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ALAN WALTERS
17 May 1983

Prime Minister

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WILLIAMSBURG: THE THEMATIC PAPER (REVISED) 12 MAY 1983

Exchange Rates and Intervention

Under III on page 3 it is argued that there should be intervention in exchange markets in a "coordinated manner" in instances "where we agree such intervention would be helpful". This also appears again under IV for the longer term where there is a reference to "our agreement on exchange market intervention".

The basic idea behind this can be illustrated with the dollar/yen situation now. Assume that the US and Japan agree that the dollar is high relative to the yen. The US should both increase the number of dollars and use them to buy yen ("unsterilised intervention"). Reciprocally, the Japanese Government would undertake to decrease the quantity of yen. The Central Bank would use their stock of dollars to buy yen - thus decreasing the number of yen in the hands of Japanese residents. (Coordination means that the Japanese would reinforce the American intervention rather than "sterilise" it.)

The net result of such unsterilised intervention would be an increase in the American money supply and an increase in American inflation. Yet we know the high dollar is generated by high US interest rates which are themselves the product of an expected increase in inflation which is in turn due to the Federal deficit. Such coordinated intervention would confirm market expectations of more US inflation. The Japanese inflation, already low, would be reduced further. In my view, this makes the international financial system more, rather than less, unstable.

[Similarly, had we in Britain agreed at the end of 1980 and early 1981 to a coordinated intervention with other developed countries, we would not have the low inflation rate that we have today. We would have reflated.]

We should return to our basic position that intervention is useful for day-to-day smoothing - and no more.

A New Bretton Woods

This is being pressed by the French, mainly by Jacques Attoli. I believe that the Americans are strongly opposed to even the idea of a new Bretton Woods, even at some time in the distant future. It is

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largely a way for the French to blame the sad plight of the French economy on the international monetary system rather than their own policies. And if we accede to the idea of a new Bretton Woods this does suggest that the international monetary system is in something of a crisis state. I do not think we should admit that.

AID, the IMF, SDRs and IDA Replenishments

Throughout the paper there is a commitment to "strengthen world economic institutions" and specifically to ratify the increase in IMF resources and "to provide more official assistance for developing countries" and to ensure "agreed funding levels for IDA" (the World Bank) and other banks.

In part this reflects the US Administration's desire to put pressure on Congress to ratify the new IMF and GAB agreement and to authorise funds for the 6th IDA replenishment. But this commitment in the thematic paper is much more embracing and far reaching - well beyond to the next IMF quota increase and IDA 7.

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