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 SIR R ARMSTRONG }
 MR BUCKLEY } CABINET OFFICE
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 PERM. SECRETARY
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 MR J B UNWIN
 MR P MOUNTFIELD
 MR R G LAVELLE
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 OVERSEAS SECTION (7) }

MR LOEHNIS }
 MR M J NALFOUR } BANK OF ENGLAND
 MR GILCHRIST }

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FM UKDEL IMF/IBRD WASHINGTON 251624Z SEP 84
 TO IMMEDIATE FCO
 TELEGRAM NUMBER 204 OF 25 SEPTEMBER

IMMEDIATE
ADVANCE COPY

FOLLOWING TELEGRAM SENT TO YOU FOR ACTION AT REQUEST OF ORIGINATOR.
 WAS SENT TO UKMIS NEW YORK TELNO 1 OF 23 SEPT.

BEGINS:

FM UKDEL IMF/IBRD WASHINGTON 231939Z SEP 84
 TO IMMEDIATE UKMIS NEW YORK
 TELEGRAM NUMBER 001 OF 23 SEPTEMBER

FOR PRIVATE SECRETARY TO SECRETARY OF STATE

FOLLOWING IS TEXT OF CHANCELLOR OF EXCHEQUER'S STATEMENT TO THE
 INTERIM COMMITTEE ON SEPTEMBER 22. FOR YOUR INFORMATION, THE TEXT
 HAS NOT (REPEAT NOT) BEEN MADE AVAILABLE TO OTHER PARTICIPANTS OR
 TO THE PRESS.

BEGINS

1. MR CHAIRMAN, YOU ARE PRESIDING OVER OUR DISCUSSIONS TODAY IN THE
 KNOWLEDGE THAT THIS PARTICULAR SET OF RESPONSIBILITIES WILL SHORTLY
 COME TO AN END. WE WISH YOU WELL IN YOUR IMPORTANT NEW ROLE.
 MEANWHILE, WE WILL NEED, AND I KNOW WE WILL RECEIVE, THE BENEFIT
 OF YOUR GOOD SENSE AND EXPERIENCE TO GUIDE US TODAY AS IT HAS IN THE
 PAST.

THE WORLD RECOVERY

2. THE WORLD RECOVERY IS PROVING STRONGER THAN MANY EXPECTED A YEAR
 AGO WITH PARTICULARLY RAPID GROWTH IN THE UNITED STATES, AND A MORE
 GRADUAL UPTURN IN OTHER INDUSTRIAL COUNTRIES. THE RISE IN ACTIVITY
 IN THE INDUSTRIAL WORLD, COUPLED WITH THE ADJUSTMENT EFFORTS OF
 DEVELOPING COUNTRIES, HAS BROUGHT A SHARP REDUCTION IN THE CURRENT
 PAYMENTS DEFICITS OF MANY DEBTOR COUNTRIES. A PARTICULARLY WELCOME
 FEATURE OF THE PRESENT SITUATION IS THAT

PAYMENTS DEFICITS OF MANY DEBTOR COUNTRIES. A PARTICULARLY WELCOME FEATURE OF THE PRESENT SITUATION IS THAT WORLD TRADE SEEMS LIKELY TO RISE BY A HEALTHY 8 PER CENT THIS YEAR AFTER FOUR YEARS OF VIRTUAL STAGNATION.

3. THE UNDERLYING FACTORS BEHIND THE RECOVERY HAVE BEEN THE FIRM EFFORTS MANY OF US HAVE MADE TO REDUCE INFLATION, CURB BUDGET DEFICIT

5 AND TO REMOVE THE RIGIDITIES THAT AFFECT SO MANY OF THE ECONOMIES. WE MUST CONTINUE WITH THESE POLICIES, WITH RENEWED DETERMINATION.

4. IN THE UNITED KINGDOM, AS A RESULT OF THESE POLICIES, WE ARE NOW IN THE FOURTH YEAR OF ECONOMIC RECOVERY, WHILE INFLATION HAS REMAINED RELATIVELY LOW AT 5 PER CENT.

