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Prime Minister



Treasury Chambers, Parliament Street, SW1P 3AG
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We have arranged for
Mr de Larosiere to come in,
with the Chancellor,
privately at 7445m
Monday.

PRIME MINISTER

MCS 19/11

IMF QUOTA INCREASE AND THE INTERNATIONAL DEBT AND BANKING SCENE

As you know, I have thought for some time that an early resolution of present international discussions on replenishing IMF resources could contribute to greater confidence in the international debt and banking field. I think too that the United Kingdom may be able to play a useful part in achieving such a resolution. The objective would be similar to the one you had in mind when you were considering whether and how to advance the timing of the 1983 Seven Power Economic Summit partly in order to tackle these debt and banking problems.

2. We have now reached a point where 13 of the 22 constituencies which make up the IMF Interim Committee have said they would support me for the Chairmanship of the Committee. In addition to all the larger and medium sized developed countries and Canada, Australia and New Zealand, I have the support of India, Brazil, Mexico, Sri Lanka, the Philippines and Zaire. The US, Japan, France and Germany have all been active on my behalf. It would still be a mistake to take the outcome for granted - the present Belgian Finance Minister - who has had the job once before - might like to be a candidate in the event of an upset - but it seems likely that Larosiere (who wishes me to accept) will shortly be able to initiate the formal procedure which should settle the matter.

3. I intend to play an active role in advancing the next meeting of the Interim Committee from the date now planned at the end of April to late January or early February, and seeking to ensure that agreement on new resources for the Fund is reached

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at that meeting. It would indeed be unwise to advance the meeting unless there were good prospects of agreement. A deal fortifying the monetary system would help confidence; failure to agree would be correspondingly damaging.

4. At the Toronto meeting of the IMF in September it looked as if opinion was moving towards an Eighth Quota Increase which would raise the Fund by between 50 and 65% from the present level of 62 billion SDRs to 90 to 100 billion SDRs. This quota increase would have become effective after ratification from 1 January 1986. However the United States then argued for a much smaller (but unspecified) quota increase, plus an Emergency Fund fed by borrowing. The details and character of the Emergency Fund were not well defined.

5. In October and November there have been two rounds of discussion in Washington between the Finance Ministries of the Five on a possible replenishment "package" intended to command the widest possible agreement. Three main elements of this package would be:-

i. a quota increase to at least 85 billion SDRs, but more probably to between 90 and 100 billion. The Americans have moved a long way on this;

ii. a determined effort to make this operative from 1 July 1984 instead of 1 January 1986, including legislation in the US Congress in 1983. The effect of acceleration would of course be that the enhanced resources would be available sooner and that present IMF resources would have to last only 18 months instead of 3 years. This would be very relevant to the increased demands on the IMF from Latin America, Eastern Europe and elsewhere;



iii. a pre-arranged lending facility for the IMF based on the present General Arrangements to Borrow of the Group of Ten industrial countries, but intended to have the support of Saudi Arabia also. The present GAB enable the Ten (plus Switzerland) to lend to the IMF so that the Fund can lend in turn to one of the Ten; it is a mutual help agreement, with a ceiling of 6.2 billion SDR's which has been unchanged since 1962. This might be replaced by a new limit of 15 to 20 billion SDR's, which would cover both traditional lending to the Fund for GAB members and an emergency facility for lending to the Fund for non-members. To activate this reserve facility there would have to be a situation imposing an exceptional strain on the international monetary system; and the Fund would have to show that it was running out of resources to meet valid applications. This version of an emergency borrowing facility seems to have been accepted by the Americans as a satisfactory variant of their own Toronto proposal. It is in fact simpler and more attainable because it builds on existing institutions, and on the recent precedent under which Saudi Arabia and the main developed countries made parallel loans totalling over 5 billion SDR's to the Fund. It requires a decision only of the Ten developed countries, not the whole IMF membership; and the Ten retain control of its activation.

6. A package with these main components has a number of attractions. Advancing the operative date and including the pre-arranged borrowing facility would be a response to the widely felt need for special, urgent action by the international community. The package could have more appeal for the US Congress than a straight quota increase on traditional lines, partly because the innovations follow US proposals and partly because



the lending facility could be used to help Latin America but would remain largely under US control, given their weight in the G10. From our own standpoint I believe this package would strike the right balance between the inflationary ambitions of some LDC's about the scale and terms of future borrowing from the IMF and the type of quota review first envisaged by the Americans which would probably be non-negotiable and would do nothing for confidence in the system.

7. During the past week we have been able to discuss the package with both Larosiere and with other Community Finance Ministers. Larosiere is well content and sees here a basis for agreement at an advanced Interim Committee meeting. There is general support within the Community, which suggests that the G10 also are likely to be supportive. There are plans for G5 and G10 meetings in the coming weeks to carry matters forward. But special efforts will be needed to ensure the agreement of the Saudis and of some of the major LDCs. Larosiere will certainly play a part in that. There are also some contentious questions on the permissible scale of access to the Fund by borrowers after the Eighth Quota Increase; and on the distribution of quota increases in the light of changes in relative economic strength among members. We shall have to decide by mid-December whether there is enough agreement to justify bringing forward the Interim Committee meeting.

8. I hope that in parallel with these efforts on IMF resources it will be possible to see progress on specifically banking issues where there could be benefits for confidence. I am in touch with the Governor about this. However this is likely to be a more gradual and piecemeal business than the more structured initiative on IMF resources. The international banking scene is of course a little less worrying than in the early autumn, given the IMF agreement with Mexico and Argentina - and the

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Argentine agreement with the British banks. But the gradual deterioration in the financial situation of Yugoslavia causes increasing concern.

9. I am copying this minute to the Foreign and Commonwealth Secretary, to Gordon Richardson, and to Sir Robert Armstrong.

G.H.

18 November 1982