO HIGH BUT HAS RISEN FURTHER OVER THE PAST YEAR--ALTHOUGH IN RECENT MONTHS THERE HAS BEEN A WELCOME IMPROVEMENT IN THE TREND.

AND THE COMPOSITION OF UNEMPLOYMENT IN THE UNITED KINGDOM IS CHANGING.

YOUTH UNEMPLOYMENT IN THE UK IS LOWER THAN IN MOST OF THE EUROPEAN COMMUNITY, AND FALLING. WE HAVE TACKLED THIS SERIOUS SOCIAL PROBLEM BY A SUBSTANTIAL EXPANSION OF YOUTH TRAINING AND POLICIES AIMED AT PRICING YOUNGSTERS BACK INTO JOBS.

BY CONTRAST, OUR MOST DIFFICULT PROBLEM HAS BEEN THE GROWTH OF LONG-TERM UNEMPLOYMENT. ACCORDINGLY, WE

HAVE NOW DEvised A PACKAGE OF MEASURES CAREFULLY DESIGNED TO HELP THE LONG-TERM UNEMPLOYED IN THEIR SEARCH FOR WORK. THERE IS INCREASING EVIDENCE THAT THIS WILL PROVE SUCCESSFUL.

IN CONCLUSION, LET ME PAY A BRIEF TRIBUTE TO THE MANAGING DIRECTOR OF THE FUND, JACQUES DE LAROSIERE, WHO HAS SADLY ANNOUNCED HIS IMPENDING RETIREMENT.

DURING HIS EIGHT YEARS AS MANAGING DIRECTOR HE HAS HAD TO TACKLE TASKS TOUGHER AND MORE INTRACTABLE THAN THOSE FACED BY ANY OF HIS PREDECESSORS. HE HAS DONE SO IN A MANNER THAT HAS EARNED THE ADMIRATION AND RESPECT OF THE ENTIRE WORLD.

WE ARE FORTUNATE INDEED TO HAVE BEEN SERVED BY SO DEDICATED AND SURE A GUIDE, AND WE ARE INSPIRED BY HIS EXAMPLE AS WE RESOLVE TO TACKLE THE PROBLEMS THAT STILL LIE BEFORE US.