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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

THE BRITISH SHARE IN MULTILATERAL FINANCIAL ORGANISATIONS

Memorandum by the Chancellor of the Exchequer and
the Secretary of State for Foreign & Commonwealth Affairs

We were invited at OD(80)19th meeting to review Britain's share in the International Monetary Fund, the World Bank and certain other organisations. The Committee wished to consider whether our shareholding and the expenditure involved should be reduced to accord more closely with the relative size of our economy, thus releasing funds for other purposes.

2. Our agreed conclusions are:

(a) there are considerable advantages in maintaining our present position in the IMF, but we will by the mid-80s in any case move to a lower position;

(b) as far as the World Bank is concerned, a reduction in our shareholding would not significantly relieve our multilateral aid bill over the next few years;

(c) the International Development Association (IDA) makes much larger demands on the aid programme, but we

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are bound by international commitment until the mid-80s, and an opportunity to consider reducing our share will not occur until proposals for the 7th Replenishment of IDA begin to be formulated in late 1981 or early 1982.

3. Annex A is a note agreed by officials which sets out the background in more detail.

4. We invite the Committee to endorse these conclusions.

G.H.

H.M. TREASURY

C.

29 October 1980

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ANNEX A

NOTE BY OFFICIALS

Our Quota Position in the IMF

We still have the second largest quota in the IMF and shareholding in the World Bank. We were co-founders of both Institutions with the United States in 1946. Our economy - with our colonies - then ranked second in the free world. Determination of quotas in the IMF traditionally depends on a number of factors (share of world trade, scale of reserves etc as well as GNP). Political considerations also enter into it (eg desire of US to retain blocking vote, LDC aspirations and solidarity, European Community solidarity etc). Objectively, our IMF ranking should probably now place us 5th instead of 2nd. Because of Japanese pressure for a larger quota, there is already an understanding that quotas will be reviewed at the time of the next (roughly quinquennial) regular quota increase. By the mid-80s, therefore, we will almost certainly come down - at best - to 5th.

2. In the IMF it was in the past in our interest to retain a large quota because our quota determines the scale of our borrowing rights at any given level of conditionality. This is now much less important but should not perhaps be entirely dismissed.

3. An increased IMF quota has no immediate effect on public expenditure or the level of the reserves. A quarter of the increase is paid to the IMF in Special Drawing Rights (SDRs), but that payment adds to our reserve position in the Fund, and because it can be recalled at any time, counts as part of our reserves. The other three-quarters are paid in the form of non-interest bearing sterling notes. When the IMF needs to use sterling for a loan to another member country, the non-interest bearing notes are converted into a drawing on our National Loans Fund via the Exchange Equalisation Account. This drawing is not public expenditure under present definitions, but its monetary effect is the same as public expenditure overseas, or sales of sterling for intervention purposes by the Exchange Equalisation Account.

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4. The size of the IMF quota governs the share of any allocation of SDRs by the Fund. The UK will have received about \$2 billion worth of SDRs for the reserves by next January - about twice France's allocation.

Financial Implications of our Shareholding in the World Bank

5. The World Bank operations are financed mainly from the proceeds of market borrowing which are on-lent. This market borrowing is founded on the subscribed capital of member Governments, borrowing is founded on shareholding. Only part of the capital is paid up. The UK's payments count as public expenditure. Capital replenishments are relatively infrequent. The paid-in proportion of the forthcoming general capital increase (GCI) will be 7½%. The UK's allocated share of this, based on our existing shareholding, is about 7¼%. This would involve payments of about £100 million before July 1986, mostly or possibly entirely outside the PESC period.

6. The UK could decide to subscribe to less than the shares allocated to it, but if the GCI is to remain fully subscribed other countries would have to be prepared to take up the shares foregone. A reduction of 1% in our prospective post-GCI shareholding would probably not call into question (in the next few years at any rate) the British right to one of the appointed seats on the Executive Board. The amount to be saved from reducing our subscription to the GCI to achieve a 1% drop would be of the order of £30 million spread over 5 years, but such action also needs to be set against wider implications discussed below.

Relationship between IMF Quotas and World Bank Shareholding

7. Our quotas in the IMF and shareholdings in the World Bank are not rigidly connected, and the link has tended to become less close than it was in the early days. But they cannot be too far divorced. We could hardly expect to go out of our way to reduce our World Bank obligations while seeking to retain the kind of position in the Fund which has tended to be advantageous to us.

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8. A decision on whether to take up the full allocated shareholding or go for something less need not be taken for some time yet. The US Congress has not yet approved American participation in the general capital increase, and there are other factors likely to lead to delays.

The IDA

9. The International Development Association (IDA), is the soft loan affiliate of the World Bank. It is wholly financed by direct contributions from member countries. The British contribution to the 6th Replenishment operation "IDA 6" is 10.1%, considerably above our GNP share of some 5%. The decision to participate at this level was taken before the public expenditure cuts. We negotiated a favourable phasing of our payments. But we cannot very well go back on the commitment we have made. Unlike the United States administration, whose intention may be frustrated by the Congress, we cannot normally plead such force majeure.

10. However, if the American Administration could not get Congressional approval for its obligations to IDA 6 an opportunity might arise for a fresh negotiation, in which in theory the UK could seek a lower share. But in practice it would be very difficult to get agreement with other donors which would result in lower contributions by us over the next six years than we have negotiated under the present agreement. The attempt to do so would be hard to square with the Venice Summit Communiqué, and the circumstances would not be propitious because of the damage to IDA from the loss or reduction of the US contribution; and on the whole it is judged that Congressional acceptance will ultimately be secured.

