

SUBJECT

cc Harlow

File  
cc AW, JWP

## 10 DOWNING STREET

From the Private Secretary

13 April 1983

Dear John,

CALL UPON THE PRIME MINISTER BY MR. CLAUSEN, PRESIDENT OF THE IBRD

Mr. A. W. Clausen called upon the Prime Minister this morning. He was accompanied by Mr. Benjinck. Mr. Alan Walters was also present.

Mr. Clausen said that in the present world-wide economic malaise, what was needed was sound sustainable growth. To achieve this it would be important to secure growth in the developing countries, which were important markets for the developed countries. In the case of the United States alone, 40% of exports currently went to developing countries, compared with 29% 11 years earlier. The same was true in Europe and elsewhere. The IBRD could be helpful in achieving this end, particularly since commercial banks were drawing their horns in at present.

The Prime Minister commented that many banks had overlent, and many developing countries had overborrowed. The last thing that the member governments of the IBRD should do would be to encourage imprudent lending and borrowing. Mr. Clausen agreed. The soundness and prudence of the World Bank's operations had created the ironical situation in which the IBRD enjoyed the finest spreads, notwithstanding that its lending was to developing countries, while commercial banks, with less concentration in their loan portfolios on developing countries, were obliged to pay wider spreads. The Prime Minister commented that the IBRD's backing for its lending was, no doubt, in part its past profits; but also the backing of its member governments. Mr. Clausen said that the developing countries had considerable resources to mobilise and develop. Even where there were serious debt problems, as in the case of Mexico, there was frequently no insolvency, but simply a liquidity problem. The World Bank could be of great assistance in some of these cases. The Prime Minister said that she accepted that there was an important role for the IMF and IBRD in such cases. But she had to insist that no action should be taken which might lead to undermining the soundness of the Western banks. Such action would lead to calamity. In the case of many countries with debt problems, if their difficulties could properly be described as liquidity difficulties, these were often difficulties which would last for many years. One always had to remember that liquidity difficulties could lead to bankruptcy and collapse.

/ Mr. Clausen

Mr. Clausen said that the commercial banks' lending was unconditional. Many countries which sought to borrow from the IBRD were following unsound policies, for example, subsidising consumption, and with little confidence in their financial markets. The conditionality of IBRD lending was in these circumstances vital. The Prime Minister agreed, and said that it was essential for the necessary conditionality to be tough and to extend over a sufficient period of time. There was always a temptation, as in Britain in the latter years of the previous Government, to go back to the bad old ways once the loans had been disbursed. Mr. Benjinck said that the loans were disbursed in tranches, and that no tranche would be released if the loan conditions were not being honoured. Mr. Clausen pointed out the extent to which IBRD lending was project-directed.

The Prime Minister said that we were spending more and more of our aid through multilateral channels. We found that we earned no credit for such aid from recipient countries. She noted, too, that our contribution to IDA was larger than would be justified by our relative GNP. Mr. Clausen recalled, with gratitude, the initiative which the United Kingdom had taken in breaking the log-jam of IDA VI. He said that he believed that there was an understanding amongst many of the member countries that the United Kingdom's IDA percentage should be reduced. But he very much hoped that the United Kingdom would be prepared to show the leadership on IDA VII which it had showed in IDA VI. The accession of the People's Republic of China to the IDA (with which the United Kingdom had agreed) made it all the more essential that there should be an adequate Seventh Replenishment. He believed that a Replenishment of \$15-16 billion was becoming something of a rallying point for IDA VII. The Prime Minister said that she could give no promises about IDA VII. The United Kingdom's record on IDA was a good one. One of the problems was that a large percentage of IDA's funds went to India, and no-one was ready to argue that India should receive a reduced percentage. Mr. Clausen said that the proportion going to India was 40% a few years ago. Two years ago it was 37% and still going down. But both India and China had access to capital markets, and the aim must be to concentrate IDA lending on those countries whose credit rating meant they had little or no alternative source of capital - for example, the countries in sub-Saharan Africa.

Mr. Clausen expressed the hope that there would be discussion at Williamsburg of conditional development assistance, and that the Prime Minister would feel able to urge President Reagan to see to it that the United States met its commitments on IDA VI. The Prime Minister said that the United States had historically been a very generous country. She would not be prepared to criticise the Americans publicly. She pointed out that the United States had already done much in recent months to help the developing world, for example, in drip-feeding Mexico: the Fed's motive in this had been largely, no doubt, to sustain the United States' banks with high exposure to Mexico, but this action had not been without cost to the United States economy, given the monetary and inflationary consequences of this action.

/ Mr. Clausen

Mr. Clausen went on to ask the Prime Minister for her support in removing constraints on IBRD lending, referring specifically to the \$60 billion lending ceiling. The Prime Minister enquired what the cost to the UK would be. Mr. Clausen said it might mean bringing forward the next IBRD capital increase by about 6 months; or issuing a guarantee. The Prime Minister said that she, again, could make no promises, and expressed doubts about the issuing of a guarantee, however unlikely it was to be called.

Summing up the points he wished to make, Mr. Clausen said that he hoped that the British Government would support action to allow the IBRD to grow a little more to accommodate China; and to show leadership at the Williamsburg Summit on IDA VII. The Prime Minister said that China was able to raise capital on her own credit, and was capable, with her natural labour resources, of becoming a wealthy country, if her political system were to change. She noted Mr. Clausen's points, and reiterated that she and Mr. Clausen shared the same objective, of promoting sound and sustained non-inflationary world growth.

I am sending copies of this letter to Brian Fall (Foreign and Commonwealth Office), Michael Power (Overseas Development Administration), and Richard Hatfield (Cabinet Office).

*Yours sincerely,*

*Michael Scholar*

---

John Kerr, Esq.,  
H.M. Treasury.