F.C.S. 54.

SUBJECT
cc Master.

10 DOWNING STREET

From the Private Secretary

5 June, 1984

Mr. Malcolm Fraser

Thank you for your letter of 4 June.

Mr. Malcolm Fraser called on the Prime Minister this morning. He said that he wished to put to Mrs.Thatcher his view, which coincided with the views of the other members of the "Interaction Council", and a recent report by certain banks, that if the US economic policies continued, there would be a major banking collapse within the next few years and we should be back to the situation of the 1930s. Re-iteration by US spokesmen of statements that there was no need for a lack of confidence was not enough. Many banks were not now viable. Australian and American firms were shifting accounts from one American bank to another in an attempt to find security for their deposits. Many of the developing countries could not repay their debts. If certain Latin American governments tried to pay their debts now, their leaders would be lynched.

The Prime Minister said that countries such as Brazil and Mexico were not short of saleable assets. It was wrong to let off lightly countries which had assets but refused to take the correct financial steps. Argentina was buying arms but was not repaying its debts.

Mr. Fraser reiterated that in his view many banks were now simply not viable. The power of the poor, whether they were buying arms or not, was in certain circumstances enough to destroy the financial system.

Mr. Fraser then raised the question of the US deficit. When the Prime Minister commented that President Reagan must deal with this problem after the US elections, he observed that that might be too late. The need for congressional approval would probably mean that no decisive action could be taken until April or May. A recent report by central

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banks had urged a comprehensive rescheduling of debts in order to preserve the system. The banks would have to write off some debts, even if this affected their profits. OPEC deposits needed to be put on a longer term basis. There would also need to be fresh commitments by central banks and governments, the size of which might depend on the extent to which they themselves had contributed to existing problems. The best way of inspiring confidence would be if the Economic Summit publicly recognised that there was a major problem and showed that action would be taken. On this last point, the Prime Minister commented that it was important that the Summit should not overstate the gravity of the problem, for that in itself could harm confidence. But she agreed that it was necessary to list the possible ways of handling the international debt situation and she would probably be doing this in her keynote speech.

I am copying this letter to David Peretz (H.M. Treasury) and Richard Hatfield (Cabinet Office).

A. J. COLES

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