5. IN RECENT YEARS THE EMPHASIS OF POLICY IN MANY COUNTRIES, INCLUDING THE UK, HAS BEEN ON FINANCIAL STABILISATION. AND WE HAVE SEEN THE BENEFITS OF THAT STABILISATION. BUT WHILE MAINTAINING THIS IMPROVE MACRO POLICY WE MUST NOW PLACE MORE EMPHASIS ON MICRO-ECONOMIC AND STRUCTURAL PROBLEMS, WHICH ARE THE CAUSE OF THE CONTINUING HIGH LEVEL OF UNEMPLOYMENT WHICH SO MANY OF US FACE TODAY.

6. IMPROVED MICRO POLICIES INVOLVE DIFFICULT CHOICES -- JUST AS WITH IMPROVED MACRO POLICY.

THE UK IS DETERMINED TO CONTINUE TO OPERATE POLICY TOWARDS THE TWIN OBJECTIVES OF MICRO AND MACRO POLICY:

- A MACRO POLICY DESIGNED TO KEEP INFLATION LOW
- A MICRO POLICY DESIGNED TO IMPROVE PRODUCTIVE POTENTIAL AND ENSURE ADEQUATE EMPLOYMENT PROSPECTS IN THE FUTURE.

DIALOGUES

7. THE ISSUES RAISED BY RECOVERY HAVE REMINDED US ALL OVER AGAIN OF THE INTERDEPENDENCE OF THE FORTUNES OF DEVELOPING AND DEVELOPED COUNTRIES. WE SHARE AN INTEREST IN RE-EXAMING ASPECTS OF THE INTERNATIONAL MONETARY SYSTEM, THE ROLES OF MULTILATERAL INSTITUTIONS, PROBLEMS OF FLOWS OF RESOURCES, OF INVESTMENT AND DEBT, AND OF TRADE AND PROTECTIONISM.

8. THE LONDON ECONOMIC SUMMIT IN JUNE OF THIS YEAR RESPONDED POSITIVELY TO MANY DEVELOPING COUNTRIES' UNDERSTANDABLE REQUEST FOR A DIALOGUE ON THESE MATTERS.

9. AS SECRETARY REGAN HAS REMINDED US, THE LONDON ECONOMIC SUMMIT DECLARATION OF THE HEADS OF GOVERNMENT OF THE 7 MAJOR INDUSTRIALISED COUNTRIES EXPLICITLY ASKED THEIR FINANCE MINISTERS TO CONSIDER THE SCOPE FOR INTENSIFIED DISCUSSION OF INTERNATIONAL FINANCIAL ISSUES OF PARTICULAR CONCERN TO DEVELOPING COUNTRIES WITHIN THE DEVELOPMENT COMMITTEE OF THE BANK AND FUND. AT THE COMMONWEALTH FINANCE MINISTERS' MEETING IN TORONTO EARLIER THIS WEEK WE CONCLUDED THAT A SPECIAL MEETING OF THE DEVELOPMENT COMMITTEE SHOULD BE HELD NEXT SPRING FOR THIS PURPOSE.

10. I THEREFORE WELCOME SECRETARY REGAN'S RESPONSE TO THE LONDON SUMMIT INITIATIVE.

11. HE HAS PROPOSED A VARIANT OF THE ORIGINAL PROPOSAL, UNDER WHICH THERE SHOULD BE A SPECIAL DISCUSSION IN THE INTERIM COMMITTEE AS WELL AS IN THE DEVELOPMENT COMMITTEE. CLEARLY THE FUND WILL NEED

THERE SHOULD BE A SPECIAL DISCUSSION IN THE INTERIM COMMITTEE AS WELL AS IN THE DEVELOPMENT COMMITTEE. CLEARLY THE FUND WILL NEED TO BE DEEPLY INVOLVED, WHATEVER HAPPENS, SINCE MANY OF THE ISSUES TO BE DISCUSSED FALL WITHIN ITS COMPETENCE. AND CLEARLY THE PAPERS ON THESE ISSUES WILL NEED TO BE PREPARED BY THE FUND.

