cc Mr. Coles
Mr. Middleton

PRIME MINISTER

COMMENTS ON SIR JEREMY MORSE'S LECTURE
AS REPORTED IN THE TIMES OF 13 APRIL

Morse's suggestions are:

1. "There should be a bigger role for official international agencies such as the IMF and World Bank in channelling international capital flows with commerical banks playing a smaller role."

Answer

Since 1960, total international liquidity created by the IMF has increased from £800m SDRs to £50.4 bn in November 1982. Relative to world exports, the international liquidity of the IMF has expanded since 1960 by 4½ times. This expansion of international liquidity has fuelled the world inflation. Countries hit by unfavourable real disturbances could finance temporary deficits by borrowing in international capital markets at a proper opportunity cost. Instead they have tended to increase the world money supply by borrowing at concessionary rates from the IMF.

There is ample evidence that IMF credit availability encourages rescheduling. In fact 14 member countries out of a total of, on average, 114 IMF members accounted more than 80% of the years for which debt was rescheduled. Clearly debt rescheduling is not due to accidental processes. Rescheduling begets further rescheduling for the same debtors. Additional IMF funds would simply encourage yet more rescheduling and fuel more inflation.

This fact, of course, also discredits the argument that IMF conditionality induces countries to "put their house in order". The evidence suggests that it gives rise only to a very temporary adjustment; then the persistent rescheduling countries get back to their old habits and the fund of subsidised lending.

/2. The World Bank

2. "The World Bank should provide guarantees and political risk insurance for some poorer countries."

Answer

This is a distinct possibility that's worth exploring. It is, however, very difficult to define political risks as we all know. I suspect that further investigation would show that it is implausible but it is worth thinking further along these lines.

3. "Further move towards fixed exchange rates."

Answer

I think he chooses exactly the wrong option which is some kind of intervention on EMS lines, to smooth out the little bumps and introduce big ones. I believe our arguments against joining the EMS apply mutatis mutandis to any other system of crawling pegs or semi-fixed exchange rates.

4. "Special drawing rights should be extended to take the place of currency reserves."

Answer

If this is the case then there should be a proper private market in SDRs. In particular it should be possible for non-Government agencies to hold SDRs and to trade in them. His objective is to "bring greater control and management to international liquidity and prevent inflation recurring". But holding reserves in SDRs will certainly not prevent inflation recurring. Indeed, while reserves have been, partially at least, in the form of SDRs, we had the biggest peace-time inflation for centuries.

5. "The IMF, OECD, BIS and World Bank should cooperate more closely."

Answer

I think this is not objectionable, but he does see this as a preparation for forming a new institution to act as a world monetary authority. This would bring "discipline at the core

/of the system"

of the system". There I am distinctly nervous because it suggests an international regulation of world lending and international capital markets.

6. Finally, Morse stressed that his proposals did not mean trying to recreate the Bretton Woods system. But he is very keen on promoting the elements of Bretton Woods that still exist, and wishes to "bring in the Socialist countries as members of the monetary institutions".

Conclusion

I find Morse's arguments, when they are clear, to be often wrong and misplaced. Much of the report, however, is vague and insubstantial. I hope to have a copy of his speech early tomorrow morning and I will report if there is any substantial difference between my conclusions here and those I reach after reviewing his every word.

[Peter Middleton attended the lecture - he confirms my note.]

AW

ALAN WALTERS
13 April 1983