

COVERING CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH



25 January 1983

Prime Minister

will reading before Mr. Bush's

visit.

A.F.C. 27.

Dear Sir,

Annual Review from HM Ambassador:
Washington

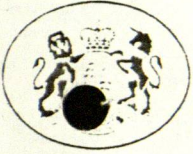
The Foreign and Commonwealth Secretary thinks the Prime Minister may be interested to see the enclosed copy of Sir Oliver Wright's Annual Review for 1982.

Yours ever

(R B Bone)
Private Secretary

A J Coles Esq
10 Downing Street

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UNITED STATES: ANNUAL REVIEW 1982

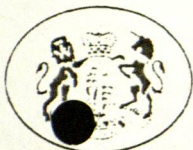
SUMMARY

1. Thanks to the Falklands factor, the reputation of Britain stands high in the US. But the US, a superpower with global interests, will seek to mend its fences with Latin America and go on voting for negotiations to settle the dispute (paragraphs 1-3).

2. The US economy has not so far responded to the President's medicine. Reaganomics was politically popular but its component parts are economically incompatible. The mid-term elections gave Mr Reagan a clear warning that his and the electorate's priorities are no longer the same (paragraphs 4-5).

3. A sea-change has therefore come over the political scene. The 98th Congress will be less disposed to do what the 40th President proposes. Soon the 1984 elections will start to cast their shadow. The main question is: will Reagan stand again? He has until the autumn to make up his mind: the people will tell him (paragraphs 6-9).

4. In foreign policy, the relationship between the US and its Allies over defence and economic issues will continue to dominate the scene. The pipeline dispute is symptomatic of a more fundamental divergence of view on the nature of relations with the Soviet Union. On defence matters, Americans find it extraordinary that Europeans devote so much energy to protesting



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against the United States, which is protecting them, and so little to demonstrating against the Soviet Union, which is threatening them (paragraphs 10-14).

5. In the wider sphere, the world recession is responsible for many other problems: protectionism, the anguish of the farmers, the inadequate defence performance of the weaker brethren. Shultz, the success story of the year, believes that the industrialised world should have economic expansion as its objective for 1983. This seems to be shaping up as the main item for the agenda for the Williamsburg Summit in May (paragraphs 15-18).

6. But the US remains obsessed with the superpower relationship. The nuclear freeze movement is different from European movements in that the US cannot opt out. The MX is in trouble. The idea of a Reagan-Andropov Summit is in the air, but the President is keeping his options open (paragraphs 19-21).

7. The visceral relationship (paragraph 22).



BRITISH EMBASSY,
WASHINGTON, D.C. 20008
TELEPHONE: (202) 462-1340

FROM THE AMBASSADOR

5 January 1983

The Right Honourable
Francis Pym MC MP
Secretary of State for Foreign
and Commonwealth Affairs
London SW1

Sir,

ANNUAL REVIEW

The Falklands Factor

1. For someone who only arrived here in the autumn, it is hard to believe that the Falklands crisis was the dominant issue, not only in Anglo/US relations, but also for the US public and media for much of the earlier part of this year. This was the first year since Suez, or perhaps Skybolt, that we faced a potential crisis in Anglo/US relations and the first time in recent memory that a British problem has so dominated public and press attention here. The issue has begun to fade from American minds. But it has left its mark.
2. The principal benefit is that the American view of Britain has changed. Americans had been tempted to lump us together with most of their other European Allies, as symbols of declining willingness or ability to exercise our national strength in defence

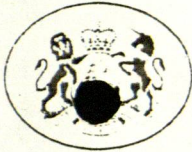
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of our interests. The single-minded response of Her Majesty's Government to the invasion of the Falklands, the skill and courage of Her Majesty's Forces and the nation's ability to translate resolve into results were a revelation to many Americans who still have fresh in their memories the disaster they suffered when they tried something on a much smaller scale in the desert of Iran two years ago. In this country nothing succeeds like success. At the start of my mission in Washington, I am the happy beneficiary of the fact that the reputations of Britain and of Her Majesty's Government stand high in the estimation of the US Administration and the American people.

3. At the same time, the Administration bent over backwards to preserve their relations with Latin America. They hesitated on the brink before giving us their unstinting, but not always unequivocal, support. They were with us when it mattered, in resistance to aggression; they are neutral on the question of sovereignty; and with their Civil War experience, they do not regard the principle of self-determination as absolute, even though they invented it themselves. These factors conditioned their vote at the General Assembly of the United Nations and are reminders that the United States is a superpower with global interests. As such, it will continue to seek to mend fences with Latin America and vote for negotiations to settle the underlying dispute.

