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original to Brent Scowcroft

12/10/76

THE WHITE HOUSE
WASHINGTON

Brent Scowcroft

*Why don't you
keep this just it is
helpful or needed later.*

THE WHITE HOUSE
WASHINGTON

~~CONFIDENTIAL~~

November 30, 1976

Mr. President:

Chancellor Schmidt is undoubtedly calling you to report the results of a meeting which the EC held yesterday to discuss the British situation, among other things.

Based on his discussions with the British, Ed Yeo's feeling is that Callaghan's position with regard to IMF negotiations is ambiguous. I am sure he would argue that you should urge Schmidt that we both make clear to the British that we will not intervene with the IMF nor will we provide large amounts of credit if the British insist on doing business as usual. I suggest, however, that you listen to Schmidt's report and generally adhere to the line you took in your last conversation with him -- urge the British to continue their process of accommodation with the IMF.

Before you talk with Schmidt, you may also wish to glance at the attached letter which was just delivered by the German Embassy. It is the personal letter to you which Schmidt in his last phone call mentioned he was sending.


Brent Scowcroft

Attachment

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DECLASSIFIED
E.O. 12958 (as amended) SEC 3.3
MR # 09-53,02

state dept. ltr 9/29/09

By dsl NARA, Date 11/12/09



December 1, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: BRENT SCOWCROFT/ALAN GREENSPAN

SUBJECT: Your Telephone Call to Prime Minister Callaghan

1. I wanted to get in touch with you after my conversation yesterday with Helmut Schmidt. I was a bit puzzled by some of the points Schmidt made to me regarding the possibility of your imposing import restrictions and the closing of exchange markets in the event that agreement could not be reached between the IMF and the UK in the near future.
2. This surprised me because I had thought, that while your negotiations with the Fund were admittedly difficult, progress was in fact being made and that chances for a successful agreement appeared to be reasonably good. Indeed my conversation with Helmut was the first indication I have had that there was a real problem. Could you provide me with a clearer picture of the situation?
3. (If Callaghan responds that the negotiations are going very poorly and the United States must intervene to modify the Fund's position.) As I indicated in my message of November 24, we believe that the best agreement between the Fund and Britain would be on which was not influenced by external pressures. We have not attempted to influence the Fund's judgment or position. While we have closely followed your negotiations with the Fund, in our view, avoidance of outside pressures would hold the best possible chance of insuring the credibility and the success of the final outcome. I understand that Mr. Witteveen is now in London to devote his personal attention to the negotiations. We continue to expect that a reasonable agreement will be worked out and that the UK and the Fund will be able to completely close any gaps between them.

AUTHORITY State Dept. Ltr. 9/29/09

BY dal NARA, DATE 11/12/09



4. (If Callaghan faises the issue of sterling balances.)
As I also said in my message of the 24th and my earlier
one of November 21, we are preparing ourselves to deal
with sterling balances. We intend to move sympathetically
when substantial agreement has been reached with the Fund.
(IF asked about the need for Congressional approval.)
It may be that Congressional approval of some sort will
be required to implement our side of whatever agreement
is reached on sterling balances. But I can assure you
that if a responsible agreement is reached I personally
will exert every effort, and the Treasury will do
likewise, to insure the necessary Congressional action.



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	1976	1977		1978	
		(in billions £ sterling)			
		Healey Proposal	Witteveen Proposal	Healey Proposal	Witteveen Proposal
Cuts in expenditures		1.0	1.5	1.5	2.0
Expenditure Cuts or Increases in Indirect Taxes			<i>1976 prices</i>	<i>500 - GDP</i>	
Sale of Burmah Oil Shares		0.6		<i>10.5</i>	
Public Sector Borrow- ing Requirement	11.3	8.7	8.2	8.5	8.0
As a percentage of GDP	11.3%	7.5%	7.1%	6.6%	6.2%
Current Account Balance of Payments	-3.2	-1.0		+2.8	
Increase in Money Supply (M 3)	16.1*	11.8%	10%	14%	12%
Change in Public Expenditure Programs at 1976 prices (New Definition)		-2.4%		-.4%	
Domestic Credit Expansion		7.7		6.2	
Tax Cuts (if IMF estimates of PSBR on present policies are accepted)					
				.8	.4

*Annual rate based on first 10 months

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E.O. 12958 (as amended) SEC 3.3
MR # 09-33, #4
State Dept ltr 9/29/09
By dal NARA, Date 11/12/09





British Cal - not accept IMF

Immediate consequences -

Trade restriction
closing exchange market

Thursday -

Schmitt / Callaghan, (personal etc)

No budgeting of gap.

moderate free market
with controls. (left wing)

Only 2 in cabinet will
accept IMF. Henley + one more.