12. BUT THE PRECISE QUESTION OF WHETHER WE NEED A SPECIAL MEETING OF THE INTERIM COMMITTEE AS WELL AS THE DEVELOPMENT COMMITTEE, OR WHETHER WE SHOULD BEGIN WITH A MEETING OF THE DEVELOPMENT COMMITTEE, WHICH WOULD THEN BE ABLE TO REFER TO THE INTERIM COMMITTEE ANY PROPOSALS ON MATTERS WHICH CLEARLY FALL WITHIN THE COMPETENCE OF THE FUND, IS SOMETHING ON WHICH IT WOULD BE FOOLISH TO TAKE A DOGMATIC POSITION. LET US SEE WHICH PROPOSAL COMMANDS THE GREATEST DEGREE OF ACCEPTANCE. WHAT IS IMPORTANT IS THAT THE DIALOGUE TAKES PLACE, AND DOES SO FIRMLY WITHIN THE FRAMEWORK OF OUR EXISTING INTERNATIONAL FINANCIAL INSTITUTIONS.

13. I NOW TURN TO THE QUESTION OF SDRS.

14. I AM NOT PERSUADED OF THE CASE FOR AN ALLOCATION OF SDRS ON THE CRITERIA WE ARE REQUIRED TO APPLY TO THIS DECISION.

15. NOR AM I IMPRESSED BY ARGUMENTS THAT ARE SOMETIMES ADDUCED TO BOLSTER THE CASE WHICH RELY ON AN OUTDATED VIEW OF THE ROLE OF THE SDR IN THE SYSTEM.

16. MOREOVER, I DOUBT IF AN ALLOCATION WOULD HAVE A HELPFUL BEARING ON THE REAL PROBLEMS WE HAVE TO CONSIDER. IT COULD INSTEAD BE AN UNHELPFUL DISTRACTION.

17. LET ME EXPLAIN BRIEFLY WHY I REACH THESE CONCLUSIONS.

18. FIRST, THE QUESTION OF CRITERIA. IN AN EXCHANGE RATE SYSTEM WHERE THE MAJOR CURRENCIES FLOAT, THE REQUIREMENT FOR RESERVES IS LESS THAN IT USED TO BE. IT IS ALSO THE CASE -- AND THE DEBT PROBLEM ITSELF BEARS WITNESS TO THIS -- THAT OVER THE LAST DECADE POTENTIAL SOURCES OF LIQUIDITY FOR CREDITWORTHY BORROWERS HAVE INCREASED BEGIN SQUARE BRACKETS LAST WORD UNDERLINED END SQUARE BRACKETS. HOWEVER, EVEN WITHOUT REFERENCE TO THESE POINTS I SEE NO REASON TO BELIEVE THAT GLOBAL RESERVES ARE INADEQUATE. NON-GOLD RESERVES HAVE INCREASED BY 12 PER CENT SINCE THE END OF 1982. IN GLOBAL TERMS, PRESENT LEVELS RELATIVE TO IMPORTS ARE CLOSE TO THE AVERAGE OF THE 1970S. FINALLY, WE ARE ALSO REQUIRED TO TAKE A LONG-TERM VIEW. THE PROSPECT FOR THE PERIOD AHEAD IS THAT CENTRAL BANKS WILL HAVE THE OPPORTUNITY TO INCREASE THEIR HOLDINGS OF DOLLARS

19. SECOND, THE ROLE OF THE SDR. AN IMPORTANT ELEMENT OF THE ARGUMENT FOR AN ALLOCATION HAS THE FLAVOUR OF GIVING THE SDR THE BENEFIT OF THE DOUBT ON SOME GENERAL PHILOSOPHIC GROUNDS. BUT I THINK A FAIRER WAY OF LOOKING AT IT WOULD BE TO RECOGNISE THAT THE CIRCUMSTANCES WHICH LED US TO SEEK TO DEVELOP THE SDR NO LONGER EXIST. THE SYSTEM WE HAVE IS A MULTICURRENCY RESERVE SYSTEM. THAT IS ONE REASON WHY I WELCOME RECENT MOVES TO INTERNATIONALISE THE YEN.

