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Treasury Chambers, Parliament Street, SW1P 3AG
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29 April 1983

Michael Power Esq.
Private Secretary
Overseas Development Administration
LONDON

Dear Power,

In view of Mr. Raison's visit to Washington next week you may wish to show him the attached copy of the Chancellor's speech to The Development Committee on 28 April. The strictly IBRD/IDA issues are covered in the third section; but the treatment of the IMF issues (the second section), and World Economic Prospects (first and last sections), also created some interest.

Copies of this letter and the speech go to Michael Scholar (No. 10), John Holmes (FCO), John Rhodes (DoT) and Richard Hatfield (Cabinet Office).

Yours ever,

John Kerr.

J O KERR
Principal Private Secretary

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SIR GEOFFREY HOWE'S STATEMENT TO
THE DEV. CTTEE ON APRIL 28, 1983

AS DELIVERED

DEVELOPMENT COMMITTEE: SPEAKING NOTES

WORLD ECONOMIC SITUATION

The world economic situation has been particularly difficult for us all since the second oil price shock in 1979. At least part of the problems we have had to face derive from lax policies in the past. It was widely thought that governments could borrow and spend their way out of recession. In practice, of course, this belief served only to postpone necessary adjustments and actually contributed to the severity of the problems of the world economy.

It has been, and still is, important to learn from these past mistakes. Although the transition to lower inflation has been, and still remains, difficult, considerable successes from the policies most of us have pursued are now apparent.

Certainly the difficulties have affected us all. The recession in the industrial countries has pushed unemployment to tragically high levels. And in

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the non-oil developing countries, who enjoyed growth at an average of 5 per cent growth a year in the years before 1979, output actually fell last year.

Every member of this Committee can recite the several causes of our present difficulties, which are at the same time symptoms of the underlying problem. Excessive debt commitments; depressed export earnings; high real interest rates; higher energy costs; a sharp--and inevitable--contraction in net bank lending; and equally inevitably, I am afraid, a slowdown in aid flows as donor countries sought to correct their own fiscal imbalances, for those fiscal imbalances have been, and in many cases still are, one cause of our problems--most of all high interest rates.

Even in the face of these difficulties, many developing countries have achieved considerable adjustment. Indeed many have adjusted better than some industrial countries. We should not fail to applaud this progress--even though we emphasise that the adjustment process must continue, if

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recovery is to be on a sustainable basis.

IMF ISSUES

Let me say a word at this point, Mr Chairman, in my capacity as your counterpart, the Chairman of the IMF Interim Committee.

Clearly the Fund retains a vital responsibility for the process of adjustment, and particularly for the short-term debt problems which are still afflicting some developing countries - and not only developing countries, I am afraid - with special severity.

I believe the international financial community can take some credit for the speed and potential effectiveness of what has already been done. Last autumn, the IMF and many governments including my own were able rapidly to put in place appropriate rescue schemes for debtor countries that were able and willing to undertake the adjustments of their own economies which, in conjunction with the IMF, they agreed to be necessary. But as a result the need

/for increased

for increased IMF resources--repeatedly urged by the Committee--as well as by others deeply concerned with problems of developing countries, UNCTAD, and the Brandt Commission--became more obvious, and more urgent. I believe that the agreements which were reached, ahead of schedule, in January and February this year were an effective response. As you know, the resources available through the General Arrangements to Borrow are to be increased, and made more widely available; and IMF quotas are to be increased by nearly 50%. The effect of those changes--and we must go on explaining and emphasising this fact--will be to double the resources in practice available to the IMF, some two years earlier than had been planned. No mean achievement, and I pay tribute to my Interim Committee colleagues who helped secure it.

It is important, of course, that the quota and GAB increases should be ratified promptly. Even so, there could be a need for the IMF to restore its liquidity later this year by borrowing. If

/sums available

from official sources do not match expectations and requirements, then we shall need to consider--very carefully--borrowing from commercial markets.