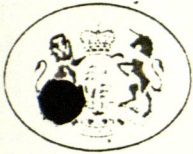


The Domestic Economy

4. Looking at the wider scene, 1982 has been a difficult year for the United States. The dominant problem has been the failure of the economy as yet to respond to the President's medicine in the way he hoped it would. The trouble with Reaganomics is that its component parts - tax cuts, increased defence spending and a balanced budget - were politically popular but are economically incompatible. There is pent-up demand and there is money to spend, but the customers are not, as yet, buying. The public are not yet disposed to blame the President for this, though some are starting to; and he can point to some real achievements, notably a reduction in the rate of inflation from 8.5% at the beginning of the year to 5% on the latest figures in December and a series of reductions in the prime rate from 16% to 11.5%. There are some signs that the drop in interest rates is beginning to stimulate such key sectors as the construction and automobile industries. And the behaviour of Wall Street suggests that investors are on their marks ready to go as soon as the economic indicators point convincingly in the right direction.

5. But there are as yet few signs that the first two instalments of the tax cut, which has contributed to record budget deficits, have produced a general stimulus to economic recovery. The size of the deficit did, however, force the

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long-term
interest
rates
remain
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size of the budget
deficit
makes it unlikely that they will fall.

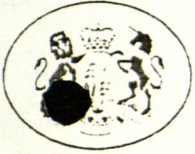


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President to accept a massive (\$98 bn) tax increase in mid-year. This went much against the grain of his philosophy. So did a \$5 bn job-creating programme financed by a 5¢ rise in the tax on petrol: the tax was called a "user fee" and the programme billed as improving the nation's road and bridge infrastructure. Thus was ideology reconciled with real life. The President will continue to resist cuts in defence expenditure, and will be extremely reluctant to accept further tax increases. Congress will not allow him to cut social expenditure. So far the American public accepts the President's argument that it would be wrong for the Administration to spend its way out of recession and high unemployment. Nevertheless, the electorate gave Mr Reagan a clear warning in the mid-term elections in November that his and their priorities were not the same: at 10.8% unemployment is at a post-War record and far higher among the young and the minorities. As one year-end commentator unhelpfully put it: the confusions in Congress and at the White House reflect the confusions in the public mind.

The Political Climate

6. In the past few weeks therefore a sea change has come over the political scene here. The final convulsions of the 97th Congress were but a preview of the forthcoming attractions of the 98th about to begin. The mid-term elections put 26 more Democrats in the House, and 81 new Congressmen altogether, most of

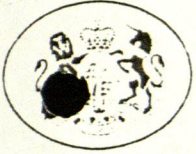


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them, be they Republican or Democrat, elected in a very different national mood from that which prevailed in 1980. Such is the absence of Party discipline here that most of these 81 are unknown quantities: the old hands simply do not know what the freshmen think or how they will vote. 1983 promises therefore more checks than balances between the two equal poles of United States Government: the 98th Congress will be less disposed to do what the 40th President proposes.

7. While something of a mid-term malaise is beginning to set in, Mr Reagan is not the man to lapse into the maudlin self-examination that characterised President Carter at a similar period. With his optimistic cast of mind and warm, ready smile, he still commands widespread trust and affection in the Sunbelt and Middle America ; though not as much as a year ago. He is not as Mr Carter was becoming at a similar period, a liability to his party, though by no means all Republicans sought his help on the mid-term hustings. He will, moreover, come under increasing pressure from within the Republican ranks, either to declare his determination to stand again in 1984 and thus to rally the party behind him or, failing that, to make clear that he plans to bow out.

8. I do not believe that Mr Reagan has yet made up his mind; nor does he need to do so until the autumn. He is fond of saying that the people will tell him what to do, ie if he



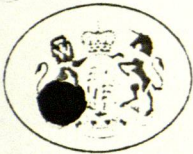
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retains public support he could well stand again, though he would by then be nearly 74. But he will find it increasingly hard to hold the line as some of the Republican hopefuls like Senator Dole and Congressman Kemp make their own ambitions increasingly public. Moreover for the first 18 months of his first term, he had his way with the Congress. From now on he won't; and it remains to be seen how much enthusiasm he retains for his job when so much of it will amount to a slogging match with the Congress, elected in a different mood from the one which sent him to the White House in 1980.

9. Senator Kennedy's decision not to seek the Democratic nomination has deprived the Republicans of their best hope of portraying the Democrats as old fashioned, irresponsible big spenders, and of a candidate they were looking forward to attacking on other grounds. The 1984 election campaign is not yet under way but it will be by the autumn and will increasingly dominate the actions of the Administration and of Congress in 1983. The Democrats have their own problems. Mondale and Glenn, the present frontrunners, represent differing tendencies within their party. Mondale is well organised; Glenn isn't. Neither is an inspiring candidate. And the Democrats have yet to offer a convincing alternative economic policy.