20. THIRDLY, THE DISTRACTION POINT. AN ALLOCATION OF SDR WILL NOT SOLVE THE DEBT PROBLEM. IT WILL NOT SOLVE THE PROBLEM OF US INTEREST

SOLVE THE DEBT PROBLEM. IT WILL NOT SOLVE THE PROBLEM OF US INTEREST RATES. THERE ARE ISSUES HERE WHICH WE NEED TO TACKLE. IF DEBTOR COUNTRIES CAN RECOVER CREDITWORTHINESS, AND IF WE ARE SUCCESSFUL IN ENCOURAGING NEW KINDS OF CAPITAL FLOWS TO THEM, THIS WOULD DEAL WITH THE RESERVE AND OTHER PROBLEMS WITH WHICH THEY ARE FACED IN AN APPROPRIATE MANNER.

21. I NOW TURN TO THE QUESTION OF THE LEVEL OF ACCESS TO IMF RESOURCES. THIS IS THE MOST IMPORTANT OPERATIONAL DECISION WE HAVE TO CONSIDER TODAY.

22. IT IS TEMPTING SIMPLY TO KEEP THE EXISTING LIMITS. AND IN THE CASE OF THE CFF, GIVEN RECENT TRENDS IN COMMODITY PRICES, THIS DOES SEEM THE RIGHT CONCLUSION.

23. BUT AS TO ACCESS LIMITS PROPER, I BELIEVE THAT A MODEST CHANGE IS IN ORDER. IF WE WERE TO MAKE NO MOVEMENT AT ALL, WE WOULD BE FAILING TO RECOGNISE THAT WORLD ECONOMIC CONDITIONS HAVE IMPROVED. WE WOULD ALSO BE FAILING TO ACKNOWLEDGE THE AGREED TEMPORARY NATURE OF THE ENLARGED ACCESS FACILITY. CLEARLY, WE NEED TO KEEP ENLARGED ACCESS ARRANGEMENTS GOING FOR THE TIME BEING. BUT WE SHOULD ALSO BE TAKING THE FIRST STEP BACK TO A QUOTA-BASED FUND.

24. I DO BELIEVE, HOWEVER, THAT WE HAVE TO BE VERY CAUTIOUS ABOUT ANY REDUCTION IN THE CUMULATIVE LIMITS WE SET. IF WE SET THEM TOO LOW WE RULE OUT THE POSSIBILITY OF FOLLOW ON PROGRAMMES FOR COUNTRIES WHO REQUIRE ANOTHER YEAR OR TWO OF FUND SUPPORT.

25. THIS IS NOT TO SAY THAT I FAVOUR PROLONGED USE OF FUND RESOURCES. AS A GENERAL PRINCIPLE I BELIEVE THE OPPOSITE. WHAT I AM SPEAKING OF HERE, IN SUGGESTING MAINTENANCE OF GENEROUS CUMULATIVE LIMITS, IS HELPING THROUGH THE FINAL STAGE OF TOUCH BUT EFFECTIVE ADJUSTMENT PROGRAMMES. I BELIEVE WE SHOULD ASK THE EXECUTIVE BOARD TO THINK ABOUT HOW BEST TO MAKE A CLEAR DISTINCTION BETWEEN THE TWO, AND I WELCOME THE MANAGING DIRECTOR'S STATEMENT THIS MORNING THAT HE INTENDS TO ADDRESS THIS ISSUE.

US BUDGET DEFICIT

26. I SPOKE EARLIER OF THE NEED FOR FURTHER ACTION IS THE RECOVERY IS TO BE SUSTAINED. THE MOST PRESSING ISSUE HERE IS THE HIGH LEVEL OF US AND CONSEQUENTLY WORLD INTEREST RATES. DURING THE PERIOD WHEN MONETARY GROWTH AND INFLATION WERE BEING REINED BACK FROM THE EXCESSES OF THE 1970S, SOME RISE IN INTEREST RATES WAS ALSO TO BE EXPECTED. BUT NOW THAT GREATER FINANCIAL STABILITY HAS BEEN ACHIEVED IN MOST MAJOR INDUSTRIAL COUNTRIES, WE MIGHT HAVE EXPECTED LOWER INTEREST RATES TO ENCOURAGE AND SUSTAIN THE REVIVAL OF INVESTMENT AND TIME ON WHICH GROWTH SO HEAVILY DEPENDS. THIS YEAR'S RISE IN INTEREST RATES, THEREFORE, IS PARTICULARLY UNHELPFUL.