I should like to pay tribute to the energy and imagination with which the Managing Director and Staff of the IMF have met the demands recently made for their help. They have moved with commendable speed to establish and develop contact with commercial banks, as well as governments, central banks, the BIS and the World Bank, to seek cooperative action in maintaining flows of funds on a sufficient scale to give time for the adjustment programmes in which they are also deeply involved to take effect.

I believe we have shown that the international community can effectively tackle these major debt problems, given the essential contribution which debtor countries themselves must make. This does not mean that we can afford to relax our vigilance. But I do not at present see scope for, and I confess that I am in any case distrustful of, any "blanket solution" to current debt problems. Proposals of this kind usually envisage major institutional developments which would take years to implement, or substituting Government decisions and public funds for market judgment and finance. The hubris of statesmen - more accurately perhaps of those who seek, generally in vain, to earn that title - who are confident that they can outguess the markets rarely goes unpunished.

/One further IMF

One further IMF question is relevant to the work of this Committee. We agreed in February that consideration should again be given to the idea of a further SDR allocation. This is not the time or the forum in which to offer conclusions on that question. It will be discussed in the IMF Executive Board and Interim Committee later this year. For the present, I record only that I believe our discussion needs to be based on a thorough analysis of the likely demand for, and supply of, reserve assets over the next few years, going well beyond simple comparisons of reserve assets with growth of imports. It should consider such questions as:

- the impact of partially floating exchange rates on demand for reserves;
- the prospective scale and duration of payments imbalances which may need to be financed;
- the effect on reserve holdings, and needs, resulting from likely changes in the balance of payments positions of different groups of countries;

/- and realistic

- and realistic assumptions about continued flows of commercial lending.

I am sure that we can look to the IMF staff to undertake this kind of analysis during the coming weeks.

WORLD BANK AND IDA

I turn now to the issues which are directly the concern of this Committee - those that affect the Bank and IDA.

It is worth noting at the outset that, while the most obviously severe debt problems have often been those of relatively advanced developing countries previously able to attract commercial capital on a large scale, we must not forget that virtually all developing countries have been hit by the recession, and that the plight of the poorest has been particularly severe. Although, or perhaps because, their problems do not always hit the world's headlines, they deserve this Committee's particular consideration.

/For countries at

For countries at many different stages of development, the World Bank continues to play a vital role. The United Kingdom has supported the special action programme to help speed up disbursements of existing IBRD loans, and to remove some of the present restrictions on structural lending. There have been calls for the removal of the present 10% ceiling on the Bank's non project lending. I understand this is not in fact seen as an undue constraint in the immediate future. Even so, I believe that in due time the Executive Board should consider whether there should be some relaxation in this ceiling.

The Board will also need to consider the Bank's proposals for a modest increase in its five year lending programme. It is my view that a selective capital increase based on the relative increases agreed in the IMF quota review would provide a basis for a modest expansion in lending. And I hope that the IBRD Management will soon bring forward detailed proposals. In the meantime, I am sure that the Bank is right to make the most of opportunities for co-financing with private

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institutions, and I welcome the recent introduction of new instruments for this purpose.

It is equally important that the major donor countries should maintain their support for IDA at reasonable levels. That is why I welcome the US Administration's intention to continue to seek Congressional approval for the supplementary IDA 6 appropriation this year. Clearly they are making strenuous efforts to secure this - and we must all hope that they succeed. Any further delay in IDA 6 appropriations would have very serious consequences for the future of IDA and for the countries which depend upon it. Similarly, we must strive for an early agreement on a reasonable total for the 7th replenishment, distributed on an equitable basis among the donor countries. I hope that it will be possible to make real progress on this before the next meeting of the Committee. Of course we will only succeed in doing so, if all participants are prepared to discuss a realistic IDA 7 total. The United Kingdom has demonstrated in the past the importance which we attach to IDA: and it is undiminished. But, as a true friend

/of IDA, I do

of IDA, I do warn that this Committee would do it a disservice if we were to raise expectations about IDA 7 which we are subsequently unable to deliver.

