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FROM WASHINGTON 070446Z FEB 85  
TO IMMEDIATE FCO  
TELEGRAM NUMBER 414 OF 6 FEBRUARY  
INFO SAVING C.G. NEW YORK

PRIME MINISTER'S VISIT TO WASHINGTON: ECONOMIC BRIEFING

1. THE ARRANGEMENTS FOR THE PRIME MINISTER'S ROUND TABLE BREAKFAST MEETING ON 21 FEBRUARY ON ECONOMIC/TRADE ISSUES ARE IN HAND. ECONOMIC ISSUES WILL ALSO BE AMONG THOSE TO BE COVERED AT THE MEETINGS WITH SENATOR DOLE AND OTHER SENIOR SENATORS, AND IN THE HOUSE, ON 20 FEBRUARY. AND THE PRIME MINISTER WILL OF COURSE HAVE SEPARATE MEETINGS WITH SECRETARY BAKER, CHAIRMAN VOLCKER AND MRS DOLE. YOU MIGHT WELCOME SOME ADVICE ON THE HANDLING OF THESE MEETINGS.

2. I SUGGEST THAT THE OVERALL THEME MIGHT BE THE IMPACT OF THE US ECONOMY ON THE INTERNATIONAL ECONOMY; AND THAT THE PRIME MINISTER MIGHT AIM TO COVER US GROWTH, INTEREST AND EXCHANGE RATES; THE US BUDGET AND TRADE DEFICITS, AND US TRADE POLICY; THE PROSPECTS FOR TAX REFORM; AND THE HANDLING OF INTERNATIONAL DEBT PROBLEMS. I HOPE THAT SHE WILL ALSO TAKE THE OPPORTUNITY TO PRESS OUR VIEWS ON EXTRATERRITORIALITY AND UNITARY TAX.

US BUDGET DEFICIT, TAX REFORM AND INTEREST RATES

3. THE PRIME MINISTER WILL NO DOUBT WISH TO DISCUSS THE PROSPECTS FOR REDUCTIONS IN THE BUDGET DEFICIT, SINCE THESE CLEARLY ARE IMPORTANT FOR THE FUTURE COURSE OF US INTEREST RATES. SHE MAY WISH TO MAKE HER OWN ASSESSMENT OF THE ADMINISTRATION'S CHANCES (POOR IN MY VIEW) OF GETTING ALL THE DOLLARS 50BN IN REDUCTIONS PROJECTED IN THE PRESIDENT'S FY86 BUDGET (REGAN'S ESTIMATE, GIVEN TO THE CHANCELLOR ON 18 JANUARY, WAS ABOUT DOLLARS 40BN), AND OF THE LIKELIHOOD THAT ANY ALTERNATIVE PROPOSALS PUT TOGETHER IN CONGRESS MIGHT RUN BETTER. DEFENCE IS THE KEY.

4. ON TAX REFORM THE REGAN PROPOSALS ARE, IN THE CORPORATE FIELD, VERY SIMILAR TO PROVISIONS IN THE 1984 UK FINANCE ACT. THE PRESIDENT'S POSITION IS STILL RESERVED; HE HAS STRESSED THE NEED FOR BIPARTISAN SUPPORT FOR REFORM. THE PRIME MINISTER MAY WISH TO EXPLORE THE PROSPECTS BOTH ON THE HILL AND WITH SECRETARY BAKER; SHE MAY ALSO WISH TO DISCUSS THE ESTIMATES THAT VARIOUS MEMBERS OF THE ADMINISTRATION (AND PAUL VOLCKER) HAVE MADE ABOUT ITS LIKELY EFFECT ON US INTEREST RATES.

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/ INTERNATIONAL

#### INTERNATIONAL DEBT

5. IT WOULD BE REASONABLE TO POINT OUT THAT THE CONTINUED SUCCESSFUL HANDLING OF INTERNATIONAL DEBT PROBLEMS ON A 'CASE-BY-CASE' BASIS PROBABLY REQUIRES NOT ONLY SUSTAINED SOUND ECONOMIC POLICIES BY DEBTOR COUNTRIES BUT ALSO CONTINUED UNITED STATES GROWTH, REASONABLE LEVELS OF US INTEREST RATES, AND THE MAINTENANCE OF AN OPEN TRADING SYSTEM. SECRETARY SHULTZ'S VIEWS ON THIS WOULD BE WORTH HEARING. THE PRIME MINISTER MIGHT ALSO ASK ABOUT ACTION BY DEVELOPED COUNTRIES TO ENCOURAGE DEVELOPING COUNTRIES TO MAKE GREATER USE OF PRIVATE DIRECT AND EQUITY INVESTMENT FLOWS. SHE MAY WISH TO DISCUSS WITH VOLCKER THE PROSPECTS FOR PARTICULARLY LARGE DEBTORS.