27. A MAJOR FACTOR BEHIND THIS STATE OF AFFAIRS IS THE CONTINUING LARGE US BUDGET DEFICIT. THE RISE IN THE AMERICAN STRUCTURAL DEFICIT AT A TIME WHEN PRIVATE CREDIT DEMANDS ARE ALSO INCREASING HAS RAISED US DOMESTIC INTEREST RATES, PARTICULARLY REAL INTEREST RATES, AND RESULTED IN AN UNHEALTHY OVERVALUATION OF THE DOLLAR. BUT IT HAS ALSO TENDED TO INCREASE PRESSURE ON RATES IN THE REST OF THE WORLD, DESPITE THE EFFORTS OTHER GOVERNMENTS HAVE BEEN MAKING TO REDUCE THEIR OWN STRUCTURAL BUDGET DEFICITS.

BEEN MAKING TO REDUCE THEIR OWN STRUCTURAL BUDGET DEFICITS.

28. I FEAR THAT THE BLUNT TRUTH IS THAT A RISING US STRUCTURAL BUDGET DEFICIT, FINANCED IN LARGE PART BY DRAWING ON THE SAVINGS OF THE REST OF THIS WORLD, AND ACCOMPANIED BY MASSIVE CURRENT EXTERNAL DEFICITS, IS UNHEALTHY AND UNSUSTAINABLE.

29. THE 'DOWNPAYMENT' MEASURES THAT THE ADMINISTRATION HAVE PREPARED TO REDUCE THE DEFICIT ARE WELCOME BUT IT MUST BE IN THE INTEREST OF THE US ITSELF, OTHER INDUSTRIAL COUNTRIES, AND THE DEVELOPING WORLD THAT FURTHER ACTION IS TAKEN AS SOON AS FEASIBLE TO PUT THE DEFICIT ON A CONVINCING DECLINING PATH.

30. LET ME CONCLUDE THIS SECTION WITH TWO QUOTATIONS.

31. INCREASES IN OUR INTEREST RATES DIRECTLY ADD TO THE STRAIN ON THE EXTERNAL PAYMENTS OF HEAVILY INDEBTED DEVELOPING COUNTRIES, AND, OVER TIME, THE CAPITAL FLOWS AND TRADE IMBALANCE WILL NOT BE SUSTAINABLE, POSING THE RISK OF FURTHER FINANCIAL DISTURBANCES IN THE ABSENCE OF NEEDED POLICY ADJUSTMENT. ... WE CANNOT, IN MY JUDGEMENT, ESCAPE THE NEED FOR DECISIVE ACTION TO REDUCE OUR FEDERAL BUDGET DEFICIT.

32. MR PAUL VOLCKER, CHAIRMAN OF THE FEDERAL RESERVE BOARD, SPEAKING TO THE SENATE SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY IN JUNE OF THIS YEAR.

33. I AGREE WITH CHAIRMAN VOLCKER.

34. WITH RESPECT TO THE BUDGET DEFICITS, AS THINGS NOW STAND, DEFICITS NEXT YEAR WILL REMAIN IN THE SAME AREA AS CURRENTLY, AND UNACCEPTABLY LARGE THEREAFTER. THE IMPLICATIONS FOR FINANCIAL MARKETS AND THE ECONOMY BECOME MORE ADVERSE PRECISELY AS GROWTH IN THE PRIVATE SECTOR GENERATES MORE NEED FOR CREDIT AND CAPITAL. THAT OUTLOOK MUST BE CHANGED IN THE ONLY WAY IT CONSTRUCTIVELY CAN BE -- MOVING BEYOND THE WELCOME "DOWN PAYMENT" TO FURTHER SUBSTANTIVE ACTION ON THE BUDGET AS SOON AS FEASIBLE.

