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Chancellor of the Duchy of Lancaster

Prime Minister

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PRIME MINISTER

1. May I draw attention to the following:

The United States

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1. Has a massive budget deficit - currently estimated at \$170 billion to \$179 billion or well over £100 billion;

2. Has very high rates of interest.

Nevertheless

1. The US economy is recovering very rapidly: growth by Q4 1983 more than double that in the UK - 5½% compared with 2½% in the UK.

2. Unemployment lower - 10% compared with 13.7% in the UK. Increase since 1979 much less than in the UK.

3. Inflation lower - 3.5% compared with 3.7%.

2. We have always taken the view that a high deficit means high interest rates. The President has challenged this view. Official discussions have been inconclusive. There is another strand of thought suggested by the current performance of the American economy. It may well be that what really matters is not so much the size of the deficit - or the PSBR - but its composition. That a deficit due to a high level of expenditure is damaging. But a deficit due to a low level of taxation may not be. The difference lies in the fact that in the first case Government expenditure is pre-empting an increasing share of the national resources. While in the second case it is the private sector which is given the opportunity and impetus to expand. If this thesis is true it would go a long way to explain the apparent irrational policy the President is pursuing and the even more irrational success it is achieving.

Similar to renewed inflation?

3. The implications for our own policy are profound. I do not propose raising the matter in our discussion on public expenditure tomorrow. It might well confuse the argument - even though in fact it powerfully supports the case for reducing expenditure. Nevertheless we shall need to return to the matter before the Budget strategy is settled. And as getting the economy moving is of the essence in relation to unemployment it is relevant also to the Chequers discussions.

A.C.

COCKFIELD

20 July 1983

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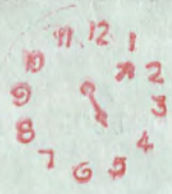
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