#### TRADE

6. THE PRIME MINISTER'S VISIT PROVIDES AN IMPORTANT OPPORTUNITY TO MAKE AT TOP LEVEL SOME OF THE POINTS IN FCO TELNO 86 ABOUT THE NEED FOR POSITIVE MANAGEMENT OF EC/US ECONOMIC RELATIONS OVER THE COMING YEAR. SHE MAY WANT TO SHOW THAT WE UNDERSTAND THE US DOMESTIC PRESSURES CREATED BY THE HIGH DOLLAR AND TRADE DEFICIT, AND THAT WE SHARE MANY US OBJECTIVES IN ENLARGING THE AREA OF INTERNATIONAL TRADE SUBJECT TO GATT DISCIPLINES THROUGH A NEW TRADE ROUND: BUT SHE WILL ALSO WANT TO BRING HOME THAT WE MUST ALL WORK TOGETHER TO ACHIEVE THIS, AND THAT THIS MEANS THAT ALL OF US MUST MEANWHILE RESIST PROTECTIONIST PRESSURES IF INTERNATIONAL TRADE, ON WHICH THE US TOO IS INCREASINGLY DEPENDENT FOR ITS PROSPERITY, IS NOT TO SUFFER

IT IS IMPORTANT THAT US OPINION-FORMERS ARE CONSTANTLY REMINDED OF THIS MESSAGE.

7. BOTH IN HER MEETINGS ON THE HILL AND IN THE ROUNDTABLE MEETING HERE, THE PRIME MINISTER MIGHT WISH TO REFER TO THE INCREASING PRESSURE FOR SOME FORM OF US IMPORT SURCHARGE. THIS IDEA IS BEGINNING

TO GATHER SUPPORT FROM INDIVIDUAL CONGRESSMEN AND IS NOW THE SUBJECT OF A STUDY BY THE CONGRESSIONAL BUDGET OFFICE. IT IS SO FAR CONDEMNED THROUGHOUT THE ADMINISTRATION, BUT IT COULD BECOME MORE ATTRACTIVE IN THE COMING MONTHS AS THE DIFFICULTIES OF BUDGET DEFICIT REDUCTION BECOME INEXORABLY CLEARER, AND AS PROGRESS ON THE INTERNATIONAL TRADE FRONT PROVES DISAPPOINTING, AS IT INEVITABLY WILL. A SURCHARGE COULD SEEM THE WAY TO KILL TWO BIRDS WITH ONE STONE. I WOULD SEE CONSIDERABLE ADVANTAGE IN THE PRIME MINISTER'S EXTRACTING FIRM, FORMAL AND FREQUENT STATEMENTS OF ADMINISTRATION AND CONGRESSIONAL OPPOSITION TO A SURCHARGE.

#### EXTRATERRITORIALITY

8. IN ADDITION TO OUR PROBLEMS OVER LAKER (ANY REFERENCE TO WHICH WILL PRESUMABLY NEED TO BE CONSIDERED NEARER THE TIME IN THE LIGHT OF THE PROGRESS OF BA'S SETTLEMENT NEGOTIATIONS - SEE MY TELNO 378), WE STILL FACE CONTINUING DIFFICULTIES OVER THE EXTRATERRITORIAL APPLICATION OF US EXPORT CONTROLS. DESPITE THE SETTLEMENT OF THE TRANS-SIBERIAN PIPELINE CONTROVERSY, THE US ADMINISTRATION HAS NEVER ABANDONED ITS ATTEMPTS TO CONTROL CERTAIN TYPES OF 'RE-EXPORT'

CONFIDENTIAL-2-

IFRSM

FROM THE UK. THE 99TH CONGRESS WILL RENEW THE ATTEMPT TO PASS NEW LEGISLATION TO REPLACE THE 1979 EXPORT ADMINISTRATION ACT. LAST OCTOBER, THE EAA CONFERENCE ABANDONED AN ATTEMPT TO LIMIT US FOREIGN POLICY CONTROLS TO GOODS OR TECHNOLOGY EXPORTED ONLY FROM THE USA, BUT DID AGREE TO RULES IMPOSING SOME DISCIPLINE ON THE ABILITY OF THE PRESIDENT TO IMPOSE FOREIGN POLICY CONTROLS ON EXPORTS SHIPPED UNDER A PRE-EXISTING CONTRACT. ALTHOUGH THERE IS UNLIKELY TO BE ANY SUPPORT FOR RADICAL AMENDMENTS DESIGNED TO REMOVE THE EXTRATERRITORIAL FEATURES OF THE EAA, IT WOULD BE WORTH PLACING ON RECORD AT A HIGH LEVEL OUR CONTINUED CONCERN AT THE POSSIBILITY OF NEW LEGISLATION TO REASSERT US EXTRATERRITORIAL CONTROL OVER 'RE-EXPORTS' AND THE EXPORT ACTIVITIES OF FOREIGN SUBSIDIARIES OF US FIRMS. WE MIGHT ALSO SIGNAL OUR SUPPORT TO THOSE IN CONGRESS TRYING TO IMPROVE THE PROVISIONS ON CONTRACT SANCTITY, THIS LAST IS HOWEVER A LOWER PRIORITY: EVEN THE UK HAS ON OCCASION ACTED IN EMERGENCY TO PREVENT DAMAGING EXPORTS DESPITE EXISTING CONTRACTUAL COMMITMENTS.

