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FM WASHINGTON 272355Z AUG 82

TO ROUTINE FCO

TELEGRAM NUMBER 2870 OF 27 AUGUST

INFO SAVING CG'S USA, UKMIS NEW YORK

PRESIDENT REAGAN AT MID TERM

1. CONGRESS AND THE PRESIDENT ARE ON HOLIDAY. NEITHER WILL RETURN TO WASHINGTON UNTIL AFTER LABOUR DAY (6 SEPTEMBER) WHICH WILL ALSO MARK THE START OF THE CAMPAIGN FOR THE MID TERM CONGRESSIONAL ELECTIONS. THIS IS THEREFORE A GOOD MOMENT TO TAKE STOCK.
2. MR REAGAN WAS ELECTED TWO YEARS AGO ON THE LOWEST TURNOUT OF VOTERS SINCE 1948. THE EXTENT OF HIS VICTORY WAS MORE A MEASURE OF CARTER'S COLLAPSE AS A CREDIBLE PRESIDENT THAN ENTHUSIASM FOR MR REAGAN. INDEED, HE HAD BEEN CONSIDERED AN UNELECTABLE IDEOLOGUE BY MOST OF HIS OWN PARTY UNTIL A FEW MONTHS BEFORE. BUT IN THE END, THE ELECTORATE CHOSE MR REAGAN, NOT SO MUCH BECAUSE THEY ENDORSED HIS PARTICULAR BRAND OF CONSERVATISM AS BECAUSE HE OFFERED TOUGH-MINDED, BUT WARM-HEARTED LEADERSHIP AND UNDERTOOK TO RESTORE AMERICA THROUGH A STRONG DEFENCE, A SOUND ECONOMY, AND A REDUCTION IN GOVERNMENT INTERFERENCE.
3. MANY WERE SCEPTICAL ABOUT WHETHER MR REAGAN'S ECONOMIC PLANS WOULD WORK AND, IN PARTICULAR, WHETHER HE COULD SECURE THE DRASTIC CUTS IN GOVERNMENT SPENDING WHICH WOULD ENABLE HIM TO CARRY OUT OTHER PARTS OF HIS PROGRAMME WITHOUT INCURRING ENORMOUS DEFICITS. BUT HIS BASIC APPROACH: TO CUT GOVERNMENT SPENDING: TO CUT DIRECT TAXATION AND TO INCREASE SPENDING ON DEFENCE WAS VERY POPULAR, AND STILL IS. MR REAGAN'S SUPPORTERS KNEW THEY WOULD HAVE TO TIGHTEN THEIR BELTS. WHAT FEW OF THEM CAN HAVE FORESEEN WAS THE EXTENT OF THE RECESSION, THE STEEP RISE IN UNEMPLOYMENT, AND THE IMPACT WHICH CUTS IN GOVERNMENT SPENDING WOULD HAVE ON MIDDLE-CLASS AMERICANS WHO BELIEVED THAT THEY HAD MOST TO GAIN FROM MR REAGAN'S POLICIES.
4. MR REAGAN HAD PERHAPS UNDER-ESTIMATED THE EXTENT TO WHICH AMERICA HAD BECOME A WELFARE STATE. ALL WERE IN FAVOUR OF CUTTING GOVERNMENT SPENDING. BUT IT SOON BECAME APPARENT THAT ALMOST EVERY FAMILY IN AMERICA WAS THE BENEFICIARY OF ONE OR OTHER SOCIAL PROGRAMME, BE IT STUDENT LOANS, MEDICARE OR SOCIAL SECURITY (EG STATE PENSIONS) AND THAT IN A TIME OF RECESSION AND RISING UNEMPLOYMENT, MANY OF MR REAGAN'S MIDDLE-CLASS SUPPORTERS HAD BECOME MORE DEPENDENT ON THE STATE THAN THEY HAD REALISED - AND RESENTFUL OF ANY ATTEMPT TO ERODE, IN HARD TIMES, THE BENEFITS WHICH THEY HAD EARNED IN EASIER DAYS. CONGRESS' UNWILLINGNESS TO CUT SPENDING AS MUCH AS THE PRESIDENT WOULD LIKE, AND PUBLIC REACTION TO THE PRESIDENT'S OWN ATTEMPT TO GRASP THE NETTLE OF SOCIAL SECURITY, REPRESENTED THE FIRST CLEAR SIGN THAT THE ELECTORATE WAS UNWILLING TO PAY THE SHORT TERM PRICE HE WAS ASKING FOR THE PRIZE OF LONGER TERM PROSPERITY.

