

ADVANCE COPY

IMMEDIATE

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MR POWELL No.10  
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MR LAVELLE }  
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MR HATFIELD }  
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CONFIDENTIAL

FM WASHINGTON 140626Z FEB 85

TO IMMEDIATE F C O

TELEGRAM NUMBER 511 OF 13 FEBRUARY

INFO SAVING C G NEW YORK, UKREP BRUSSELS, BONN, PARIS.

M.I.P.T.: (NOT TO ALL): PRIME MINISTER'S VISIT - ECONOMIC ASPECTS

1. FEW HERE IN WASHINGTON QUESTION THAT IN HIS FIRST TERM THE PRESIDENT WROUGHT AN ECONOMIC MIRACLE. EVEN THE DEMOCRATS CANNOT GAINSAY THE ANNUS MIRABILIS OF 1984 WHEN AT 6.8 PERCENT ECONOMIC GROWTH WAS THE FASTEST SINCE 1951 (AND THE FIGURES ARE LIKELY TO BE REVISED UPWARDS, FOR GROWTH IN THE LAST QUARTER WAS ABOVE THE ORIGINAL 3.9 PERCENT ESTIMATE), AND INFLATION, AT 4 PERCENT, HAD BEEN KEPT LOW FOR FOUR CONSECUTIVE YEARS - TWO FACTORS WHICH MATERIALLY HELPED TO DELIVER A MASSIVE PRESIDENTIAL ELECTION VICTORY. THE ADMINISTRATION BELIEVE THAT THE ECONOMY IS SET FAIR THROUGH 1985.

2. TRUE, THERE IS A LOT OF TALK ABOUT THE PERILS OF THE BUDGET AND TRADE DEFICITS. BUT THERE IS NO SENSE IN THE ADMINISTRATION'S TOP ECHELONS OF EMERGING CRISIS OR NEED FOR URGENT ACTION. THE PERILS, IF PERILS THEY BE - AND SOME INFLUENTIAL VOICES EVEN DISPUTE THAT - ARE THOUGHT TO ARISE ONLY IN THE MEDIUM TERM. THUS, NISKANEN, MEMBER OF THE COUNCIL OF ECONOMIC ADVISERS, LIKENS THE BUDGET DEFICIT TO QUOTE A SLOW-ACTING BUT POTENTIALLY LETHAL CANCER UNQUOTE. EVEN THE ORTHODOX CONGRESSIONAL BUDGET OFFICE COUCHES ITS WARNINGS IN TERMS OF QUOTE THE LONG RUN CONSEQUENCES OF SUSTAINED DEFICITS UNQUOTE WHERE THE LONG RUN MEANS QUOTE INTO THE NEXT DECADE UNQUOTE. TRUE TO FORM, VOLCKER IS STILL PUBLICLY MAINTAINING THE CALL FOR EARLY ACTION, THOUGH HE HAD ADMITTED TO ME PRIVATELY THAT HE DOES NOT THINK HIS WARNINGS HAVE MUCH IMPACT.

3. THE CURRENT STRENGTH OF THE DOLLAR DOES NOW GIVE RISE TO SOME CONCERN IN THE ADMINISTRATION, BUT NOT, APPARENTLY, TO THE EXTENT OF STIMULATING REMEDIAL ACTION. ITS RISE IS ASCRIBED TO THE BELIEF THAT UNITED STATES ECONOMY OFFERS INVESTORS A SAFE AND PROFITABLE HAVEN, OR AS MCNAMAR WOULD HAVE IT QUOTE THE BEST AFTER TAX RETURN AND THE LEAST SOVEREIGN RISK UNQUOTE. EQUALLY THE SLUMP IN THE EUROPEAN CURRENCIES IS, TO A LARGE EXTENT, SEEN IN THE ADMINISTRATION AS A REFLECTION OF THE WEAKNESS OF THE EUROPEAN ECONOMY.



ATION AS A REFLECTION OF THE WEAKNESS OF THE EUROPEAN ECONOMIES, FLOWING FROM OVER-UNIONISATION, MARKET RIGIDITIES, AND LACK OF OPPORTUNITY FOR ENTREPRENEURIAL TALENT. (THEY HAVE A DIFFERENT EXPLANATION FOR THE WEAKNESS OF THE YEN EXCHANGE). INSTEAD OF GRUMBLING ON ABOUT THE DOLLAR, THE ADMINISTRATION BELIEVE THAT WE SHOULD BE GRATEFUL FOR THE OPPORTUNITIES WHICH THEIR TRADE DEFICIT AFFORDS OUR EXPORTERS. THERE IS AN INCLINATION TO REGARD ANY CRITICISM AS WHINGING AND WHINGING WON'T WORK IN THE EBULLIENT WASHINGTON OF 1985. IN ANY CASE, THEY SUSPECT THAT IF THE DOLLAR FELL WE SHOULD FIND OTHER THINGS TO COMPLAIN ABOUT: INCREASED COMPETITION FROM U.S. EXPORTS, E.G.

