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FM WASHINGTON 292000Z MAY 84

TO PRIORITY FCO

TELEGRAM NUMBER 1659 OF 29 MAY

SECRETARY OF STATE'S BILATERALS WITH REGAN AND LAROSIERE

SECRETARY REGAN

1. THE SECRETARY OF STATE'S BILATERAL WITH TREASURY SECRETARY REGAN PROVIDED AN OPPORTUNITY TO REVIEW THE PROSPECTS FOR THE LONDON SUMMIT, DISCUSS THE INTERNATIONAL DEBT SITUATION, RECEIVE AN ORAL REPORT ON US EFFORTS TO LIBERALISE JAPANESE CAPITAL MARKETS, DISCUSS THE PROSPECTS FOR INTEREST RATES AND THE US BUDGET DEFICIT AND TO DISCUSS UNITARY TAXATION. REGAN WAS SUPPORTED BY MCNAMAR, SPRINKEL AND MULFORD.

LONDON ECONOMIC SUMMIT

2. SECRETARY REGAN SAID THAT THE ADMINISTRATION WAS BASICALLY CONTENT WITH THE DRAFT COMMUNIQUE FOR THE LONDON ECONOMIC SUMMIT, BUT THAT HE THOUGHT A FEW CHANGES WERE DESIRABLE. IN PARTICULAR, HE WOULD WISH CHANGES TO BE MADE TO THE WORDING SUGGESTED BY THE FRENCH ON THE URGENCY OF THE FOLLOW-UP TO THE G10 STUDIES ON THE OPERATION OF THE INTERNATIONAL MONETARY SYSTEM AND TO THE QUOTE NORTH-SOUTH UNQUOTE REFERENCES IN THE COMMUNIQUE IN VIEW OF THE NEED NOT TO REVIVE INTEREST IN GLOBAL NEGOTIATIONS.

INTERNATIONAL DEBT

3. IN A DISCUSSION OF INTERNATIONAL DEBT, WHICH REGAN THOUGHT WOULD BE ONE OF THE MAIN THEMES OF THE SUMMIT, HE SAID HE DID NOT BELIEVE THAT THE FORMATION OF AN ACTIVE DEBTORS' CARTEL AND THE DECLARATION OF MORATORIA WAS AN IMMINENT THREAT, ALTHOUGH HE THOUGHT IT COULD BECOME ONE IF INTEREST RATES CONTINUED TO RISE. HE BELIEVED THAT SOME DEBTOR NATIONS WERE TALKING TOUGH AT PRESENT BECAUSE THEY THOUGHT THIS WOULD LEAD TO PRESSURE BEING PUT ON THE US AT THE LONDON SUMMIT TO GIVE THEM MORE FAVOURABLE TREATMENT, AND TO BRING DOWN US INTEREST RATES. SECRETARY REGAN POINTED OUT THAT A RISE IN THE PRICE OF OIL WOULD SERIOUSLY DAMAGE THE PROSPECTS OF MOST LDCS FOR REPAYING THEIR DEBTS.

INTEREST RATES

4. ON THE PROSPECTS FOR INTEREST RATES, SECRETARY REGAN SAID THAT THE STRONG RISE IN THE US ECONOMY HAD LED THE FED - WHICH FEARED A REVIVAL OF INFLATION - TO RESTRAIN THE GROWTH OF THE MONEY SUPPLY. THIS RESTRAINT WOULD NOW BE LESS THAN IT WOULD BE OTHERWISE BECAUSE OF THE DIFFICULTIES EXPERIENCED BY THE CONTINENTAL BANK OF ILLINOIS. HE DID NOT SHARE THE FED'S INFLATIONARY FEARS. THE PROSPECTS FOR DEALING WITH THE US BUDGET DEFICIT WERE GOOD. A DEFICIT

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OF DOLLARS 170 BN WAS THE MOST EXPECTED FOR FY84. BY FY85 THE DEFICIT COULD BE AS LOW AS DOLLARS 145 BN, WHICH WOULD ONLY AMOUNT TO 3 PER CENT OF GNP. THIS WAS ASSUMING THAT THE DOWN-PAYMENT PACKAGE WOULD CLEAR THE CONGRESS, WHICH NOW SEEMED VIRTUALLY CERTAIN. OVER AND ABOVE THIS, SECRETARY REGAN CLAIMED THAT THE PRESIDENT WAS COMMITTED TO TAKING FURTHER DEFICIT-REDUCING ACTION IN THE PERIOD BEYOND THE ELECTIONS.

