cc Mr. Wiggins
Mr. Lankester

OVERTAKEN

PRIME MINISTER

VISIT OF MR. "TOM" CLAUSEN

1. I understand that Mr. Clausen discussed with Giscard d'Estang two policy proposals:

a. the capital increase of the Bank;

b. the increase in the loans/capital gearing ratio from 1:1 to some unspecified higher figure. (In Bank America the ratio is over 20:1).

The French were "not opposed" to either of these broad propositions. So Mr. Clausen may try them out today.

2. As reported in the Wall St. Journal, the McNamara plan for Bank lending for the quinquennial period 1981-5 was to expand by about 80% (including energy and China). Both a. and b. would be needed together with IDA (soft loan facility) replenishment. Having been rebuffed by Stockman on the IDA proposals, Mr. Clausen appears to be concentrating on securing the increase of the Banks capital and using it as a basis for expanding Bank loans.

3. The Bretton Woods agreement specifically prevented the IMF and the Bank behaving as ordinary banks. They were to be "cloakrooms" where they could lend only the amount of their reserves. They could not "create" money. [The Americans insisted on this, against Keynes' view, since they believed that if the IMF and Bank behaved like banks with only fractional reserves they would create money and contribute significantly to world inflation. Keynes thought there would be a great post war slump and the problem would be falling not rising prices.] Over time these principles have been only modestly compromised (by the issue of SDRs, for example) and they remain substantially true today.

4. The Reagan administration is likely to continue its present squeeze on the Bank, largely because it disapproves of the McNamara policy with its extensive loans to enemies of the West.

/It is thus

It is thus unlikely that the Treasury would approve of the change in the gearing ratio, and there are likely to be some difficulties even in securing final agreement for the capital increase.

5. Clausen must be thinking about his general strategy within the framework which the Reagan administration has set. He will be looking to see if there is any possibility of using the more "internationalist" Europeans to soften up the Reagan hard line.

AW

18 March 1981

CHANCELLOR OF THE EXCHEQUER

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17th March 1981

M O'D B Alexander Esq.
10 Downing Street
LONDON
SW1

Dear Michael,

CALL BY MR A W CLAUSEN

As requested in your letter of 24 February, I am sending a brief for the call which Mr Clausen is making on the Prime Minister and the Chancellor on 18 March.

I am sending copies to Roderick Lyne (FCO) Mrs Dinham (ODA) David Wright (Cabinet Office) and Tim Allen (Bank of England).

Yours sincerely

John Wiggins

A J WIGGINS
Private Secretary

MR CLAUSEN'S CALL ON THE PRIME MINISTER - 18 MARCH 1981

Mr A W (Tom) Clausen, President of the Bank of America, and President/designate of the World Bank, will call on the Prime Minister at 4.45 pm on 18 March. He will be accompanied by Mont E. McMillen, Executive Vice President of the Bank of America responsible for operations in Europe, the Middle East, and Africa.

2. The Chancellor will be present.

3. Mr Clausen will be calling separately on the Governor of the Bank of England (on the morning of 18 March) and on Lord Carrington immediately after the meeting with the Prime Minister.

4. Despite the fact that Mr Clausen does not arrive in the World Bank until May and does not take over until July, we suggest taking this opportunity to impress on him the British Government's general views on the future of the Bank. - Annex A

5. Briefs on the other subjects mentioned in Mr Clausen's letter have also been prepared:

(a) The world economy; - Annex B

(b) Energy; - Annex C

(c) The development of the economies of the Third World; - Annex D

(d) The Bank of America's role in the economy of the UK. - Annex E

We have also prepared:

(e) A personality note on Mr Clausen; - Annex F

(f) A note on Polish debt in which the Bank of America has a large stake. - Annex G

ANNEX A

WORLD BANK ISSUES

Points to Make

(a) Congratulate Mr Clausen on appointment. Interested to hear how he sees the future role of the World Bank. The UK (still second largest shareholder) has consistently supported the World Bank and will continue to do so.

(b) We were concerned about the lack of realism in Mr McNamara's outlined plans for a massive expansion of World Bank lending and borrowing (particularly the large increases in concessional funds through IDA). It is not sensible to look at "needs" without giving proper weight to the wishes of the developed countries on whom the organisation ultimately depends.

(c) The oil price increases, and accompanying recession, have worsened the situation for LDCs, but also reduced the ability of the developed countries to help. Most of the main industrialised countries, including the US and the UK, are cutting back on public expenditure. It seems that the American contributions to IDA 6 and to the general capital increase only escaped because they were international commitments, already agreed.