35. MR PAUL VOLCKER, SPEAKING TO THE SENATE SUBCOMMITTEE ON BANKING IN JULY OF THIS YEAR.

36. I AGREE WITH CHAIRMAN VOLCKER.

DEBT

37. I TURN NOW TO THE PROBLEM OF INTERNATIONAL DEBT.

38. THE CASE BY CASE APPROACH, WHICH WE HAVE ADOPTED -- AND RIGHTLY SO -- REPRESENTS A COHERENT STRATEGY. IT RESTS ON COMMON PRINCIPLES -- ABOVE ALL ON THE CENTRAL IMPORTANCE OF COUNTRIES TAKING MEASURES TO PUT THEIR FINANCES IN ORDER AND RESTORE THEIR CREDITWORTHINESS. BUT IT RECOGNISES THE INESCAPABLE FACT THAT EVERY DEBTOR COUNTRY IS INDIVIDUAL AND DIFFERENT. THEY ALL HAVE DIFFERENT RESOURCES AND ABILITIES, DIFFERENT KINDS OF SCALES OF DEBTS AND INTERNATIONAL FINANCIAL AND ECONOMIC DIFFICULTIES AND OPPORTUNITIES.

39. IT ALSO RECOGNISES THE NEED TO BUY TIME, IN THIS SITUATION TIME IS A VALUABLE COMMODITY, BORROWING COUNTRIES NEED TIME FOR

TIME IS A VALUABLE COMMODITY, BORROWING COUNTRIES NEED TIME FOR NEW POLICIES TO WORK; BANKS NEED TIME TO ADJUST THEIR BALANCE SHEETS. AS SO OFTEN IN INTERNATIONAL AFFAIRS, PATIENCE IS A PRIME VIRTUE. THE EVIDENCE OF THE LAST YEAR IS THAT IN MANY COUNTRIES NEW POLICIES CARRIED THROUGH WITH GREAT COURAGE ARE TAKING EFFECT, AND THAT WE ARE SLOWLY MAKING REAL PROGRESS. MEANWHILE WE ALL OWE AN INCALCULABLE DEBT OF GRATITUDE TO THE MANAGING DIRECTOR FOR THE KEY ROLE HE HAD PLAYED WITH SUCH DISTINCTION IN BRINGING THIS ABOUT.

40. BUT WE ALSO NEED TO USE THIS TIME WE HAVE BOUGHT TO DEVELOP NEW IDEAS ON HOW TO BRING GREATER STABILITY INTO THE FINANCIAL ENVIRONMENT OF DEBTOR COUNTRIES IN THE MEDIUM-TERM.

41. THE LONDON SUMMIT ALSO ADDRESSED THIS ISSUE. IT COMMENDED MULTI-YEAR RESCHEDULING IN APPROPRIATE CASES. IT ENCOURAGED CLOSER COOPERATION BETWEEN THE WORLD BANK AND THE FUND. IT COMMENDED THE ENCOURAGEMENT OF PRIVATE INVESTMENT, AND THE SEARCH FOR THE DEVELOPMENT OF OTHER LONG-TERM FORMS OF FINANCE TO SUPPLEMENT OR SUBSTITUTE FOR BANK LENDING.

42. ALL THESE APPROACHES NEED TO BE PURSUED WITH VIGOUR. BUT THE DEBT PROBLEM IS BOUND TO REMAIN A MATTER OF SERIOUS CONCERN SO LONG AS PRESENT LEVELS OF INTEREST RATES PERSIST.

CONCLUDING REMARKS

43. MR CHAIRMAN, I HAVE TOUCHED TODAY ON THE OPERATIONAL DECISIONS IMMEDIATELY BEFORE US. I HAVE SAID SOMETHING ABOUT WAYS IN WHICH I BELIEVE WE CAN MAKE MORE PROGRESS, OVER A RATHER LONGER TIME SCALE, IN AREAS OF PERSISTING CONCERN TO THE INTERNATIONAL COMMUNITY. WE WILL NOT SAY THE LAST WORD ON ANY OF THEM TODAY. BUT WE CAN CHART THE WAY FORWARD. AND WE CAN EXPLORE TOGETHER HOW TO BUILD UPON THOSE AND OTHER IDEAS IN THE TWO FURTHER MEETINGS WE HAVE IN VIEW IN COMING MONTHS.

ENDS

TEXT OF INTERIM COMMITTEE COMMUNIQUE NIFT.

FCO PASS DESKBY 260800Z MRS DIGGLE TREASURY.

WICKS

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