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5. MR REAGAN HAS NOW HAD TO CHANGE TACK BY ESPOUSING A TAX INCREASE TO WHICH, BY INSTINCT, HE IS OPPOSED, IN ORDER TO KEEP DEFICITS WITHIN TOLERABLE LIMITS. HE HAS SPENT TOO MUCH OF HIS CAREER DECRYING HIGH DEFICITS - AND THE RAISING OF TAXES TO DEAL WITH THEM - TO BE ABLE TO CLAIM CONVINCINGLY THAT HE IS STILL CHARTING HIS ORIGINAL COURSE. CONVERSELY, HE HAS RECEIVED LITTLE CREDIT FOR HALVING THE RATE OF INFLATION (LARGELY ATTRIBUTED TO THE FED'S TIGHT MONETARY POLICY) WHILE GETTING MOST OF THE BLAME FOR HIGH INTEREST RATES.

6. MR REAGAN HAS THUS FAILED TO BRING DOWN GOVERNMENT SPENDING AS MUCH AS HE WOULD HAVE WISHED. BUT HE HAS ALIENATED A NUMBER OF IMPORTANT VOTER GROUPS (EG BLUE COLLAR WORKERS AND MINORITIES) BY BRINGING IT DOWN AS MUCH AS HE HAS. THE TAX CUTS FOR INDIVIDUALS AND BUSINESS REMAIN BUT THERE IS LITTLE SIGN YET OF THE RETURN OF BUSINESS CONFIDENCE WHICH THEY WERE DESIGNED TO GENERATE. HIGH INTEREST RATES HAVE NEGATED THEIR EFFECT. MR REAGAN'S ACHILLES HEEL HAS PEHAPS BEEN HIS COMMITMENT TO MAJOR INCREASES IN DEFENCE SPENDING OVER THE NEXT THREE YEARS. SOME INCREASE IN DEFENCE SPENDING WAS AND

STILL IS THOUGHT NECESSARY BY MOST AMERICANS. BUT MANY ARE COMING TO BELIEVE THAT THE SCALE OF DEFICITS NOW CONTEMPLATED ARE TOO HIGH A PRICE TO PAY FOR SUCH A STRONG DEFENCE. MOST AMERICANS ACCEPTED MR REAGAN'S ARGUMENT THAT, UNDER CARTER, THE UNITED STATES HAD PUT ITSELF AT A NUCLEAR AND CONVENTIONAL DISADVANTAGE TO THE SOVIET UNION. THEY DID SO BECAUSE THEY WERE SICK OF SEEING AMERICA BEING PUSHED AROUND ABROAD. IRAN WAS THE FINAL STRAW. MR REAGAN VOICED THEIR SENSE OF HUMILIATION AND FRUSTRATION. BUT INsofar AS THE U S WINDOW OF VULNERABILITY FOR THE AMERICAN PUBLIC WAS AS MUCH ONE OF MORALE AS OF MISSILES, MR REAGAN HAS ALREADY GONE A LONG WAY TOWARDS CLOSING IT. THERE IS LITTLE STOMACH FOR A MILITARY CONFRONTATION WITH ANYONE, LEAST OF ALL WITH THE SOVIET UNION. DOWNING LIBYAN AIRCRAFT WAS POPULAR: THE PROSPECT OF MILITARY ENGAGEMENT OF ANY KIND - BE IT IN EL SALVADOR OR LEBANON - IS NOT.

