



10 DOWNING STREET

From the Private Secretary

4 March 1983

Dear John,

Call on the Prime Minister by Dr. Henry Kaufman

At the Prime Minister's request Dr. Henry Kaufman called upon her this afternoon.

Dr. Kaufman said that recovery was indubitably under way in the United States. It was more modest than the headlines suggested; the strength of the stock and bonds markets made some commentators exaggerate the strength of the likely recovery. Consumption was picking up and so was private sector housing, helped by lower interest rates. Businesses would be concentrating their attention in the year ahead on improving their balance sheets. There would be no jump in capital outlays. The increase in GNP in the first quarter of 1983, of some 4%, was an inventory response. Prices were not rising, there was much unutilised capacity and excess supply, and there was no re-emergence of inflation. Real interest rates were spectacularly high, at around 8% for long term rates compared with a 1.1% post-war average.

The Prime Minister enquired whether the large deficit was responsible for this situation. Dr. Kaufman said that it was partly responsible. But the volatility of financial markets had led investors to require a premium in their lending rates. To get rid of this premium would require a period of stability in the markets. Furthermore, there was much outstanding indebtedness, which had led to a deterioration in credit structure. The deficits were not yet crowding out private sector borrowers, but given the US Government's borrowing plans across the entire maturity structure, businesses would assuredly in time be crowded out - or, rather, priced out as the economy took off. The problem would be that corporations would be unable to secure the debt structure they required for a sustained recovery. Dr. Kaufman said that he believed that there would need to be defence and social security cuts, as well as the removal of the indexed tax system introduced by President Reagan.

Dr. Kaufman said that he wished to plead one point with the Prime Minister. He was most concerned about the international debt situation. The commercial bankers and the international institutions had so far done good work, but the size of international indebtedness was a blockage to growth. The US would not be able to pull the world economy out of recession. Other countries, including the developing countries, would need to grow. The Prime Minister enquired what action Dr. Kaufman

SUBJECT

cc Mester

File

cc 700

bc Bl
Aw

DA

JK

recommended. He replied that resolutions beyond the IMF would be required; from the political leadership in the industrialised countries. Another official institution would need to be established providing intermediate and long term credits. The Prime Minister commented that this proposal had been looked at again and again. She accepted Dr. Kaufman's analysis of the problem, but could not see clearly what the solution should be. One thing was clear - that no solution could be chosen which aimed entirely to relieve countries of the consequences of their own actions. There could be no solution to these problems unless countries were obliged to exert themselves in order to put matters right.

I am sending a copy of this letter to John Holmes (Foreign and Commonwealth Office).

Yours sincerely,

Michael Scholau
—

John Kerr, Esq.,
HM Treasury.

GK