

PRIME MINISTER

cc Mr Norgrove

FINANCIAL DEVELOPMENTS

Sir James Goldsmith has telephoned me from New York and asked me to pass on the following thoughts.

It is perfectly evident that politicians are losing their heads completely in the present situation and will do all the wrong things unless given a strong lead. The Americans are the worst. They are "panicking and dead". They will go unerringly for the soft option. The only person who can give a lead is you.

The Americans are set to do after the event what they should have done before, i.e. cut the deficit. Six months ago that would have been preventative medicine which might have worked. Now it will only aggravate the situation. Reducing expenditure and raising taxes in the situation we now face will precipitate a deflationary slump.

The level of savings in the United States in recent years has been low. This is because people do not save a fixed proportion of their earnings, they build up a specific nest-egg. With high stock market values, they have stopped saving and switched to spending on discretionary items. Now that the value of their nest-eggs has been halved, they are going to start saving ferociously. The deficit will therefore increase even further because revenue will fall.

What is needed is an Economic Summit with you in the lead. At this there would be agreement: to lop \$60 billion off the US deficit (half by increasing revenue, half by increasing *reducing* taxes); Japan and Germany to boost their economies to the tune of \$30 billion each; and Japan to make a loan to the developing countries to bail them out.

At the same time the EMS must be broken open. At the moment the whole of Europe is in thrall to Germany's deflationary

policies. The French are actively considering this. You were wise enough not to get dragged into the snake in the first place.

Without these steps, we shall have a deflationary crisis exactly on the lines of 1929. What we have is a political problem which has precipitated an economic crisis not visa versa. Governments are just about to do exactly the wrong thing.

On the BP share issue, his advice is that you should stick to it. But he has an alternative solution. Hanson Trust have \$5 billion in cash to spare at present and they could be allowed to sweep the market.

I said that I would pass all this on. It is somewhat lacking in internal consistency.

C.D.P.

CHARLES POWELL
26 October 1987

EL3CFW

Dan Man Pd.

11/11/11