Good point.

Hart?

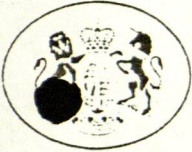


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The World Elsewhere

10. In foreign policy there is one issue that has occupied us in 1982 and that will preoccupy us no less in 1983, namely the relationship between the United States and its Allies both in the defence and economic spheres. Some of the wounds have been inflicted gratuitously, notably that caused by the President's policy on the Soviet pipeline. This wound would probably still be festering were it not for the subtle ministrations of Shultz, whose appointment to succeed Haig in mid-year has been one of the year's success stories. But the pipeline row was symptomatic of a more fundamental disagreement between the US and her Allies on the nature of relations with the Soviet Union, which has still to be resolved. The Americans expect the "studies" to be taken seriously.

11. US public and Congressional doubts about European willingness to match the US effort in Western defence are linked with the often heard contention that America's massive defence effort spares the Europeans and the Japanese from spending more of their own resources on their own defence, and in so doing frees European and Japanese budgets to be spent on the subsidisation of their domestic industries and their exports to the United States. Absurdly over-simplified as the argument is, one can hear it expressed by liberal Democrats and conservative Republicans alike.



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12. The emotional currents feeding protectionism come from many directions: the impenetrability of the Japanese import market; the absurdities of the CAP; recent French protectionist measures; European subsidies to industry and so forth. The UK's firmness in resisting protectionist demands is appreciated and the UK regarded, with Germany, as a positive influence in this regard. The Americans gave the recent GATT Ministerial poor grades but excluded the Germans and ourselves from the general opprobrium. Our own self-discipline on steel is also understood, but tends to be discounted by the failure of the Community as a whole to match it.

13. It may seem fanciful to draw a connecting line between "peace" demonstrations at Greenham Common and the protectionist mood in the United States, but insofar as the anti-nuclear movement in Europe is nourished by anti-American sentiment, it fuels the growing public feeling here that the US must look to its own interests. Even those opposed to President Regan's policies find it extraordinary that quite so many Europeans should devote so much energy to protesting against the United States, which is protecting them, and so little to demonstrating against the Soviet Union, which is threatening them.

14. For all its occasional ineptitude this is an Atlanticist Administration. Henry Kissinger, with characteristic hyperbole, suggested that it might be the last of its kind. Kissinger, while always interesting, is not always right. All senior



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members of the Administration and most responsible Congressmen to whom I have spoken are acutely aware of the dangers. But it is symptomatic of the political trend that a recent call from a Senate Sub-Committee for a cut in the US military commitment to Europe generated enough Congressional support to force the Administration to a compromise; and that a life-long freetrader, like former Vice-President Mondale, should now be flirting publicly with protectionism as he launches his bid for the Democratic Presidential nomination.

The Prospect before us

15. Of course, many of our present miseries are due to the worldwide recession and the over-commitment of the commercial banking system to impoverished debtors. A pick-up in the world economy would do wonders both for resisting protectionist pressures, cheering up the farmers and meeting defence commitments. Hence George Shultz' belief that the industrialised world ought to have economic expansion as its objective for 1983. The US economy has a key role to play in this and Shultz' own forecasts tend to be more bullish than the statistics warrant. But as Harold Macmillan once remarked, statistics are about as much use as a guide to economic policy as looking up tomorrow's train in last year's Bradshaw.

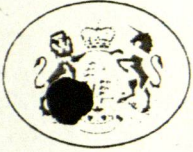
16. Lest I should give the impression that a bleak 1982 is giving way to a grim 1983, I do not believe that the problems



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which will affect us most closely - namely the state of the world economy and the risks associated with American disillusionment with the allies - yet register more than about three on the Richter scale. And there are some brighter spots. The change of government in Germany has changed the whole tone of US/German relations. Atmospheric matters a lot here and the semi-public running battles with Schmidt and Apel were having a progressively unsettling effect. No less important has been the impact on US foreign policy of the appointment of Shultz to succeed Haig. Shultz has not only brought a balanced temperament to the conduct of foreign policy, but a capacity to see the world clearly and to see it whole. This in turn has brought relations between the State Department and the White House to a level of harmonious cooperation unknown for a decade or more.

17. With Shultz, primacy in the formulation and execution of foreign policy seems to have been restored to the State Department, though the decisions, under the American system, are for the President alone. At the White House, Judge Clark, as National Security Adviser, has no pretensions to knowledge of foreign policy. As one wag put it, Clark is "living proof that still waters can run shallow". Shultz has also had a major impact on policy, particularly the Siberian pipeline dispute and in the formulation of the President's policy statement on the Middle East.



