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NOTE OF BREAKFAST MEETING BETWEEN THE CHANCELLOR OF THE EXCHEQUER AND THE SECRETARY OF THE US TREASURY AT 7.30 A.M. ON 24 SEPTEMBER 1984

THOSE PRESENT:

United Kingdom

Chancellor of the Exchequer
H M Ambassador
Mr. G. Littler
Sir T. Burns
Mr. N. Wicks
Mr. D. Peretz
Mr. H.G. Walsh

United States

Secretary Regan
Under Secretary Sprinkel
Assistant Secretary Mulford
Mr. C. Dallara
Mr. C. Hicks
Ms. Helen Walsh

1. Secretary Regan introduced a short discussion of the day's developments in the foreign exchange rate markets. Going on to interest rates, he believed that Morgan Guaranty's reduction in its prime rate of 1/4% the previous Friday had been a "pre-emptive strike" because that bank expected a 1/2% reduction in the prime rates of other banks which had not yet been forthcoming. He commented that banks were usually aggressive in putting up their rates but tended to be slow in reducing them. (Mr. Sprinkel added that this applied to central banks as well.)

Coal Strike

2. In a discussion of economic developments in the UK, the Chancellor said the second dock strike had ended but the coal strike (which had lasted for six months) was still in progress. There would be an important ballot of colliery overseers on the following Wednesday; they were balloting on whether to support the strike. A two-thirds majority was necessary. Their decision was significant in that some coalface miners were at work and could not continue without supervision. The political background to the coal strike was that a Marxist union leader had been looking to present the Government with a political challenge for some time. But the timing of the strike was favourable to the Government, since it had begun in the Spring and when coal stocks were high. It was also helpful that the Government was just beginning its second term of office. The men were slowly trickling back to work and the TUC were not particularly happy with a strike that had been called without a vote. Public opinion was largely on the side of the Coal Board. Sir Terence Burns said that the strike would reduce GDP growth in the UK by 1% in 1984, although the annual rate of reduction was slightly greater in the second quarter. The Chancellor said that the union had hoped that the Government would crumble at an early stage; hoped to get all miners out on strike, and further hoped that there would be massive support from other unions. In the event none of this had happened. He saw the outcome as being that the union would eventually be forced to hold a strike ballot, in which case the miners could well decide to go back to work.

Agriculture

4. In a discussion of agricultural policy, Secretary Regan explained that the Administration's Payment in Kind (PIK) programme had ended earlier in the year. Under this programme farmers were in effect paid not to produce and were given grain out of storage which they were

.../2

allowed to sell at a profit. Following the ending of this programme, a deal had been concocted between the farmers and Congressmen to make \$1.3 billion available through the Farm Credit Bureau to relieve the debt of farmers. The Administration had just announced a programme under which the Farmers' Home Administration will be granting five years of grace on both principal and interest for farmers in financial difficulties. He had been against these proposals but had lost the battle. In resisting such proposals, and those for US retaliation against the CAP, it would be helpful if CAP reforms were carried out.

5. The Chancellor described the European Community had managed to get agreement to a cutback in milk production. This had given rise to political problems when small dairy farmers went out of business, albeit farmers who should not have been in production in the first place. There was a further need to reduce CAP expenditure, especially on Mediterranean agriculture which would become more expensive after the accession of Spain and Portugal to the Community planned for 1 January, 1986.

Unitary Taxation

6. In response to a question from the Chancellor, Secretary Regan said that he had been disappointed by the outcome of his Working Group; it had been on the verge of agreement (with US business fully in agreement and State Governors partially in agreement) when State tax commissioners had dug in their heels. The result was that the States and US business had each to be allowed separate appendices in the final report, expressing partly dissenting views. He had told States that they must act by 31 July, 1985 or face the possibility of pre-emptive Federal legislation; that threat was still in place. The Chancellor said that he would need to know by the beginning of July 1985 whether progress was being made because he had to consider how to react to UK pressures for retaliation within the Finance Bill timescale.

7. Secretary Regan said that the Administration was doing what it could to encourage elimination of world-wide combined reporting at State level. It would be most helpful if foreign businessmen continued to make it clear that they would not invest in States with worldwide combined reporting; the recent trip to the United States of the Japanese Keidanren had been most effective. Mr. Walsh said that he understood the position in Florida to be that the last remaining obstacle to repeal of unitary tax should have been removed by the agreement of the Association of Florida Industries to make good the State's estimated gain of \$74.6 m from the introduction of world-wide combined reporting, even though that gain had not fully been realised. Secretary Regan said that he had asked Mr. Magowan (Chairman of Safeway stores) to mobilise US business in California against the unitary tax. Mr. Walsh said that the basic problem in California was that the interests of the domestic and foreign multi-nationals diverged. If it were suitably modified, the Alquist Bill would meet foreign companies' needs, and also those of the Governor since the revenue loss involved was only slightly above \$200 million. It would not, however, meet the domestic companies' request for dividend relief which would bring the cost up to \$500 million and make the legislation

CONFIDENTIAL

-3-

unacceptable to the Governor. Domestic companies would therefore continue to try to block the Alquist bill. There was potential antagonism between the foreign companies and the domestic ones during the coming session of the California legislature.

