c. Mr. Hoskyns
Mr. Wolfson

PRIME MINISTER

Meeting with the Chancellor - Thursday 4 October

The Chancellor will no doubt want to report on the Commonwealth Finance Ministers and IMF/World Bank meetings. Nothing of much significance appears to have happened at either of these meetings. I attach the communique of the Interim Committee. The one significant initiative which the Committee considered was the idea of a Substitution Account: this is the proposal that Central Banks should deposit excess dollar holdings with the IMF and receive in return bonds denominated in SDRs. The Americans and the Germans have been very keen on this proposal because it would take pressure off the dollar. I understand that the Chancellor is rather lukewarm no doubt because he is sceptical about the prospects for SDRs being fully accepted as an international currency. A number of problems remain to be resolved: the size of the Account, the rate of interest that would be paid on the bonds, and the question of exchange risk. The Interim Committee have asked the IMF to do further work on the Account, and report back.

press release in this folder

The world economic assessment which has emerged from speeches in Belgrade is predictably gloomy. Mr McNamara has also, as his wont, been emphasising the plight of the world's poorest - and lambasting the USA in particular for their aid policies.

The Chancellor may also raise with you the question of NEDC membership. Three members - Lord Roll, Mr Michael Shanks, and Sir Leslie Murphy - are coming up for renewal. The Chancellor wants to replace Lord Roll by the Governor of the Bank: this seems very sensible given the intention to build the NEDC up a little (rather than pursue the idea of a separate Economic Forum). Michael Shanks (who represents the consumer interest) has not been an effective member, and the Chancellor wants to replace him - I think with a representative of small business. I think small business should be represented, but so too should consumers - even though Shanks may not be the best person. But if Shanks or someone else represents consumers (Why not a woman? There are none on NEDC at present), there may be a problem in bringing in

/a

a small business representative. One possibility would be for such a representative to replace Leslie Murphy; but I understand the Chancellor wants to keep Murphy on for one more year. The other options are: either to increase the total numbers (but there isn't room round the NEDC table!), or to ask the CBI to give up one of their six places, or to replace Charles Villiers if and when he goes from British Steel (and not to appoint his successor to NEDC).

I have asked the Treasury for advice on when you should take the chair at the NEDC. It seems to me that you should do this before long - the general economic discussion which is planned in lieu of the Economic Forum would be a good opportunity. You might press the Chancellor on when this particular meeting is to take place: if it is to have any influence on trade union thinking this winter, it really ought to be no later than December. E decided the meeting should be in December, but the Treasury is showing signs of wanting to put it off.

Other Issues

i) The Chancellor may want to come back to you on enterprise zones. You have said that he must not announce this proposal at Blackpool - quite rightly since the idea is not fully worked out yet, and Jim Prior is far from happy.

ii) Exchange Control. I have suggested that the Chancellor should come and discuss his proposal for a further package when he has something in writing - probably the week after next.

iii) Mortgage Rates. The present position is that the building societies will increase the mortgage rate from 11¾ per cent to 12½ per cent from 1 January unless competing interest rates fall back significantly in the meantime. The grossed-up investors rate was put up from 11¾ per cent to 12½ per cent in August, and the local authority three-month rate - which is the main competing rate - is currently 14¼ per cent. To prevent an increase in the mortgage rate, the local authority rate would need

/to come down

to come down to 12 per cent as a maximum - and probably lower. Only in these circumstances would the building societies be prepared to roll back the investors rate to 11¾ per cent - which is what they would have to do for the mortgage rate to stay where it is and for them to cover their costs. (At present, of course, with the mortgage rate lower than the investors rate they are operating at a loss.) The building societies are beginning to send out notices confirming that the mortgage rate will go up in January. They could send out further notices reversing this if interest rates did come down; but they would need a firm indication of lower interest rates by the end of November if they were to do this - since they need to give a month's notice to investors if there is to be any change in the investors rate.

It seems increasingly unlikely that we will achieve the necessary fall in interest rates in time. Indeed, there could be pressure for a still higher mortgage rate than 12½ per cent. For if the present disparity between the three-month rate and the building society investors rate continues, it is unlikely that the building societies will be able to attract enough funds to continue lending at what they and the building industry consider to be a desirable level. The August building society figures show a net inflow of just under £300 million - which is well up on the previous two months' figures, but about £100 million less than what DOE consider to be necessary if their lending is to continue at the present level.

When we considered all this in July, you asked for a contingency plan to be drawn up for either providing building societies with a subsidy, or loans which would be repaid during the current Financial Year.
The Chancellor was strongly against any such scheme because of its public expenditure implications, and

/ because it

because it would look like a "U-turn" on monetary policy. In addition, the building societies chairman (Leonard Williams) told Mr. Heseltine and Mr. Lawson that they would not be willing to accept a loan or interest rates subsidy scheme. I understand that these schemes are "on the stocks", and could be readily activated; but despite the political difficulties of the 12½ per cent mortgage rate coming through in January, I think the objections to either of these schemes are very great.

Are you content for action on these schemes to be stood down? Or do you want to retain the option of introducing one or other of them? If the latter, I suggest you should mention this to the Chancellor now.

R.

3 October 1979

World Bank

European Office : 66, avenue d'Iéna 75116 PARIS, France - Telephone 723 54 21

EMBARGO: HOLD FOR RELEASE UNTIL DELIVERY
EXPECTED AT 11:00 A.M., TUESDAY,
OCTOBER 2, 1979, BELGRADE, YUGOSLAVIA
(1000 HOURS GREENWICH MEAN TIME;
6:00 A.M. U.S. EASTERN DAYLIGHT
SAVING TIME)

He added criticism of U.S. aid policy.