4. CERTAINLY THE HIGH DOLLAR AND HIGH REAL INTEREST RATES ARE PUSHING MANY FARMERS, AND THEIR LOCAL BANKS, INTO DEEP TROUBLE. AND THE SAME IS HAPPENING TO THOSE OTHER PARTS OF THE AMERICAN ECONOMY FACING FOREIGN COMPETITION. BUT THE ADMINISTRATION DEALS WITH THESE INDUSTRIES' PROBLEMS BY PROGRAMMES DIRECTED TO THEIR PARTICULAR NEEDS, SUCH AS HELP TO FARMERS STRUGGLING WITH INDEBTEDNESS (WHILE TRYING TO REDUCE FARM SUPPORT GENERALLY) AND EVEN SPECIFIC MEASURES OF PROTECTION (E.G. STEEL AND TEXTILES) RATHER THAN BY AN EARLY CHANGE IN OVERALL ECONOMIC POLICIES WHICH WOULD ENABLE INTEREST RATES AND THE DOLLAR TO COME DOWN.

5. SO THE PRIME MINISTER WILL BE GREETED BY AN ADMINISTRATION SATISFIED WITH ITS PAST ECONOMIC SUCCESSSES, CONFIDENT IN ITS PRESENT POLICIES, AND OPTIMISTIC ABOUT FUTURE SUCCESS.

6. THE PRIME MINISTER'S APPROACH IN ANY DISCUSSION WITH THE PRESIDENT AND SECRETARY BAKER ABOUT THE TURBULENCE IN THE EXCHANGE MARKETS WILL NEED TO BE JUDGED IN THE LIGHT OF UP-TO-DATE MARKET EVENTS.

7. MORE GENERALLY, I SUGGEST THAT, WHILE RECOGNISING THE IMPRESSIVE AMERICAN ECONOMIC PERFORMANCE, AND ITS ROLE IN STIMULATING EUROPEAN GROWTH, AND ENABLING THE INTERNATIONAL BANKING SYSTEM TO MANAGE 3RD WORLD DEBT, SHE SHOULD SEEK TO REINFORCE AND QUICKEN THE PRESIDENT'S RESOLVE IN DEALING WITH THE BUDGET DEFICIT. THE PRIME MINISTER MIGHT POINT TO THE DANGERS OF PROTECTIONISM, ARISING FROM THE TRADE DEFICIT: AND THE RISK TO THE ECONOMY OF THE FREE WORLD IF THEY WERE NOT SUCCESSFULLY RESISTED. VOLCKER TOLD ME LAST NIGHT THAT HE TAKES VERY SERIOUSLY THE THREAT OF AN IMPORT SURCHARGE (IN TRUTH, A TAX ON IMPORTS), WHICH I WARNED ABOUT IN MY TELNO 414. IT IS ALWAYS BETTER HERE TO ACCENTUATE THE POSITIVE: WE SHOULD KEEP THE ADMINISTRATION COMMITTED TO A NEW G.A.T.T. ROUND AS THE BEST METHOD OF STAVING OFF PROTECTIONIST MEASURES.

8. BEYOND THIS, THE HIGH DOLLAR, AS WELL AS BRINGING ENORMOUS PROBLEMS FOR THE PRESIDENT'S ALLIES IN THE MANAGEMENT OF THEIR OWN ECONOMIES, WILL BRING A SUBSTANTIAL PENALTY IN THE LONGER TERM FOR THE UNITED STATES. SHE MIGHT POINT OUT THAT THE U.S. ECONOMY IS INCREASINGLY BEING KEPT AFLOAT ONLY BY CURRENCY INFLOWS FROM ABROAD, FINANCING THE U.S. DOLLARS 100 BN CURRENT ACCOUNT DEFICIT. HOW LONG WILL THE FINANCIAL MARKETS BE WILLING TO OBLIGE - AND AT WHAT COST IN INTEREST RATES? IT WOULD BE A TRAGEDY IF THE PRESIDENT, WHO HAS DONE SO MUCH TO RESTORE HIS COUNTRY'S, AND THE ALLIANCE'S, MILITARY SECURITY, WERE TO GO DOWN IN THE HISTORY BOOKS AS THE PRESIDENT WHO HAD UNDERMINED HIS COUNTRY'S ECONOMIC SECURITY BY PUTTING THE UNITED STATES INTO HOCK WITH THE REST OF THE WORLD.