The Federal US Elections

8. In a discussion of the election prospects, Secretary Regan said that the next main events were the debates between the two Presidential candidates and the two Vice Presidential candidates. The President felt confident about the Presidential debate, but the Secretary thought that the debate between Vice President Bush and Mrs. Ferraro might be difficult for the Vice President. If Bush took a modest, understated approach, Mrs. Ferraro would cut him down with sharp sallies. On the other hand, if he raised the temperature, he would be accused of being over-aggressive. Secretary Regan said that he thought, especially since votes were counted on a state-by-state basis, there was little doubt about the outcome of the Presidential Election. He commented that US Presidential candidates were not as used to the cut and thrust of debate as UK political leaders. The Chancellor noted that British Prime Ministers never agreed to head-to-head debates with leaders of the Opposition during election campaigns, although these sometimes might take place between individual constituency candidates.

9. Mr. Wicks asked about the prospects in the Congress, and in particular about whether a Reagan landslide would benefit Congressional Republicans. Secretary Regan said that, in past elections, the "coattail effect" had been minimal. There was however a maximum effort to associate local candidates in difficult races with the President, for instance in the Senatorial race in Tennessee.

Beirut

10. In a short discussion about Beirut, Secretary Regan said that he thought the attack on the Embassy might have been an inside job. The attacker never reached the inner compound but was able to reach as far as he did by attacking (just before protective gates had been installed) with over 900lbs of explosive. The Chancellor said that he was glad the UK had been able to help out during the incident.

Oil Prices

11. Secretary Regan said that he had been puzzled by the UK decision in the Summer to support oil prices at a time when they were softening, and when the US was hoping that they would decline to \$27 or \$25 a barrel. He was surprised when BNOB came out in favour of no reduction in prices and in effect held OPEC's hand. The Chancellor said that the UK's desire was simply to see an orderly market. He was quite content to see oil prices edging down in real terms; but sharp price movements were in no one's interest. One problem was that OPEC quoted its prices in dollars and, since the dollar had been going up, this meant that stable nominal prices in dollar terms represented rising real prices in other currencies. While the UK would not intervene to stop a slow decline in real prices, it did wish to stop rapid fluctuations which had a disruptive effect on a number of

countries. Secretary Regan said that, since the UK action, the oil price had firmed. The Chancellor replied that to some extent this was a matter of a normal seasonal pattern and said that the UK was neither a member of OPEC nor holding their hand and pointed out that it had consistently refused to limit crude oil production. Mr. Wicks said that the UK action had represented smoothing only and that a UK "signal" by itself could not have reversed the trend of the entire oil market.

Tax Reform

12. Secretary Regan said that he would propose a revolutionary tax reform in his report to the President. He thought that the general American citizenry would welcome the concept proposed, although specific sectors might object. The Chancellor said that it was desirable to put such a reform into effect quickly, and that his experience was that the presentation of the concept was very important. If this were done well, it could make it much less difficult to deal with groups disadvantaged by the reform. Secretary Regan said that the very different political processes in the US than in the UK made it difficult to introduce reforms quickly and that the Administration's proposals would be subject to passage through the relevant Senate and House Committees. Certain pre-election pledges had also to be met. The groups disadvantaged by the reform would be many and scattered widely.

Hong Kong

13. In a short discussion on Hong Kong, the Ambassador said that the UK expected to initial an Agreement on Wednesday and would send the text to the Treasury. This would spell out the deal between the two sides in a great amount of detail. Secretary Regan said that he did not understand why the Chinese had agreed to the detailed provisions thirteen years before the Agreement was due to take effect. The Chancellor said he thought that there were several reasons, including the financial interest of the Chinese. At the back of their minds he also thought the Chinese believed that, if they behaved well over Hong Kong, it would improve their chances in due course of reaching a similar agreement over Taiwan. The Ambassador said that the agreement would be self-policing: the Chinese would wish to further their interests in Taiwan, would wish to maintain Hong Kong's viable economy and would wish to use the Hong Kong Agreement as a benchmark as to whether their word could be accepted in the future. The Chancellor commented that the outcome would be that a part of a Communist country would be more capitalist than any capitalist country.

14. The meeting ended at 8.30 a.m.

H.G.

H G Walsh
24 September, 1984

CONFIDENTIAL

-5-

Circulation: PS/Chancellor
PS/Financial Secretary
Mr. Littler
Sir T. Burns
Mr. Lavelle
Mr. Spence (Inland Revenue)

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