(d) In these changed circumstances the World Bank should concentrate, with greater care than in the past, on only financing activities which would not otherwise occur. There is no point in simply substituting World Bank financing for other flows.

(e) There is a strong case for the Bank further adapting its lending to secure greater involvement of private capital. Not only does this introduce a measure of market discipline, but in present circumstances is one of the few ways whereby the World Bank can mobilise additional funds for investment in the Third World.

Background

2. Mr Clausen takes over from Mr McNamara as President of the International Bank for Reconstruction and Development (World Bank) on

1 July, 1981, the start of the Bank's fiscal year. He also becomes _ex officio_ President of the International Development Association (IDA) which lends money on very soft terms to the poorest countries with funds provided on grant terms by the developed countries, and also of the International Finance Corporation (IFC) which helps to promote private sector and equity investment in developing countries.

3. The World Bank finances its operations by borrowing on world capital markets. The UK has made no capital payments (except to maintain value of subscriptions) since the Bank was initially set up. We share, with other developed countries, a general interest in the success of the Bank as one of the Bretton Woods institutions and the most effective international agency helping developing countries. There are also procurement benefits for British companies which gain contracts from projects financed by the Bank. But the government would like to shift the balance of the aid programme from multilateral towards bilateral expenditure, and this will have implications for our ability to contribute to further replenishments of IDA and possibly to the general capital increase.

4. The following are notes on the main current issues.

General Capital Increase

5. A general capital increase of $40b which when fully subscribed should approximately double the Bank's capital was agreed in January 1980. Shares are allocated pro rata to member countries according to their existing holdings and will be open for subscription after September 1981. Only 7½% has to be paid in. The total cost to the UK, if we decide to take up our full shareholding, would be of the order of £100m spread over 5 years. The Reagan Administration is seeking Congressional approval to take up the American share in full.

(Line to Take if Raised)

6. The UK has supported the GCI, but no decisions have been taken about the level or timing of our subscription. It will be interesting to see whether the American Administration has difficulties in obtaining Congressional authorisation.

6th Replenishment of IDA (IDA 6)

7. The IDA 6 Agreement provides a total of $12b of which the British contribution is £555m, a share disproportionately large in relation to the relative size of our economy. The US Administration intends to seek Congressional authorisation for the full American contribution ($3.24b), but to postpone commitments into the second and third years of the Replenishment period. The full implications of this have not yet been worked out.

8. Most of the other donor countries have agreed to participate in a bridging operation to allow IDA to continue making loans. We have recently obtained Parliamentary authority to advance a promissory note of up to £185m, our first year's tranche, as a contribution to this arrangement We are depositing half of this and may consider advancing the other half later if a request is made. All actual expenditure on these deposits will occur much later. Despite the bridging, IDA is likely to run out of commitment authority in April.

9. There is no disposition among the developed countries to offer more bridging finance, but officials will review the situation at the end of this month.

Energy Affiliate

10. The World Bank would like to increase its lending for energy projects from $13b to about $30b over the next 5 years. As one way of doing this they are working up proposals to establish a new energy affiliate in the hope that it might mobilise additional (mainly OPEC) funds which might not otherwise be available. The energy affiliate idea was mentioned in the Venice Summit communique. We are sceptical about the value of the energy affiliate idea which might involve a further multilateral aid expenditure. Much depends upon the details. There will be no point in setting up a new international institution unless that was the only way of engaging additional OPEC funds and getting round the restrictive capital gearing ratio of the IBRD. Much will depend upon the American attitude - the Americans have said that they cannot currently support the idea as it stands (probably mainly for expenditure reasons) and this may well kill the proposal at any rate for the time being.

China

11. The Peoples Republic of China took over the Chinese seat in the IMF and World Bank last year. China's low GNP per head makes it eligible for IDA terms as well as for World Bank lending, and with a population of 1 billion (compared to the 1.8 billion of the rest of the developing world) China could claim a large share at the expense of traditional borrowers such as India. This is bound to increase pressures for a large replenishment of IDA next time.

(Line to Take)

12. We welcome China's membership of the International Financial Institutions. Lending to China should be built up gradually. There could be no question of gearing up the whole World Bank operation to take account of the advent of another 1 billion people.

PLO

13. Following the difficulties last year about the invitation to the PLO to attend the IMF/World Bank Annual Meeting as observers, the problem was remitted to a committee under the Chairmanship of the New Zealand Prime Minister Mr Muldoon. The Executive Boards of the Bank and of the Fund are currently considering the committee's findings, but the important thing is for the Americans and the Saudis to reach some political agreement.

World Bank Borrowing in Sterling

14. The World Bank have indicated that, as sterling interest rates fall, they may wish to raise an issue on the London capital market. There would be no objection to this.