7. BY THE SAME TOKEN, THE PRESIDENT'S APPROACH TO THE SOVIET UNION HAS GIVEN IMPETUS AND POPULARITY TO THE NUCLEAR FREEZE MOVEMENT IN THE UNITED STATES ON A SCALE WHICH WOULD HAVE BEEN THOUGHT INCONCEIVABLE A YEAR AND A HALF AGO. THE MAIN CONGRESSIONAL SUPPORTERS OF THE FREEZE DO NOT SEE IT AS A SERIOUS CONTRIBUTION TO THE DISARMAMENT DEBATE SO MUCH AS A MEANS OF KEEPING THE ADMINISTRATION UP TO THE MARK IN THE DISARMAMENT NEGOTIATIONS. THE ZERO OPTION WOULD NEVER HAVE BEEN ADOPTED WITHOUT IT. IT IS A MEASURE OF THE CHANGED PUBLIC MOOD THAT, IN THE FORTHCOMING ELECTION CAMPAIGN, THE ONUS WILL BE ON THOSE CONGRESSMEN WHO OPPOSE THE NUCLEAR FREEZE TO EXPLAIN WHY. FOR ALL THESE REASONS, MANY NOW BELIEVE THAT WHEN, AFTER THE NOVEMBER ELECTIONS, THE PRESIDENT TURNS HIS ATTENTION AGAIN, AS HE MUST, TO MEASURES TO REDUCE THE DEFICIT, HE WILL LOOK AGAIN AT THE DEFENCE BUDGET. BUT THERE WILL ALSO BE PRESSURE ON HIM, AS AN ALTERNATIVE, TO REFLATE.