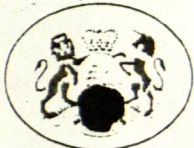
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18. That statement and the President's politically courageous decision subsequently to send US Marines to the Lebanon reflect both Mr Reagan's strength and his weakness.

The weakness is that, in foreign policy at least, he is only as good as his advisers. Had Haig remained Secretary of State, the change we have seen in Middle East policy would never have happened. Had Haig not been Secretary of State we might not have had the pipeline dispute. Reagan's strength is that he is not afraid to make policy changes and that he is not frightened of taking decisions. The main problems for the President and Shultz in 1983 will be to turn their initiatives into successes and get the world economy moving. The latter seems to be shaping up as the main item for the Williamsburg Summit.

The Superpowers

19. The real foreign policy obsession remains the Soviet Union. Through much of 1982, the relationship remained frozen partly because of uncertainty about how long Brezhnev might last and what might follow him. The answer was probably always that as to substance it would be more of the same. But with the succession of Andropov, Americans now perceive at least some signs in Moscow of a change of style. The Administration have not yet quite made up their minds how to react to this. The despatch of Vice-President Bush and Shultz, but not the President, to Moscow for Brezhnev's funeral was an indication that they wanted to make a gesture but not an exaggerated

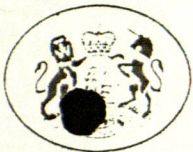


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one. There will now be probing to see how much scope there is for making progress. In general, we should expect no sudden breakthrough but, with Shultz, a steadier and more systematic approach. As the year ends, the idea of a Reagan-Andropov summit is in the air; the President is keeping his options open and insisting that, if it happens, it must have some prospect of producing results.

20. A more systematic approach and proper preparation will be needed in an Administration which has often been quick off the mark with unhelpful rhetoric and slow to seize the political advantage in presenting its policies on East/West relations and disarmament and has thereby unwittingly fuelled the "peace" movement. The nuclear freeze movement in the United States is different in character from that in Europe. There is little scope for unilateralism here. The United States as a superpower cannot hope to opt out. But there is the same concern at the ever increasing demands for defence expenditure in a time of general economic difficulty; and at the apparently indefinite accumulation of nuclear warheads.

21. The decision to cut funding for MX production reflected not only a lack of conviction about the viability of the dense pack basing mode, but also quite simply a determination to make cuts. A bi-partisan commission of the Great and the Good has been appointed to resolve the accuracy/invulnerability dilemma, and to look at the wider question of nuclear deterrence and to report by mid-February. It is difficult to predict the

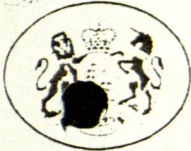


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future of MX. While pondering the matter I happened to be reading George Ball's memoirs: "The Past has another Pattern". Discussing the ill-fated Multilateral Nuclear Force of the early 60s he wrote: "once a project assumes the attributes of the grotesque it will never succeed." for, he goes on "the American people still possess a sufficient residue of commonsense to recognise the ridiculous when they see it." George Ball himself draws a parallel with MX and its railways in the desert basing mode. Today we have dense pack and the concept of fratricide. Does that also have "the attributes of the grotesque"? We shall see. Steadiness will be required on both sides of the Atlantic in the coming months if Western public opinion is not to do too much of the Russians' work for them and if, in the absence of a satisfactory outcome in the Geneva negotiations, INF deployment is to proceed. I have no doubt that Shultz' influence will be beneficial; the Americans count no less upon our own.

Envoi

22. I end, as I began, with the Falklands. My predecessor recorded that one US Senator said to him that, if we imagined that US support for Britain during the Falklands war had anything to do with the issue of principle at stake, we were mistaken. If it had been the territory of almost any other country that had been invaded, this would hardly have registered



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as a blip on US screens. The reason the American public, Congress and the Administration had rallied to our support was because it was Britain that was under attack and that, tetchy as our relationship might sometimes be, we had been able to count on a visceral feeling that America could not afford to let us down. The conventional wisdom is that it is indiscreet to talk about the special relationship. But if the relationship, as described by that Senator, is not special, what is?

23. I am sending copies of this despatch to the Chancellor of the Exchequer, the Secretary of State for Defence and the Secretary of State for Trade; to HM Ambassadors in NATO posts, Dublin and Moscow and to HM Representatives to the United Nations in New York and the European Community in Brussels.

I have the honour to be

Sir

Your obedient Servant

A handwritten signature in cursive script, appearing to read 'Oliver Wright', with a long horizontal flourish extending to the right.

Oliver Wright

225 JAN 1983