ANNEX B

THE WORLD ECONOMY

Line to Take

(i) Recession surprisingly synchronised in major economies in 1980, but apart from the UK has not been as severe as in 1974-75. The low point may now be behind us but sustained recovery may take some time to emerge.

(ii) Overall progress in slowing inflation modest (although UK an exception).

(iii) Widely recognised that priority must be given to reducing inflation so policies have remained restrictive. So far monetary policy has borne most of the anti-inflation burden. Fiscal policy has become progressively tighter in most countries.

(iv) Interest rates and exchange rates have proved volatile. US interest rates may remain high. If so other countries may see little scope for significant easing of rates.

(v) LDC's particularly hit by higher oil prices and their consequences. Best contribution industrial countries can make is to restore their own economic strength. LDC's will need to adjust. Aid only part of solution. Sensible evolution of IMF/IBRD will also help.

Background

2. GNP in major 7 economies grew around 1 per cent in 1980 (3¼ per cent in 1979). Downturn unexpectedly synchronized, but not as sharp as in 1974-75. Japan the only country to escape a downturn in GNP in the second quarter. The US economy has bounced (temporarily?) back after the record fall in GNP (9.9 per cent annual rate) in the second quarter. The recession in the seven majors as a whole may already have passed its low point. But even on optimistic assumptions little or no growth in any of the major countries, except Japan, is expected in the first half of this year.

3. Consumer price inflation in seven major economies peaked at around 13 per cent year on year in April 1980. By December it was down to $11\frac{1}{2}$ per cent. Since May, the UK the only major country where the year on year inflation rate has fallen each month. Some recent acceleration seen is US (where hopes of single figure rate in 1981 officially abandoned), France and Canada because of accelerating earnings growth and in Germany because of DMark depreciation.

4. Unemployment in OECD area increased by around 2 million in the course of 1980 to 23 million. On standardised definition (US Dept of Labour) average rate in major 7 in December 1980 was 6.1 per cent (UK 9.8 per cent on same basis).

5. Announced budget plans or monetary objectives indicate some tightening of policy in the major industrialised countries this year. Overall, discretionary fiscal action is likely to offset some of the increase in budget deficits resulting automatically from lower activity. Danger of US bduget deficit remaining higher than expected - expenditure cuts may not be realized, economy may grow more slowly than forecast. Pressure on financial markets could remain severe. US interest rates might decline only slowly from present near-record levels.

6. High US interest rates could mean continued strength of the dollar. This would reduce preceived scope for any significant easing of interest rates in the major economies (except perhaps Japan) because of attempts to resist depreciation in order to limit imported inflation.

7. Distribution of current account balances may be less satisfactory than last year. Germany is increasingly worried about its persistently large deficit, which was financed in its entirety by running down reserves: whereas the Japanese deficit has all but disappeared and high export growth may create renewed trade tensions.

8. Only a small part of the expected reduction in OPEC surplus this year is likely to benefit the smaller OECD economies. And none at all the LDCs. Their combined deficit in 1981 could be much the same as in

1980 ($67 billion, even if they cut import growth quite sharply). Adjustment is necessary but will be painful for them. Aid can help to some extent but private flows and increased borrowing from the IMF and IBRD will bear the major burden. It is in the interests of both developed and developing countries alike to facilitate this. (See separate brief on IBRD.)

ANNEX C

MEETING BETWEEN THE PRIME MINISTER, CHANCELLOR OF THE EXCHEQUER AND PRESIDENT DESIGNATE OF THE WORLD BANK

ENERGY

POINTS TO MAKE

WORLD OIL SITUATION

1. Short term outlook: World oil situation easier than last year. If no new interruption, supply should balance or slightly exceed demand for the rest of 1981. But no room for complacency: recession has been a major factor in reducing oil demand. Need for co-operation among consumer governments, particularly to cope with sudden supply shortfalls - International Energy Agency (IEA) best vehicle for this.

2. Longer term: Many uncertainties in the outlook e.g. level of OPEC production, and how quickly supplies of non-oil fuels will be expanded. Major oil consumers must stick to Venice Summit commitments to conserve energy and cut oil consumption. We see economic pricing of energy as principal means of achieving these objectives. Important for LDCs as well as big consumers to implement economic pricing.

3. One view is that oil prices will continue to rise in real terms and remain a serious constraint on growth. Mr Clausen may have views, particularly on LDCs' prospects.

UK BENEFIT FROM HIGHER OIL PRICES (if raised)

4. Oil is only a small part of our economy - about 3% of GDP last year. We share consumer countries' interest in healthy world economy. So we too want to avoid further sharp increases in oil prices.