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8. AGAINST THIS BACKGROUND, THE REPUBLICANS ARE NOT SANGUINE ABOUT THE PROSPECTS IN THE NOVEMBER ELECTIONS. ALL 435 MEMBERS OF THE HOUSE (243 DEMOCRATS AND 192 REPUBLICANS) WILL BE SEEKING RE-ELECTION AS WILL ONE THIRD OF THE SENATE (20 DEMOCRATS, 12 REPUBLICANS AND 1 INDEPENDENT). THIRTY-SIX GOVERNORSHIPS (20 DEMOCRATS AND 16 REPUBLICANS) ARE AT STAKE. IN THE SENATE, THE EFFECTIVE REPUBLICAN MAJORITY IS SEVEN. A YEAR AGO, THE REPUBLICANS SPOKE OF INCREASING THEIR SENATE MAJORITY. NOW, THEY WILL COUNT THEMSELVES LUCKY TO HANG ON TO A BARE MAJORITY - LOSING ONE OR TWO SEATS - AND MAYBE PICKING UP ONE OR TWO. IN THE HOUSE, SOME LOSSES ARE USUAL AT MID TERM. IN 1978, CARTER LOST 3 SENATE AND 12 HOUSE SEATS - ABOUT AVERAGE. MOST US EXPERTS THINK THE REPUBLICANS WILL DO WORSE THAN THAT. THE BIG QUESTION IS HOW MUCH WORSE. IT MAY BE WORTH NOTING THAT THE LAST TIME MID TERM ELECTIONS WERE FOUGHT WITH UNEMPLOYMENT AT OVER 7 PER CENT (1958) THE REPUBLICANS LOST NEARLY 50 SEATS. OVER THE LAST HALF-CENTURY NO PARTY THAT HAS LOST MORE THAN A COMBINED TOTAL OF 35 SENATE AND HOUSE SEATS AFTER TWO YEARS IN POWER HAS RETAINED THE WHITE HOUSE TWO YEARS LATER. THE IMPLICATIONS ARE OBVIOUS FOR THIS AUTUMN WHEN UNEMPLOYMENT WILL BE AT 10 PER CENT. BUT THERE ARE COMPENSATORY FACTORS FOR THE REPUBLICANS. SINCE THE ELECTORATE IS HALF A MILLION STRONG IN EACH CONGRESSIONAL DISTRICT, TELEVISION IS A VITAL PART OF THE CAMPAIGN. THE REPUBLICANS CAN AFFORD A MEDIA BLITZ IN KEY DISTRICTS. THEY HAVE DOLLARS 30 MILLION TO SPEND IN THE CAMPAIGN. THE DEMOCRATS HAVE DOLLARS 3 MILLION. REPUBLICAN TV COMMERCIALS BLAMING THE DEMOCRATS FOR THE FAILURES OF THE PAST AND CLAIMING THAT MR REAGAN HAS MADE A START TO PUT THINGS RIGHT ARE ALREADY BEING AIRED. POLLS SHOW THAT CARTER IS STILL BLAMED JUST AS MUCH AS REAGAN FOR THE COUNTRY'S ECONOMIC CONDITION. MOST MEMBERS OF CONGRESS BELIEVE THAT MR REAGAN STILL HAS STRONG CREDIBILITY WITH THE AMERICAN PEOPLE, HENCE THE DILEMMA FOR THOSE REPUBLICANS WHO VOTED AGAINST THE TAX BILL LAST WEEK AND THE SATISFACTION OF THE DEMOCRATS WHO SUPPORTED IT AND WHO THEREFORE BELIEVE THEY HAVE MADE IT MORE DIFFICULT FOR MR REAGAN TO ATTACK THEM IN THE FORTHCOMING CAMPAIGN. MR REAGAN HIMSELF HAS STRIVEN HARD TO PRESERVE HIS IMAGE AS THE OUTSIDER TAKING ON THE WASHINGTON ESTABLISHMENT. THIS MAY ALIENATE WHAT MR REAGAN CALLS THE STRIPED PANTS BRIGADE ON THE POTOMAC BUT ELSEWHERE THE MESSAGE GOES DOWN WELL. INDEED, ONE IMPORTANT ASPECT OF THE PRESENT POLITICAL SCENE IS THAT MANY AMERICANS, WHILE DISAPPOINTED THAT EVENTS HAVE CONSPIRED TO PREVENT MR REAGAN FROM DOING WHAT HE HAD SET OUT TO DO, STILL BELIEVE IN HIM. THE DEMOCRATS CERTAINLY DO NOT HAVE MUCH POSITIVE APPEAL AS AN ALTERNATIVE.

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9. I DO NOT FORESEE ANY ECONOMIC NEWS IN THE NEXT TWO MONTHS WHICH IS LIKELY TO RELIEVE THE PESSIMISM OF THE U S ELECTORATE. THE STOCK EXCHANGE BOOM MAY IMPROVE THE MICRO-CLIMATE BUT IT WILL NOT RELIEVE THE ECONOMIC DIFFICULTIES OF THE MAJORITY OF VOTERS. THE NAME OF NOVEMBER'S GAME WILL THEREFORE BE DAMAGE LIMITATION FOR THE REPUBLICANS. THE TURNOUT WILL BE LOW: IT WAS ONLY 38 PERCENT IN THE LAST MID TERM ELECTIONS. IF THE REPUBLICANS KEEP CONTROL OF THE SENATE, LIMIT THEIR HOUSE LOSSES TO 25 AND KEEP GOVERNORSHIP LOSSES DOWN TO ABOUT HALF A DOZEN, THEY WILL HAVE DONE WELL AND CAN THEN BE EXPECTED TO HOLD BROADLY TO THEIR PRESENT COURSE. IF THEY WERE TO LOSE THE SENATE AND/OR MORE THAN ABOUT 35 HOUSE SEATS, THEY WOULD HAVE SUFFERED A DEBACLE, AND WOULD BE FORCED TO CONSIDER SOME SUBSTANTIAL ADJUSTMENTS TO THE POLICIES OF THEIR FIRST TWO YEARS.

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