UNITARY TAX

5. ON UNITARY TAX, SECRETARY REGAN SAID THAT THE INTENTION WAS TO GET THE REPORT OF HIS WORKING GROUP ON UNITARY TAXATION TO THE PRESIDENT THIS WEEK AND FOR THE PRESIDENT TO PUBLISH A STATEMENT ON 1 JUNE. HE SAID THAT ANY STATES THAT REFUSED TO SIGN THE REPORT WOULD BE THREATENED WITH PREEMPTIVE FEDERAL LEGISLATION IN 1985, AND THAT COMPANIES THAT TRY TO BLOCK WATER'S EDGE LEGISLATION AT STATE LEVEL WOULD ALSO BE THREATENED WITH SUCH LEGISLATION. HE WAS ANXIOUS THAT WE SHOULD COMMENT ON THE DRAFT FLORIDA LEGISLATION THAT GOVERNOR GRAHAM OF FLORIDA WOULD SEND TO THE EMBASSY, AND IMPLIED THAT PROGRESS ON UNITARY TAX WOULD COME FIRST IN FLORIDA RATHER THAN IN CALIFORNIA WHERE REVENUE CONSTRAINTS WERE VERY TIGHT BECAUSE OF PROPOSITION 13. SECRETARY REGAN WAS AMBIGUOUS ABOUT WHETHER A PRESIDENTIAL STATEMENT WOULD CONTAIN A REFERENCE TO THE THREAT OF PREEMPTIVE FEDERAL LEGISLATION IN 1985 IF NO PROGRESS WAS MADE AT STATE LEVEL, BUT NONETHELESS SUCH A THREAT SEEMED TO BE THE ADMINISTRATION'S MAIN MEANS OF SECURING THE IMPLEMENTATION OF A SATISFACTORY SOLUTION.

JAPANESE CAPITAL MARKETS

6. THE US TREASURY TEAM WAS CLEARLY VERY PLEASED ABOUT THE OUTCOME OF THE NEGOTIATIONS WITH THE JAPANESE ON OPENING UP JAPANESE CAPITAL MARKETS, AND LOOKED FORWARD TO THE FORMATION OF AN ACTIVE EURO-YEN MARKET. (THE DETAILS OF THIS WILL BE REPORTED IN A SEPARATE TELEGRAM.)

THE MANAGING DIRECTOR OF THE IMF

7. THE MD DID NOT BELIEVE THAT DEVELOPMENTS IN THE WORLD ECONOMY WERE AS BAD AS SOME DEPICTED. SO FAR THE LDC DEBTORS HAD BENEFITED MORE FROM A RECOVERY IN THEIR EXPORTS THAN THEY HAD LOST THROUGH HIGHER INTEREST RATES. FURTHER RISES IN INTEREST RATES COULD TILT THE BALANCE AGAINST THE LDCS. HE DID NOT FAVOUR INTEREST RATE CAPPING DEVICES. THE PRIORITY SHOULD BE TO SUPPORT, IN A PRACTICAL FASHION, THOSE DEBTORS WHICH WERE UNDERTAKING SUCCESSFUL ADJUSTMENT. MEXICO WAS THE CASE IN POINT. HIS PREFERRED COURSE WAS FOR THE CREDITORS TO REPLACE THE PRESENT UNSATISFACTORY ANNUAL RESCHEDULINGS WITH MULTI-YEAR RESCHEDULINGS, COVERING PERHAPS FOUR YEARS. THIS WOULD HELP DEAL WITH THE BUNCHING OF AMORTISATIONS. BRAZIL COULD BE THE SECOND CANDIDATE FOR SUCH TREATMENT. IF THE MEXICAN AND BRAZILIAN DEBT PROBLEMS COULD BE DEALT WITH IN THIS WAY, ANY DIFFICULTIES CAUSED BY ARGENTINA COULD BE CONTAINED EVEN IF THAT COUNTRY DID NOT AGREE TO A SATISFACTORY IMF PROGRAMME.

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8. THE MANAGING DIRECTOR HOPED THAT THE ECONOMIC SUMMIT COULD ACHIEVE THREE RESULTS. FIRST, IT SHOULD SET OUT A STRATEGY FOR OPENING UP TRADE BARRIERS AS QUICKLY AS POSSIBLE, PARTICULARLY IN A WAY WHICH BENEFITED THE LDCS. SECOND, IT SHOULD ESTABLISH A STRATEGY FOR MULTI-YEAR RESCHEDULING OF DEBT SO THAT THIS APPROACH COULD ASSIST MEXICO, BEFORE THE END OF THE SUMMER. FINALLY, THE SUMMIT SHOULD GIVE THE UNITED STATES ADMINISTRATION A STRONG WARNING THAT IT SHOULD QUICKLY CORRECT ITS BUDGET DEFICIT. THE WORLD COULD NOT EXPECT THE LDCS TO PUT THEIR OWN ECONOMIES IN ORDER WHEN THE US ECONOMY WAS NOT.

9. FCO PLEASE PASS TO PS/CHANCELLOR, LITTLER AND BOTTRILL (HM TREASURY) AND TO TAIT (ERD).

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