

PRIME MINISTER

BILATERAL WITH THE CHANCELLOR: 6 SEPTEMBER

Markets

The main item for the agenda is a general stocktaking on the markets following the decision to raise interest rates to 12 per cent. You will recall that in your talk with him this afternoon Alan Walters thought that, on present evidence, 12 per cent should be enough. I think that is probably right. But you will want to be aware of the latest MO figures (Flag A) which remain uncomfortably high. Today's market report is at Flag B.

Scottish CBI Speech

I have let the Chancellor have a copy of your draft CBI speech for Thursday. I do not yet know how he reacts to it. Presumably if he has any worries he will raise them.

Star Chamber Membership

I understand the Chancellor may raise the question of Star Chamber membership. All that has been settled so far is that Mr Parkinson will be the Chairman. The Treasury had been thinking in terms of Mr Clarke as one of the members, but following the reshuffle it is unlikely he will now be available (he will probably wish to be seen to be fighting his corner by taking the health programme to the Star Chamber).

It then becomes rather difficult to see how a strong Star Chamber team can be assembled. In the past total membership has been either 4 or 5, and we should probably be aiming for the higher number. The conceivable candidates are:-.

- the Lord President - I assume you would want him on to

cover the Parliamentary aspects

- Mr MacGregor - relatively cheap for the Treasury to settle with and a good debater (my own view, having sat in on the the 1984, 1985 and 1986 Star Chambers in my previous job, is that it is essential to have at least one good "prosecuting counsel" to interrogate the defendants - a job Kenneth Clarke did extremely well in 1986).
- Mr Ridley - possibly more difficult for the Treasury to settle with.
- Mr King - would be very good, but presumably ruled out by the pressure of North Ireland business (sitting on the Star Chamber is very time-consuming).
- Messrs Younger or Fowler - probably difficult for the Treasury to settle either of these.
- Lord Young or Mr Newton.
- the Lord Chancellor - apparently a thought the Chancellor is toying with, but would be an unorthodox appointment.

PLCG.

Paul Gray

5 September 1988

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We need to find out what RW hamner will say - NB his speech last year.

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IMF/IBRD ANNUAL MEETING, BERLIN 27-29 SEPTEMBER

1. OFFICIALS ARE PREPARING BRIEFS FOR THE FUND/BANK AUTUMN MEETING IN BERLIN, WHICH AS USUAL WILL BE PRECEDED BY A G7 MEETING. WE WISH TO KNOW WHETHER OTHER G7 COUNTRIES CONTEMPLATE TAKING ANY INITIATIVES AT BERLIN. OF PARTICULAR INTEREST ARE

(A) JAPAN: WILL THE JAPANESE RESURRECT THE DEBT PROPOSALS THAT THEY PUT TO THE TORONTO SUMMIT AT SHORT NOTICE? IN THEIR REVISED FORM THESE ENVISAGED A MIX OF SECURITISATION OF OLD DEBT, A RESCHEDULING ARRANGEMENT WITH COMMERCIAL BANKS FOR THE REMAINDER, AND IN RETURN THE DEPOSIT BY DEBTOR COUNTRIES OF PART OF THEIR RESERVES IN A SPECIAL IMF ACCOUNT SO AS TO GUARANTEE DEBT SERVICE PAYMENTS TO THE COMMERCIAL BANKS. ONE OBVIOUS PROBLEM IS THAT MANY MIDDLE INCOME DEBTORS LACK SUFFICIENT RESERVES

(B) GERMANY: DESPITE ASSURANCES THAT THE EMBASSY HAS RECEIVED (MISS MARSDEN'S LETTER OF 15 AUGUST TO WHITE) THAT KOHL DOES NOT INTEND TO PUT FORWARD A SPECIFIC PROPOSAL ON DEBT AND THE ENVIRONMENT, WE SHOULD BE GRATEFUL IF YOU WOULD WATCH CAREFULLY FOR ANY CHANGE OF HEART IN BONN.

(C) THE US: IS THERE ANY EVIDENCE THAT BRADY (NOT YET CONFIRMED IN OFFICE) WILL WANT TO MAKE A SPLASH AT BERLIN, AND IF SO ARE THE US TREASURY DEVELOPING ANY PROPOSALS?