WORLD ECONOMIC PROSPECTS

Against this background, what are the prospects for a recovery of economic activity, world-wide?

There are many voices calling for measures that would, in the comfortable phrase, "stimulate activity" - at almost any cost. It is perhaps particularly tempting - and understandably so - to make such a call on behalf of those developing countries, which do not themselves have the capacity to generate the recovery of their economies, and look instead to renewed growth of activity in industrial countries, and so the world as a whole.

But we must be careful not to attempt to solve this year's problems - or indeed last year's - at the expense of the future, and careful too not to disregard the lessons of even the recent past. All too often we have seen governments, afflicted by a fall in economic activity, attempt artificially to stimulate demand, enjoy the fruits for a brief period, but then plunge again into higher levels of inflation and further weakness of activity.

The industrial countries, and so the world, would not benefit from short-lived

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boosts to expenditure or consumption, unmatched by output: history - not least the history of my own country - shows that this leads only to renewed inflation, which is the enemy of employment. Nor is there any foundation for the idea, occasionally advanced these days, that countries which have been relatively successful in reducing their rates of inflation could help others by expanding their domestic demand in a co-ordinated way: that course too would simply generate more inflation, and so would help no-one, least of all the developing countries. The modest successes that have so far been achieved have been won by policies of sustained well-judged restraint. The policies that have brought us to the verge of recovery need to be further sustained, and not reversed. The opposite argument is remarkably perverse.

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The recovery we all need must be one that can and will be sustained - something more than a flash in the pan. And that means that it cannot and must not be inflationary. I therefore welcome the consensus which developed among certain industrial countries at the Summit meeting in Versailles last year, and has strengthened since, that our countries should concentrate on securing sustainable, non-inflationary growth for the future. I note in passing that convergence on such policies is also the most important part of the recipe for greater exchange rate stability, which would benefit developed and developing countries alike.

I believe that important progress has been made.

First, a growing number of countries have been tackling budget deficit problems effectively. The determination to gain and

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keep control of structural budget deficits is widespread and strong. It is far from easy to translate determination into achievement. But that is what must be done. It is not words but deeds that influence markets and market expectations about inflation and interest rates.

Secondly, where progress has been and is being made in this way, control of monetary growth has been possible. Largely as a result, inflation has fallen steeply among the major countries, so that it now averages about 5%, the lowest rate for a decade.

Thirdly, nominal interest rates have fallen significantly in the United States, the United Kingdom and elsewhere, affording some immediate relief to developing country borrowers on international markets.

/Fourthly,

Fourthly, oil prices have fallen by some 15%, moderating the high earnings of oil-producing countries, but offering on balance a favourable impact on both world inflation and world output.

As a result of all this, the signs of recovery are now there for all to see. They are particularly evident in those countries which have had the greatest success in bringing down rates of inflation and interest rates. So long as favourable prospects for inflation can be maintained, there is now a good prospect of real growth recovering in 1983, and strengthening as the year proceeds and into 1984.

Recovery on the scale likely to be achieved will be modest and gradual. But what matters most is that we now have within our grasp a recovery which could be durable and could gather strength without

/precipitating

precipitating renewed inflation. The one thing that could damage that prospect would be an abandonment or reversal of the very policies of fiscal and monetary restraint that have made it possible.

The consensus on strategy is there. Over the coming weeks and months we must try to develop it and reinforce it over the medium-term. It must be our objective to bring about a mutually reinforcing performance, to go on achieving convergence with lower inflation. That is the road to higher real incomes and wealth; and to lower interest rates, and hence stockbuilding, investment and output. If we can go on making progress inthis way, we shall provide an economic environment for world activity in which the problems of debt, of growing protectionism, and of weak markets for developing countries will be eased, and overcome. I believe we must; and I very much hope we shall.