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AS THE PRESIDENT WHO HAD UNDERMINED HIS COUNTRY'S ECONOMIC SECURITY BY PUTTING THE UNITED STATES INTO HOCK WITH THE REST OF THE WORLD.

9. I BELIEVE THAT SUCH AN APPROACH WOULD PROVIDE THE FRAMEWORK IN WHICH THE PRIME MINISTER COULD MAKE, AT THE VARIOUS MEETINGS, THE POINTS ON PROTECTIONISM AND OTHER TRADE AND ECONOMIC ISSUES IN MY TELNO 414. SHE MIGHT INVITE THE PRESIDENT TO WORK TOGETHER TO STRENGTHEN FREE TRADE. MOVES TO INCREASE PROTECTION, SUCH AS THE CONSULTATIONS WITH THE E.C. ON SEMI-FINISHED STEEL, WHICH THE U.S. HAVE DEMANDED, AND THE NEW TEXTILE ORIGIN RULES WHICH ARE PUNITIVE TO HONG KONG, ARE HARDLY COMPATIBLE WITH THIS.

10. IT IS PERHAPS A LITTLE SANGUINE TO BELIEVE THAT WE CAN BRING AN EARLY SHIFT IN U.S. ECONOMIC PRIORITIES. BUT I HOPE THE PRIME MINISTER WILL TAKE THIS OPPORTUNITY TO BRING HOME TO THE PRESIDENT, AS ONLY SHE CAN, THE LIKELY ECONOMIC AND POLITICAL CONSEQUENCES, FOR THE UNITED STATES AND ITS ALLIES, OF THIS ECONOMY'S GROWING DEBT. WITHDRAWAL FROM ANY DEPENDENCY ALWAYS REQUIRES DIFFICULT DECISIONS. BUT IF THE UNITED STATES ECONOMY REALLY BECOMES HOOKED, THE PROSPECTS ARE DIRE. IT WOULD, I SUGGEST, BE BETTER TO EXPRESS CONCERN ABOUT THE EFFECTS ON AMERICA THAN ABOUT THE DEFICIT'S CONSEQUENCES FOR US, AND AMERICA'S OTHER TRADING PARTNERS. FOR THE LATTER COULD BE CONSTRUED AS WHINGEING, AND COULD PROVOKE REMINDERS THAT THE U.S. HAS IN THE LAST 3 YEARS FULFILLED ITS TRADITIONAL ROLE AS MOTOR OF THE FREE WORLD'S ECONOMIES. WE CAN ACKNOWLEDGE THAT IT HAS PLAYED THIS ROLE: WHILE WARNING THAT THE FUTURE LOOKS LESS ROSY. AND WE CAN ALSO REMIND THE PRESIDENT OF THE BENEFITS WE HAVE GAINED FROM THE TOUGH MEASURES OF THE 1981 U.K. BUDGET.

11. IN ADDITION, I STRONGLY RECOMMEND THAT, IN CONTACTS WITH THE ADMINISTRATION AND ON THE HILL, AND IN PRESS AND TELEVISION INTERVIEWS, THE PRIME MINISTER SET LONDON'S RECENT FINANCIAL TURBULENCE IN ITS PROPER LONGER TERM CONTEXT. SCARGILL AND THE DOLLAR ARE THE CURRENT FLAVOURS OF THE MONTH AND AS A RESULT OUR RECORD ON GROWTH, INFLATION, AND - NOT LEAST - BORROWING NOW GETS LESS ATTENTION HERE THAN IT DESERVES. IT WOULD DO MUCH GOOD - IF THE PRIME MINISTER COMES WITH A CONFIDENT MESSAGE ON THE FUTURE OF BRITAIN. AMERICANS ADHIRE SUCCESS AND SELF-CONFIDENCE, SO A LITTLE PRIDE IN OUR ACHIEVEMENTS, WHICH ARE MANY, WILL GO DOWN WELL HERE, AT THE WHITE HOUSE ON THE HILL AND WITH THE MEDIA.

12. ADVANCE COPIES TO POWELL (NO. 10): PS/S OF S, PS/PUS, BRAITHWAITE, MARSHALL (NAD), FCO: PS/S OF S, MOD: PS/CHANCELLOR, LITTLER, LAVELLE, (HM TREASURY): PS/S OF S, DTI: HADFIELD, CARTLEDGE (CABINET OFFICE).

F.C.O. PASS SAVING: UKREP BRUSSELS, BONN, PARIS.

WRIGHT

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