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10 DOWNING STREET

From the Private Secretary

29 November 1985

Dear Rachel,

MR. ARTHUR BURNS

Mr. Arthur Burns today called in to see the Prime Minister on his way back to the US from visiting Eastern Europe.

The Prime Minister described how she saw the UK's economic performance. We had a soundly based recovery. The main worry was about the growth of unit labour costs. In terms of policy, there was increasing difficulty in assessing monetary behaviour, partly as a result of the pace of change in the financial markets. The Prime Minister said she was very concerned about the size of the US budget deficit. Even the strongest economy in the world could not continue in this way. The rash of mergers and takeovers in the United States was a symptom of disorder.

Mr. Burns suggested that Britain seemed to be catching the same disorder. However he was more optimistic than the Prime Minister about the prospects for the United States. He believed the US would get its budget deficit under control. He had himself been lobbying in favour of the Gramm-Rudman amendment, even though he knew it was a bad piece of legislation. The legislation would not he thought survive even six months and the result would be to force a compromise between Congress and the Administration. The President would be able to use the prospect of its damaging effect on the United States and on the world economy as a justification for proposing action to reduce defence and social expenditure and increase taxes. Mr. Burns said his opinion was shared by senior Republican leaders in the Senate.

The discussion then ranged more widely over a miscellany of subjects. Mr. Burns made the following comments, among others.

- (i) He had been impressed by the great improvement in

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management of the US Treasury under Mr. Baker, whose Seoul plan was winning increasing acceptance in the world's financial centres.

(ii) He had himself ceased to follow the behaviour of the various monetary aggregates in any detail. He thought it more important to watch the performance of the economy, and in this context he agreed with the Prime Minister that the performance of wages was now the United Kingdom's most pressing problem, for its effect on unemployment in particular.

(iii) Germany was now doing better economically than the rest of Europe, but they had no reason for euphoria. He had seen no return to dynamism. He spoke disparagingly of Stoltenberg's performance.

(iv) He believed the Japanese Government would take further action to stimulate their economy and liberalise capital markets.

In a brief discussion of his impressions from his visit to Moscow, Mr. Burns said the Russians he had encountered (he did not give names) seemed on the whole to be pleased with the outcome of the Summit. He had come across no criticism of it. However they were sceptical about whether the Americans would carry out the promises implicit in the joint statement and they had complained about the volatility of US foreign policy and the way the US seemed to speak with several voices. He had been surprised at how little awareness people seemed to show about the widening gap in economic performance between the USSR and the West. Either they were deliberately ignoring it or they simply lacked knowledge. Mr. Burns felt that the weakness in the Russian economy had been the main reason why Gorbachev had gone to Geneva and why there would in the end be an arms control agreement.

I am copying this letter to Peter Ricketts (FCO) and John Bartlett (Bank of England).

*Yours ever,
David*

(David Norgrove)

Mrs. Rachel Lomax,
HM Treasury.

PRIME MINISTER

VISIT OF ARTHUR BURNS

You are seeing Arthur Burns tomorrow at 1200 for half an hour but you have no other engagement until a working lunch in the flat.

Mr. Burns is calling in here on his way back from a series of visits in Eastern Europe, including the Soviet Union.

It would of course be interesting to have his views on the American economy and economic policy generally. How does he see the risks?

He may also have comments on the UK economy.

In view of his long experience you could ask him also about changing perceptions of monetary policy in recent years. Both in the United States and here over the past five years there has been decreasing reliance on single monetary aggregates and target ranges, and an increasing willingness to look at a range of indicators and to place greater reliance on judgement of financial conditions. How far is this change due to weaknesses in the approach advocated in the 1960s by Milton Friedman and others, of following a strict monetary rule? And how far is it a response (perhaps temporary) to the accelerating pace of change in financial markets, itself stimulated by the increasing openness of capital markets?

Monetary policies are rightly now given much greater importance in economic policy-making. But the way they are operated creates a need to place greater reliance on the individuals who are running them. With an increasing number of "wet" appointees being made by the US administration to the Federal Reserve Board, isn't there an increasing risk that the looseness of fiscal policy in the United States will come to be accompanied by loose monetary policy?

DN

DAVID NORGROVE

28 November 1985

BF 28.11.85 9/12/CP.



Can we
keep these
pages pl.

CR

13/11

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Condine (see below)

Arthur Burns thanks

you so much for offering
this meeting with PM.

He is very happy to
accept the time of:

12 noon Friday 29/11/85

Mr Pendleton of US
(in London)

Embassy will be arranging
transport etc.

Margo

12/11

Caroline.

It was a national holiday in the US today!



10 DOWNING STREET

wld you
dent.

CR

Arthur Burns.

MSA 11/11

Home no:

(202) 333 1636

Home address:

2510 Virginia Avenue North West.
Washington DC
20037.

Barbara Johnson stressed that any approach should be made through his secretary at the American Enterprise Institute.

Jean ~~BALBONI~~
BALESTRIERI

(202) 8626451 Direct line.

offer FRI 29 NOV.

at 12 Noon.

No alternative

in regard. CR JB

6/11



cf.
we need
to Burns
Ret. Mo.

10 DOWNING STREET

Arthur BURNS

28. Nov

Address

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30 Atc

(202) 862 6407

Barbara Johnson

[Allen Walters Sec]

Caroline

Could ~~be~~ we
discuss please?

David