11. Looking further ahead, on the assumption that IDA 6 and the general capital increase go forward as planned, we might take what opportunities are open to us thereafter to defer or avoid further World Bank calls on the developed countries. Under this approach we would support measures which could enlarge the World Bank's ability to borrow and lend without further capital replenishments (eg by greater co-financing

*The Venice Summit communiqué said "We strongly support ... the 6th Replenishment of IDA ... It is essential that all members, especially the major donors, provide their full contribution on the agreed schedule."

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with OPEC or by amending the capital lending ratio if these are feasible), or, if this is not possible, at least with replenishments involving no paid-in element. So far as IDA is concerned, where the sums involved are very much bigger, and where every replenishment, disbursed over a number of years, has tended to be greater than its predecessor, so that the obligations have a cumulative effect, there may also be questions to explore about terms of lending (50 years at 4% with a 10 year grace period to countries with a per capita income of about \$200 per annum or less) or about modifying the Bank's policies under which IDA and Bank money are blended for individual recipients, with a view to making the concessional funds stretch further and turn round more rapidly.

IMF and World Bank: Wider Implications

12. There would be no dramatic effect on the UK or any of our policies if, as a result of changes in the quota or shareholding, we dropped from second to, say, 5th or even 6th place in voting strength in the IMF and World Bank. Sixth place would carry some risk of losing direct representation, but we might still have a quota big enough to enable us to be a single country constituency, or head a group constituency. A gradual change may be inevitable, especially with the return of China to the World Bank; though the growth of our reserves, the strength of sterling, North Sea oil and some check in the last 4 or 5 years in the decline in our share of world trade may do something to make the change slower than it would otherwise have been. However a sharp change, made at our initiative, would no doubt be regarded as highlighting the decline of our influence and if we hastened it, might be seen as "contracting out". This would have some effect on our influence in such fora as the Seven Power Summits, though it would be wrong to exaggerate this.

13. In policy decisions in the IMF our right to appoint a UK Director means that we are still able to exercise some influence. Although the days of US/British dominance are gone, we can, especially if we are in agreement with the Americans and Germans, help to ensure that

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decisions favour prudent management. Some of these policy decisions could affect the UK eg because they concern the funding of the Institutions and the scale of their operations, the conditionality of IMF lending, the sale of IMF gold, the issue of SDRs, staff appointments and pay etc. If our relative standing in the institutions declined really sharply, our influence on such decisions would be reduced. In the World Bank our influence has already diminished further than in the IMF.

Other Multilateral Aid

14. The World Bank is only one of our multilateral aid channels. A breakdown is set out in the Annex to this paper. The biggest single multilateral channel is the EC. We contribute half of our "Community" aid through the Budget of the European Community, to which we pay our rated share year by year: this is mainly food aid and aid to the Mediterranean countries. The remaining half goes through the European Development Fund. Neither element attracts any relief under the 29-30 May Agreement to reduce our net budgetary contribution. The next EDF will not be negotiated till 1984, and we shall have to fight hard both to restrain its total and to get our share reduced (we only got it down from 18.7% to 18.0% last time). Meanwhile there are difficult battles ahead on budgetised aid, especially for the Mediterranean countries.

15. Contributions to the United Nations group of institutions are planned, under the aid framework, to decline in real terms. The sums which might be saved by a faster rundown would be small. There could be troublesome repercussions from the attempt, perhaps even on our right to a seat on the UN Security Council.

16. The trade effects of the different types of multilateral aid expenditure vary widely. The best is the World Bank since the amount of potential trade generated is far greater than our public expenditure contributions. Almost half of IDA procurement is now spent on borrowing countries' goods and services (local costs), but our percentage share of the procurement from donor countries remains near our share in IDA funding.

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Conclusion

17. We shall probably not be able to secure early relief on our multilateral commitments by reducing our shareholding in the World Bank. There is no point, and some disadvantage, in actively seeking an IMF quota reduction in the near future. We should however be alive to such other, and possibly more important, opportunities for reducing multilateral aid as exist: for example through resisting EC demands for increased budgetised aid and (eventually) for a much larger new EDF, and through examining steps by which the World Bank could in the longer run finance its borrowing while postponing, or even avoiding, demands upon the developed countries for new callable and certainly paid-in capital.

HM Treasury
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MULTILATERAL AID ALLOCATIONS PROPOSED
IN THE AID FRAMEWORK

	<u>£'m (cash)</u>			
	<u>1980-81</u>	<u>1981-82</u>	<u>1982-93</u>	<u>1983-84</u>
EDF replenishments	81.3	106.0	101.9	112.0
Other EC	60.9	79.9	87.7	97.7
IBRD (General Capital Increase)				
	No provision in aid framework			
IDA replenishment	53.0	95.5	125.5	149.0
Other World Bank Group	22.6	20.5	10.5	6.0
Regional Development Banks	16.2	18.7	18.8	18.0
UN Group	44.7	48.7	50.3	51.4
Other Multilateral (Commonwealth, etc. - all less than £5m a year individually)	<u>14.5</u>	<u>14.8</u>	<u>15.8</u>	<u>14.6</u>
Total	<u>293.3</u>	<u>382.1</u>	<u>410.7</u>	<u>448.8</u>
Multilateral as % of total allocated (excluding unallocated reserve)	28.1%	39.0%	41.9%	44.1%

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