ROBERT S. McNAMARA CALLS FOR FUNDAMENTAL REASSESSMENT OF DEVELOPMENT OBJECTIVES FOR THIRD DEVELOPMENT DECADE

Proposing a strategy for the Third Development Decade, Mr. Robert S. McNamara, President of the World Bank, told the Bank's Annual Meeting in Belgrade that the North-South Dialogue had become "so bogged down in arguments over means that it has tended to lose sight of the ends."

"The formulation of a development strategy for the Eighties offers the international community a valuable opportunity to reconsider the fundamental objectives of development itself," said Mr. McNamara.

Structural changes of "immense magnitude" were needed if there were to be progress in tackling the major issues of population growth, food production, employment creation, urbanization, alleviation of absolute poverty and expansion of international trade and development investment.

Mr. McNamara said the World Bank planned to assist the international community in coping with the problems of the Eighties by expanding its program in real terms over the next several years. The Bank's working plan for the fiscal years 79-83 showed new loan commitments by the Bank and its affiliates (the International Development Association and the International Finance Corporation) totaling $64 billion (in current dollars) during the period.

Shortfalls Of The Seventies

Mr. McNamara referred to the disappointments of the Second Development Decade, during which the average rate of economic growth* in the developing countries would, at best, not exceed 5.2 percent a year -- compared with the 6 percent goal of the decade. There would be serious shortfalls in the sub-

/...

* Calculated as gross domestic product, which measures the total final output of goods and services produced by the country's economy.

sidiary targets, particularly for agricultural production and for the level of Official Development Assistance from the OECD nations. And the averages concealed the real plight of the low-income countries.

"Income grew the least where it was needed the most: in the poorest countries, containing half the population of the world," Mr. McNamara said. "The economies of most of these nations, with hundreds of millions of their people already trapped in absolute poverty, scarcely advanced at all."

The World Bank President said that the Third Development Decade should give greater attention to the diversity of conditions in the developing world. Both developing and developed countries must consider in detail the hard policy choices that they will confront in the Eighties and beyond if fundamental objectives were to succeed. There should be more specific actions to help the 600 million people who are projected to remain in absolute poverty at the end of the century. And rather than an overemphasis on the elusive goal of the Seventies of narrowing the relative income gap between the industrial and developing nations, the gap should be closed between rich and poor countries in terms of the quality of life: in nutrition, literacy, life expectancy, and the physical and social environment.

Population Problem Critical

The World Bank President said that the "most critical problem of all" was population growth. Its urgency had been underestimated because crude birth rates in the developing world -- outside sub-Saharan Africa -- were declining.

But if the current trends continued -- as encouraging as they might appear -- the world would not reach replacement-level fertility (in effect, an average of two children per family) until about the year 2020, while the world's population would stabilize some 70 years later at about 10 billion people compared to today's 4.3 billion. Yet the global population could stabilize at two billion less if the date at which replacement-level fertility were reached could be advanced by 20 years.

"The time lost in temporizing with population problems is simply irrecoverable," Mr. McNamara said. "The debate over which efforts in fertility reduction are of most consequence -- socio-economic progress or family planning programs -- is largely irrelevant. Research demonstrates that both are important."

The World Bank President said population growth would be reflected by a growth in the global labor force of about 750 million people by the end of the century, two-thirds of the increase being in the developing countries; while there were enormous pressures on the cities of the development world, whose populations were doubling every 10 to 15 years.

/...

Reappraisal Of World Bank's Role

Discussing the role of the World Bank in the Eighties in the spheres of population, food production, urbanization and employment creation, Mr. McNamara said: "Increasingly, the developing countries are looking to the World Bank as their main source of external assistance. I believe, therefore, that over the next two years we ought thoroughly to re-examine our role in the development process to ensure that the Bank is meeting the evolving needs of our members, and to see if we can better provide the full range of services implicit in our mandate."

Mr. McNamara said that during the next decade the World Bank would strengthen its programs for agriculture and rural development.

The Bank was now by far the largest single source of external funding for agriculture in the developing world, currently providing more than 40 percent of all official external assistance for this purpose.

Over the past five years the Bank had directly provided about \$12 billion for agricultural development, financing projects with a total cost of about \$30 billion. Over three-quarters of this investment had been for increasing food production.

Mr. McNamara said it was expected that in the early 1980s World Bank-financed projects would contribute up to a fifth of the annual increase in food production in its developing member countries. And the investments the World Bank had helped to finance in the rural sector over the past five years were expected to raise incomes of some 60 million of the poorest people.

The Bank expected to provide \$20 to \$25 billion for agricultural investment during the fiscal years 1979 to 83, which would support a total of over \$50 billion worth of projects and programs.

Expansion Of Energy Program

Referring to the World Bank's energy program, Mr. McNamara said that the oil import bill of developing countries rose from \$4 billion in 1972 to \$26 billion in 1978, and was estimated to be about \$42 billion in 1980. This had dramatically affected the economics of energy supply, increasing the incentives for exploiting known resources in developing countries.

The Bank had tentative plans to expand its petroleum lending to \$1.2 billion per year by FY1983 -- financing, annually, oil and gas exploration and production projects with a total cost of over \$4 billion, and representing roughly a third of the total investment requirements of its developing member countries in this sector. Some 60 percent of this lending program for oil and gas would be in the poorer countries.

/...

Summing up, Mr. McNamara said: "The Bank, together with all of the international development community, should look to the new interdependent world order that will inevitably evolve in the Eighties and beyond with the vision and courage and boldness that history is clearly asking of us all.

"Procrastination and delay and inadequate effort in the face of these momentous issues can only bring the most severe penalties to those in the next century who will have to live with the consequences of the decisions we must take -- and take soon."

- 0 -