#### UNITARY TAX

9. WHEN THE CHANCELLOR OF THE EXCHEQUER CALLED ON SECRETARY REGAN ON 18 JANUARY, THE LATTER SAID THAT HE WOULD BE IN TOUCH WITH GOVERNOR DEUKMEJIAN OF CALIFORNIA, IN ADVANCE OF THE PRIME MINISTER'S VISIT, ABOUT ACTION IN CALIFORNIA THIS YEAR. THE PRIME MINISTER MAY WISH TO ASK ABOUT THIS AT THE ROUNDTABLE AND WITH SECRETARY BAKER. THE KEY POINT TO MAKE IS THAT PRESSURES FOR RETALIATION IN THE UK ARE REAL AND WILL INTENSIFY IN THE UK BUDGET AND FINANCE BILL PROCESS, AND THAT LEGISLATION, OR AT LEAST SUBSTANTIAL PROGRESS, WILL BE NECESSARY IN CALIFORNIA (THE KEY REMAINING STATE WITH WORLDWIDE COMBINATION) BY THE END OF JUNE IF THIS PRESSURE IS AGAIN TO BE SUCCESSFULLY RESISTED. (IF IT HAS NOT BEEN PUBLISHED BY THEN, THE PRIME MINISTER MAY ALSO WISH TO ASK SECRETARY BAKER ABOUT THE PROGRESS OF THE FEDERAL PACKAGE OF ASSISTANCE TO BE EXTENDED TO THOSE STATES CONSIDERING IMPLEMENTING A 'WATER'S EDGE' LIMITATION TO UNITARY TAX.)

10. THE TIDE ON UNITARY TAX IS NOW FLOWING OUR WAY: BUT THE SHEER SCALE OF THE CALIFORNIAN ECONOMY, AND OF OUR INVESTMENT THERE, MAKES A SUCCESS THERE CRUCIAL.

#### US VIEW OF EUROPE

11. FINALLY, LOW EUROPEAN GROWTH RATES (RELATIVE TO THE 1984 6.8 PERCENT HERE) HAVE LED SOME US COMMENTATORS TO REVIVE THIS AUTUMN/WINTER THEIR CRITICISM THAT THE UK AND OTHER EUROPEAN ECONOMIES ARE ARTHRITIC: UNABLE TO KEEP UP TECHNOLOGICALLY, TO CREATE JOBS, AND TO GROW. GLOOM OVER THE COAL STRIKE, AND HEADLINES ABOUT STERLING, HAVE IN RECENT WEEKS MEANT THAT THE CRITICAL SPOTLIGHT HAS TENDED TO FOCUS ON THE UK. IT WILL DO IMMENSE GOOD IF THE PRIME MINISTER WOULD USE EVERY OPPORTUNITY, INCLUDING MEDIA SLOTS, TO GET ACROSS THE TRUE FACTS, AND THE GOOD NEWS, ABOUT THE SOUND BASIS OF UK GROWTH SINCE 1981, AND THE ACTION ALREADY TAKEN AND IN HAND TO REDUCE RIGIDITIES, FREE MARKETS AND UNSHACKLE ENTERPRISE.

-3-  
CONFIDENTIAL

112

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12. FCO PLEASE ADVANCE TO POWELL (NO 10 DOWNING STREET): APPLEYARD  
(PS/SECRETARY OF STATE, FCO): PS/PUS: D M D THOMAS, BRAITHWAITE,  
MARSHALL (NAD) IN THE FCO: ROBERTS AND R WILLIAMS (DTI): AND LAVELLE  
(TREASURY).

WRIGHT

LIMITED.

NAD

ERD

ECONOMIC ADVISERS

ECD (E)

MR DEREK THOMAS.

MR BRAITHWAITE.

SIR W HARDING.

ADVANCED AS REQUESTED

-4-  
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