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✓ Mr Alexander  
Mr Lyman

For Information:

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Sir Douglas Wass  
Mr Barratt  
Mr Hancock  
Mrs Hedley-Miller  
✓ Mr Lankester - No 10

MR WIGGINS

*Prime Minister*

*This is a very good result  
of Secretary Regan.*

SECRETARY REGAN'S COMMENTS TO CONGRESS ON UK ECONOMIC POLICY

*12*

I attach a copy of the letter I have sent to Mr Sprinkel on lines  
approved by the Chancellor.

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*KFC*

K E COUZENS  
3 March 1981

enc



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Sir Kenneth Couzens KCB  
Second Permanent Secretary  
Overseas Finance

3 March 1981

PERSONAL

Mr Beryl Sprinkel  
Under Secretary Designate,  
Monetary Affairs  
US Treasury  
15th Street NW  
WASHINGTON DC 20020

*Dear Beryl*

You may have heard that what Secretary Regan said to a Congressional Committee about Mrs Thatcher's economic policy on 27 February probably received more publicity in the UK than it did in the United States. It was reported prominently in the Financial Times and the Times, and on the radio.

2. The only transcript I have so far received comes from the British Broadcasting Corporation. If this transcript (attached) is correct, I am afraid that the Committee heard one or two mistakes of fact. Since, as has been repeatedly said during Mrs Thatcher's visit to the United States, the main thrust of the economic policies of our two governments is so similar, it would be a pity if either side misunderstood what the other was doing or trying to do, or were misinformed about the environment in which the attempt was being made. So I hope you will forgive me if, with the Chancellor's agreement, I send you one or two corrections.

3. First, the proportion of the working population in Britain which, on the widest possible stretch of the term, could be regarded as working for government is 30%, not 60%. This includes everybody working for any kind of local authority and the employees of all state-owned industries and of the National Health Service. The great majority of them are not working for the Government, though they are in the public sector.

4. Secondly, Mrs Thatcher's Government reduced the top rate of tax on earned income from 83% to 60% and on investment income from 98% to 75%. They did this in their first budget a few weeks after taking office. They also raised substantially the levels of income at which these maximum rates were reached.

5. Thirdly, they did not try to control the foreign exchange markets. The reverse is true. They completely abolished all exchange controls after 40 years in the autumn of 1979 and they have permitted the exchange rate to be determined strictly by market forces. They did not join the exchange rate arrangements of the European Monetary System. So it is hard to say that "their efforts to control the foreign exchange markets were unsuccessful". As believers in market forces, they didn't make any.

6. Fourthly, "they ruined their export trade" is a bit of an overstatement. British exports had to be achieved in a harsher environment. But the volume of British exports rose 1.75% in 1980 over 1979 and their dollar value increased by 27½%. For comparison, the value increase of Japanese exports in the same period was 25% and of US exports 22½%. And value is what pays the import bill and looks after the current account.

7. Fifthly, the story about the high pay increases (so-called Clegg increases, after the Committee which recommended them) in the public services in 1979 needs correction. Mrs Thatcher decided she must honour the pledge of the preceding Government on these increases, though she would certainly say they were excessive and damaging, especially in 1980. It is incorrect to say that the workers who received these "catching up" increases were not highly unionised. They were in fact all completely unionised and negotiated on a national basis.

8. As you know, everyone in Government in Britain greatly hopes that the programme of your Government will succeed. It is in the interests of the whole Western world that it should and Mrs Thatcher has already applauded the principles on which that programme is constructed. We all recognise that in our parallel efforts we are coping with disadvantages you do not have: a higher rate of inflation to begin with; a much bigger public sector, with several major nationalised industries; much more unionisation, especially in the public sector; a much weaker economy at a lower level of productivity; and the need to make a start with the programme at the onset of a major oil price increase and recession instead of after the worst had passed.

9. So there are good structural reasons why the struggle ought to be easier for you than it is for us. But it is unhelpful, and also unrealistic to suggest that we have failed because of policy mistakes whereas you won't because you won't make any. Our Government does not accept that it has failed, as you will have gathered from Mrs Thatcher. We have after all reduced our rate of inflation faster in 1980 than any other major country. Anyway, as our Chancellor remarked, Finance Ministers have to stick together. They don't have many other friends when the going gets rough!

10. We much look forward to seeing Secretary Regan and yourself in London on 12 April - if not sooner.

My best regards. Yours sincerely  
Ken Couzens

K E COUZENS

DONALD REGAN'S CRITICISM OF MRS THATCHER'S ECONOMIC POLICY

Transcript from BBC Radio 4, Today, 27 February 1981

PROGRAMME PRESENTER: .... He was giving evidence to a Congressional Committee and was asked what mistakes the British Government had made in the economic sphere. Well he took a deep breath because he had an awful lot to say about this:

REGAN: ..... nonetheless, when Mrs Thatcher and her Party came into power practically 60% of the population in Gt Britain in one form or another was working for the Government. Luckily we don't have that in this country; And at the same time Mrs Thatcher was faced with a rate of inflation that was even greater than we have today. She also admits that the tax cuts that she proposed were not nearly as great as perhaps they should have been. You will recall that in the so called unearned income area her suggestion was from 93% down to about 80%, and in the earned area from 83% to 63%. But having done that they then raised the value added tax, VAT, there wasn't that much incentive therefore in her tax cuts in order to get her economy really started again. One other feature that happened at that time; they tried to control the foreign exchange markets. Their efforts were not successful. As a result, what happened brought the £ really up in value. So high in fact that they ruined their export trade. Therefore the programme that she had designed did not produce the stimulative effect that she wanted. Now right after that there were a large number of workers who were not highly unionised, who had not had pay increases to the equivalent of what some of the highly unionised areas of the country had. She gave pay increases in the neighbourhood of 22 to 28% within the first year of being in Government. This had to have an explosive inflationary effect. Now contrast that with what we're trying to do. What we're trying to do here is to give incentive tax cuts right across the board and to bring down, over a 3 year period, unearned income to the 50% range. At the time we're doing this this has a great impact on our capital/<sup>gains</sup>situation, it gives greater incentive

to save, to invest. We are also really deeply into budget cuts. And the Budget cuts are going to really get federal spending, fiscal responsibility if you will, where we want it. Accompanying that we have monetary reform. Now in England they did not get the M3 under control. M3 over there continued to grow at a rate of 12 to 15%. Our money is going to stay under control. The deficits that we're projecting for '82 and '83 will be financed more out of private savings than out of printing of money or monetising our debts. We think that our programme is much more sensible, much more comprehensive, and with a greater degree of chance of success than the British experience.