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FM WASHINGTON 192200Z DEC 84  
TO IMMEDIATE BEKING  
TELEGRAM NUMBER 14 OF 19 DECEMBER  
INFO IMMEDIATE HONG KONG, FCC

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FOLLOWING FOR THE PRIME MINISTER AND SECRETARY OF STATE'S PARTIES

MART: PRIME MINISTER'S MEETING WITH THE PRESIDENT AT CAMP DAVID;  
22 DECEMBER; ECONOMIC ISSUES

1. OF THE ECONOMIC ISSUES, THE BUDGET DEFICIT HAS BEEN VERY MUCH TO THE FORE IN RECENT DAYS. THE BROAD PICTURE IS THAT THE PRESIDENT HAS TO PRESENT HIS BUDGET TO CONGRESS BY THE END OF JANUARY. HE WILL GET IT BACK SOMETIME IN THE LATE SUMMER. WHETHER IT WILL BEAR MUCH RESEMBLANCE TO THE BUDGET HE SENT FORWARD IN THE FIRST PLACE, IS ANYONE'S GUESS. MY GUESS IS THAT IT WON'T, BUT THAT IT WILL ADDRESS THE DEFICIT, BUT PERHAPS NOT AS ENERGETICALLY AS WE WOULD LIKE.

2. THE NEW FACTOR IS THAT EVERYONE, PRESIDENT, CABINET, OFFICIALS, BOTH HOUSES AND BOTH SIDES OF CONGRESS AGREE THAT SOMETHING MUST BE DONE TO GET THE DEFICIT DOWN. THE TIME BETWEEN NOW AND END-JANUARY WILL BE SPENT IN MUCH TACTICAL MANOEUVRING WITHIN THE ADMINISTRATION; AND AFTER JANUARY, BETWEEN BOTH HOUSES AND BOTH PARTIES WITHIN EACH HOUSE. THE DEBATE WILL BE NOISY AND CONFUSING. DEFENCE SPENDING IS THE MOST CONTENTIOUS ITEM AND, PERHAPS FOR TACTICAL REASONS (BECAUSE HE CALCULATES CONGRESS WILL CUT IT ANYWAY), THE PRESIDENT SEEMS TO BE LEANING MORE TOWARDS WEINBERGER THAN TOWARDS HIS BUDGET ADVISERS. (THEY SOUGHT CUTS OF DOLLARS 8BN DOLLARS 20B, AND DOLLARS 30B IN FY 86/8; HE HAS OFFERED THE FULL AMOUNT IN FY86, BUT WITH THE SAVINGS TO COME FROM CREATIVE ACCOUNTING RATHER THAN PROCUREMENT CUTS, AND ONLY DOLLARS 9B AND DOLLARS 10B IN THE 2 LATER YEARS.) ALL THIS WILL TAKE MANY MONTHS TO SORT OUT. THE MAIN POINT WHICH IT SEEMS TO ME WE HAVE TO FOCUS ON IS THE NEED, FOR THE SAKE OF THE HEALTH OF THE FREE WORLD ECONOMY AS WELL AS THAT OF THE US, TO CARRY DEFICIT-CUTTING THROUGH TO THE END. I DON'T SEE THAT IT MATTERS TO US (NEXT WORD UNDERLINED) HOW THE DEFICIT IS CUT AS LONG AS IT IS CUT. THE PRESIDENT'S PLACE IN HISTORY WILL BE DETERMINED NOT ONLY BY WHETHER HE LEAVES AMERICA AND THE WORLD AT PEACE, BUT ALSO IN PART, BY THE SHAPE IN WHICH HE LEAVES THE US, AND THE WORLD'S ECONOMY.

3. THE OTHER MAIN ECONOMIC ISSUE, THE TRADE DEFICIT, SEEMS TO ME, IF ANYTHING, LIKELY TO BE EVEN MORE TROUBLESOME. THE STRENGTH OF THE DOLLAR IS CRIPPLING SOME OF THE WEAKER US INDUSTRIES AS INDEED THE STRENGTH OF THE POUND HURT BRITISH INDUSTRIES 4 YEARS OR SO AGO. PROTECTIONIST FORCES ARE THEREFORE ON THE INCREASE HERE, AND THE POSSIBLE CONJUNCTION IN 1995 OF A LOWER ECONOMIC GROWTH RATE WITH A CONTINUING STRONG DOLLAR IS SET TO BOOST THEM FURTHER. THE IDEA OF AN IMPORT SURCHARGE AS A WAY OF ATTACKING BOTH FISCAL AND TRADE DEFICITS HAS BEEN GAINING GROUND IN BUSINESS AND CONGRESSIONAL CIRCLES.

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4. WHILE THE ADMINISTRATION'S INSTINCTS REMAIN STRONGLY FREE TRADE, THEY HAVE FELT IT NECESSARY TO STRIKE A TOUGH POSITION RECENTLY IN INTERNATIONAL FORA. WITH A MAJOR REDUCTION IN US BUDGETARY SUPPORT FOR FARMERS IN PROSPECT, WE CAN EXPECT A FURTHER OUTBREAK OF HOSTILITIES OVER THE CAP AND MORE AGGRESSIVE US ATTACKS ON EXPORT MARKETS. THE OBDRATE LINE SHULTZ AND BROCK TOOK WITH THE COMMISSION LAST WEEK OVER STEEL PIPES AND TUBES HAS NOW BEEN MODIFIED AND THE PROSPECTS OF A DEAL ARE SOMEWHAT BRIGHTER. BUT THE US WITHDRAWAL FROM THE INTERNATIONAL DAIRY AGREEMENT, NOTIFIED ON 18 DECEMBER, IS A BAD AUGURY.

5. I HOPE THE PRIME MINISTER WILL PUT FIRMLY TO THE PRESIDENT THE NEED FOR ALL OF US TO RESIST PROTECTIONIST PRESSURES, AND PERHAPS REMIND HIM THAT WHEN FACED WITH SIMILAR PROBLEMS 4 YEARS AGO, WE KEPT OUR MARKET OPEN. THE FURTHER POINT WHICH SEEMS TO ME WORTH MAKING IS THAT SERIOUS PREPARATIONS FOR A NEW TRADE ROUND SHOULD BE GIVEN PRIORITY, AS BEING BY FAR THE BEST WAY OF KEEPING TO MANAGEABLE PROPORTIONS THE DAY-TO-DAY FRICTIONS BETWEEN THE MAIN INDUSTRIALISED PARTNERS AND OFFERING THE DEVELOPING WORLD THE PROSPECT OF BEING ABLE TO EARN THEIR WAY OUT OF THE DEBT MORASS. THE PRESIDENT MIGHT BE REMINDED THAT THE BONN ECONOMIC SUMMIT IS NOT TOO FAR AWAY AND THE LEADERS OF THE INDUSTRIALISED NATIONS WILL WISH TO PRESENT A UNITED AND CREDIBLY OPEN TRADING FRONT TO THE REST OF THE WORLD.

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NAD  
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NEWS.D.  
PLANNING STAFF.  
PS  
PS / LADY YOUNG.  
PS / MR. RENTON.  
PS / PUS.  
SIR. W. HARDING.  
MR. DAVID THOMAS.

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