US ENERGY POLICY

5. Welcome Reagan Administration's determination to develop United States' energy resources. Welcome decision to bring

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forward oil price decontrol. We hope for early action to deregulate gas prices; would show United States' commitment to realistic energy pricing.

BACKGROUND

WORLD OIL SITUATION

6. 1980 saw a further increase in oil prices of about $7-$8/bbl (about 14% in real terms) brought about chiefly by the Iran/Iraq war. To meet pressure on the market the December IEA Ministerial agreed to encourage the use of stocks, keep consumption under control and discourage abnormal purchases on the oil market. Since then a fall in demand and some increase in Iranian supplies has kept the market reasonably balanced. It could remain so during 1981 and 1982. But unpredictable events in the Middle East could trigger a shortage and, unless consumer governments take early, careful and co-ordinated action, further sharp price increases could ensue.

7. Over the past few years the more moderate members of OPEC have played an important part in seeking to restrain oil price increases by maintaining high production. The US/Saudi dialogue has been a key element; a souring in US/Saudi relations could detract from Saudi helpfulness on prices.

US ENERGY POLICY

8. Considerable progress has been made in US energy policy and performance in the last two years. But there are still weaknesses - energy consumption per capita remains high, low taxes on petroleum products (eg gasoline) and institutional barriers (largely environmental) to swift progress with nuclear and coal; and above all the artificially low price of natural gas.

9. Unlike oil, the decontrol of gas prices requires legislation to amend the 1978 Natural Gas Policy Act. The Act allows for periodic increases to bring gas to parity with other energy prices by 1985. But the escalation formula has not kept pace with sharp oil price increases since 1978. Decontrol of gas prices now would cost US consumers some $50 to $80 billion, and could be inflationary. Stockman (Director Office Management and Budget) and others in the Administration argue for quicker but not necessarily immediate movement of gas prices to economic levels to promote greater production and conservation. Key figures in Congress are either reluctant publicly to agree or oppose.

ANNEX D

ECONOMIC PROBLEMS OF THE DEVELOPING COUNTRIES

Line to Take

The problems of LDCs are severe, and made worse by the oil price increases, However circumstances vary greatly and many LDCs maintained good growth records after 1973-74. The North/South way of looking at the world is misleading.

2. There has been an over-concentration on official development assistance in international discussions about economic development. Aid is only one component of the development process. There is much that LDCs themselves can do to make themselves attractive for investment. Total flows more important than aid. Also the need to maintain a generally open world trading system. Industrialised countries' major contribution to helping LDCs is to restore their own economies.

3. Nevertheless aid is important particularly for the poorest countries who cannot attract private flows. UK's aid programme substantial despite cuts.

4. The IMF and the World Bank have an important role, and we support evolutionary changes so that they can play a greater part in the recycling of surpluses. But we should do nothing which might undermine the International Financial System or the confidence of capital markets.

ANNEX E

BANK OF AMERICA'S ROLE IN THE ECONOMY OF GREAT BRITAIN

(Brief for visit of Mr Clausen to the Prime Minister on 18 March)

1 The Bank of America is the largest bank in the United States and is roughly 50% larger than Barclays or National Westminster, the two largest British clearing banks. Outside the USA, the bank has offices in 100 countries which provide it with over a third of its total business.

2 The Bank of America began operations in the UK in 1931 and now has branches in London, Manchester, Birmingham and Edinburgh. Most of its business is, however, in dollars as part of the international market in London rather than in domestic sterling business. Only some £0.7 bn of its total deposits of £8.2 bn are in sterling. London is the administrative headquarters for the group's Europe, Middle East and Africa division. They also have a much smaller merchant bank (Bank of America International Ltd) and a consumer credit finance company, BankAmerica Finance (Bafin). At present Bafin's public deposits are very small but it is the intention to expand its branch network from 10 to about 30 over the next five years.

Bank of England
6 March 1981

ANNEX F

MR A W CLAUSEN - PERSONALITY NOTE

Mr A W (Tom) Clausen is President and Chief Executive Officer of the Bank of America. He has been associated with the Bank since 1949 and was elected President in 1969.

2. He was born in Illinois in 1923, and was educated at the University of Minnesota where he received a law degree. He is active in a large number of business, civic, and educational organisations. These include the Federal Advisory Council, which is associated with the US Federal Reserve System; and the Government Borrowing Committee of the American Bankers Association, where he works very closely with the US Treasury. He is also a member of the Advisory Council on Japan/US Economic Relations, and the Pacific Basin Economic Council; and a Director of organisations concerned with US trade with the USSR and with China.