2. PLEASE APPROACH FINANCE AND ECONOMIC MINISTRY OFFICIALS FOR A GENERAL DISCUSSION OF THE PROSPECTS FOR BERLIN, AND SEEK TO ESTABLISH WHETHER ANY INITIATIVES ARE IN PREPARATION. YOU MAY DRAW ON THE FOLLOWING MATERIAL, WHICH REPRESENTS UK OFFICIALS' THINKING: THE CHANCELLOR HAS NOT YET DECIDED WHAT HE WILL SAY AT THE AUTUMN MEETING. WHILE THE UK DOES NOT EXPECT ANY MAJOR NEW DEVELOPMENTS, THE AGENDA FOR BOTH THE FUND AND BANK MEETINGS DEALS WITH IMPORTANT ISSUES. RECENT WORLD ECONOMIC DEVELOPMENTS AND PROSPECTS LOOK ENCOURAGING, AND THE INDUSTRIAL WORLD IS NOW IN ITS SIXTH YEAR OF CONTINUED GROWTH. A RISK IS INCREASED INFLATION, AND GOVERNMENTS MUST GUARD AGAINST THIS THROUGH APPROPRIATE MONETARY AND FISCAL POLICIES

3. THE WORLD BANK AGENDA RIGHTLY CONTAINS TWO ITEMS ON WORLD

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TRADE, SINCE THE GATT MID TERM MEETING IS TAKING PLACE IN MONTREAL IN MID DECEMBER. INDUSTRIAL COUNTRIES WILL BE CRITICISED FOR CONTINUED, AND IN SOME CASES INTENSIFIED, PROTECTIONISM. WE SHALL WANT TO STRESS THE IMPORTANCE OF MAKING PROGRESS AT MONTREAL, PARTICULARLY ON THE STRENGTHENING OF GATT AS AN INSTITUTION, AND ON ESTABLISHING FRAMEWORKS FOR NEGOTIATION IN THE SERVICES, INTELLECTUAL PROPERTY AND AGRICULTURAL FIELDS.

4. GOOD PROGRESS HAS BEEN MADE SINCE THE SPRING MEETINGS ON HELPING THE POOREST COUNTRIES. THE ENHANCED STRUCTURAL ADJUSTMENT FACILITY (ESAF) HAS NOW BEGUN OPERATIONS: WE UNDERSTAND THAT THE GERMANS ARE STILL CONSIDERING THE FORM AND CONTENT OF THEIR CONTRIBUTION. WE VERY MUCH HOPE THAT THE NEXT PARIS CLUB MEETING, JUST BEFORE BERLIN, WILL REACH AGREEMENT ON A DEBT RELIEF SCHEME, TO WHICH WE ALL COMMITTED OURSELVES AT THE TORONTO SUMMIT, FOR THE POOREST AND MOST INDEBTED SUB-SAHARAN AFRICAN COUNTRIES, AND CARRY THIS INTO OPERATION FOR THE FIRST SUCH CASE. SUMMIT COUNTRIES WILL TAKE POLITICAL CREDIT AT BERLIN FOR SUCH AN AGREEMENT. WE ALSO HOPE THAT THE PARIS CLUB CHAIRMAN'S COMPROMISE PROPOSALS - WHICH WE HAVE NOT YET SEEN OR APPROVED - WILL ENABLE THE US AND JAPAN TO AGREE TO RESCHEDULE THESE COUNTRIES' OFFICIAL DEBTS OVER 25 (AS OPPOSED TO THE PRESENT 20) YEARS, AS THEIR CONTRIBUTION TOWARDS BURDEN SHARING AMONG CREDITORS.

5. WE SHALL BE CIRCULATING A PAPER TO THE G10 (WHICH INCLUDES BELGIUM, THE NETHERLANDS, SWEDEN AND SWITZERLAND) ON THE GROWING IMPORTANCE OF ARREARS TO THE FUND AND BANK (EG THOSE OF SUDAN AND ZAMBIA), AND ARGUE THE NEED TO DEVELOP A STICK AND CARROT APPROACH. WE EXPECT TO SAY SOMETHING ABOUT THIS IN BERLIN: ARREARS IS ON THE INTERIM COMMITTEE'S AGENDA.

6. MIDDLE INCOME DEBTORS SHOULD BENEFIT FROM THE RISE OVER THE PAST YEAR IN MANY COMMODITY PRICES AND FROM THE CONTINUING ROBUST EXPANSION OF WORLD TRADE. BUT WE RECOGNISE THAT COMMERCIAL BANKS CONTINUE TO BE RELUCTANT TO CONCLUDE NEW MONEY PACKAGES WITH THESE DEBTORS, AND THE WORLD BANK MIGHT CONSIDER WAYS IN WHICH IT COULD HELP TO CREATE THE RIGHT CLIMATE FOR RENEWED PRIVATE FLOWS.

7. (FOR TOKYO) IF THE JAPANESE SAY THAT THEY INTEND TO SEEK A MUCH HIGHER FUND QUOTA DURING THE CURRENT QUOTA REVIEW (PERHAPS RISING TO 2ND PLACE, ABOVE THE UK), YOU SHOULD DECLINE TO COMMENT ON THE SUBSTANCE, BUT POINT OUT THAT FUND QUOTAS ARE NOT ON THE BERLIN AGENDA, AND THE US ADMINISTRATION WILL NOT TAKE UP POSITIONS UNTIL CONGRESS HAS RATIFIED THE WORLD BANK'S GENERAL CAPITAL INCREASE.

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