Q - should Watterson.

Call Callaghan - to check mood or attitude

AUTHORITY State Dept. Ser 9/29/09
BY dal NARA DATE 11/2/09



REVIEW & OUTLOOK

Britain's IMF Loan

That in hand, as it were, Great Britain is now sweating out its request to the International Monetary Fund for a \$3.9 billion loan. Everyone seems to think the loan is a sure thing, and it probably is, but the Labor government of Prime Minister James Callaghan is fearful that the gimlet-eyed IMF bankers will lay down conditions so draconian that Parliament and the populace will reject them and an economic crisis will ensue.

The Brits have every reason to worry. The IMF people have been running around between the UK, Italy and Mexico leaving baskets of the long green, but things always seem to get worse after they've gone. Because the IMF operates in such great secrecy, we never quite know if it is to blame for what goes on by insisting on perverse conditions or by not insisting on beneficial conditions. But surely it has not been doing something right.

The speculation in London now seems to be that the IMF's "secret team," which is holed up in a London hotel under assumed names, has drawn up an austerity program for Britain that all but includes the rack, the boot and the thumbscrew. There's talk of drastic tightening of monetary policy, slashing of public expenditures and another round of tax increases.

Mr. Callaghan will be happy to learn, we're sure, that The Wall Street Journal will not only sympathize with him if these are indeed the conditions of the IMF, but will also cheer him if he gives the secret team the boot.

The last thing Great Britain needs is more austerity. Which is not to say that monetary and fiscal policies should not be tightened. But if we were personally lending Britain \$3.9 billion, we'd be happy with three conditions:

First, the government would simply have to pledge to sell gilts government securities — whenever the pound threatened to fall below \$1.60. This would tie the creation rate of pounds to the creation rate of dollars, and Arthur Burns is a better central banker than Britain is otherwise likely to find.

Second, this requires some restraint in fiscal policy. We wouldn't be as Scroogish as The Economist of London, which proposes the sacking of 100,000 civil

servants on Christmas Eve. We'd be satisfied if the government simply held its outlays constant at \$96 billion.

Third, we would not advance Britain a farthing unless the government agreed to another proposal that The Economist made a few weeks ago, a reduction in the top marginal rate of income tax on earned income to 55% from 83%: indeed, our third condition would include slashing the 98% rate on investment income as well. These zany tax rates, which are encountered at taxable incomes of about \$25,000, are the chief cause of Britain's tailspin, and if the government insists on holding to them why should we throw good money after bad?

The Economist says that its proposal would "cost" barely \$480 million in lost revenue. This is a shockingly trivial amount, dramatic evidence that there are few entrepreneurs, at least in the private sector, foolish enough to pay wages and salaries that will only be confiscated by the government. But in fact, we doubt that the government would lose revenues at all. The elimination of these confiscatory rates would unleash enough additional production and taxable income to make up the "lost" revenue even at lower rates.

After all, Britain would not be able to repay our hypothetical \$3.9 billion, and will not be able to repay the IMF's very real \$3.9 billion, without solving its underlying economic problem, which is faltering production. And productivity does not increase by urging all workers to work harder, spend less time on coffee breaks, etc. It expands by inviting all workers to try to figure out how to do the same work with less effort, and rewarding those who do so. Productivity is strangled in Britain when rewards are confiscated by the government.

Unfortunately, Mr. Callaghan will probably accept austerity torture at the hands of the IMF sooner than ask his Labor supporters in Parliament to lower these foolish rates, which stand as symbolic monuments to social egalitarianism. If this is what in fact happens, Mr. Callaghan will have another basket of money, but it won't do any good to the British economy.

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