3. Mr Clausen is a very private man who shuns publicity and is not easy to get to know - a quiet thinker and an introvert pragmatist. He has been largely responsible for the Bank's remarkable flair for picking out the businesses with the most potential, and getting behind them with large amounts of cash. At the Bank, he is known as a phenomenal worker and a master of organisational detail, but he has also done a good deal to delegate decision-making.

4. He has been appointed as President of the World Bank with effect from 1 July, 1981, but he will not arrive in Washington until May. He is regarded as a "banker's banker", but has also shown in his public utterances a personal sympathy for the problems of developing countries. His appointment was therefore widely supported by the member countries of the World Bank, both developed and developing.

5. Mr Clausen has naturally been guarded in public statements about how he sees his future role in the World Bank. But, to judge from press reports of interviews he is likely to share many of our own views. He is reported, for example, to have laid stress on the following points:

(a) the need to involve private capital;

(b) the need to avoid 'throwing money at problems';

(c) the importance of keeping separate the roles of the IMF and the Bank.

ANNEX G

POLAND

Line to Take

A pre-condition of a multilateral debt relief operation for government guaranteed debt would be comparable relief from other creditors including banks.

2. In view of the number of banks (250) with unguaranteed lending to Poland, how can arrangements for restructuring their debts be made on a basis which will be adhered to by all? There appears to be danger that failure to co-operate by a few banks could otherwise trigger general default, because of cross default clauses, and undermine the whole operation.

Background

3. Poland owes at least $24b to the West. Nearly half is lending by banks without guarantees from governments.

4. The Bank of America's exposure is unknown but believed to be a large share of American bank lending of $1.7b ($1.4b unguaranteed - British banks' unguaranteed lending is much lower). It was the lead bank for the 1980 $325m loan to Poland.

5. No agreement between commercial banks to restructure unguaranteed bank lending has yet emerged. On 5 March the Vice President of Poland's Handlowy met representatives of 70 Western banks. There will be further talks, possibly leading to the establishment by the banks of a task force. Chase Manhattan seem to be taking a lead.

6. Representatives of 15 creditor countries, and of Poland, met in Paris last month to consider the problem of repayments due from Poland on loans guaranteed by governments. The UK and US are represented on a task force commissioned by the meeting to do further studies. There will be a further meeting in early April. Prospects for a multilateral relief operation look good. Bridging assistance covering a proportion of debts due has been made by some countries including the UK in the meantime.

10 DOWNING STREET

From the Private Secretary

24 February 1981

B/F 17/3/81

Econ Pol

CALL BY MR. A.W. CLAUSEN

As you know the next President of the World Bank, Mr. A.W. Clausen, is due to call on the Prime Minister on 18 March. I enclose a copy of a letter which the Prime Minister has received from Mr. Clausen, setting out the subjects he hopes to discuss. I should be grateful if you could arrange for us to receive a brief by close of play on Tuesday 17 March.

I am sending copies of this letter, and its enclosure, to George Walden (FCO), with whom you will no doubt be co-ordinating your brief, and to David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

A.J. Wiggins, Esq.,
HM Treasury.

R23/2
A CR 24/2

BANK OF AMERICA

A.W. CLAUSEN
President

February 18, 1981

Dear Prime Minister:

My associates in London have confirmed to me that I will have the pleasure of visiting you in London on Wednesday, March 18, at 4:45 p.m. I am looking forward to this opportunity of meeting you as well as discussing matters of mutual concern, including global economics, energy, development of third world economies and, of course, Bank of America's role in the economy of Great Britain. As incoming President of the World Bank, I would also be interested in having an exchange of views vis-a-vis the thrust of the World Bank in the 80's.

Mont E. McMillen, Executive Vice President in charge of our entire operation for Europe, Middle East and Africa, will accompany me. I understand that we also will be honored by the opportunity to meet the Chancellor or one of his senior colleagues at the time of our visit with you.

Thank you for fitting us into your busy schedule.

Sincerely,

AWClausen

The Rt. Hon. Mrs. Margaret Thatcher
Prime Minister
10 Downing Street
London SW1, England

Mr. Lankester
Econ Pol

(2) NOTE FOR THE FILE - World Bank

I rang Mr. Waterhouse on 236-2010 x2015 to confirm that Mr. Clausen should come to see the Prime Minister at 1645 on Wednesday 18 March. Mr. Waterhouse will be letting me have a biographical note on Mr. Clausen together with a list of topics he wishes to raise.

These must then be sent to the Chancellor's office for briefing. The Chancellor will be attending the meeting.

9 February 1981