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EXDIS
FOR THE SECRETARY FROM UNDER SECRETARY BUCKLEY
ALSO FOR USEC
E.O. 12065: RDS-1 3/17/92 (BUCKLEY, JAMES L.)
TAGS: EFIN, EEWT, UR
SUBJECT: INTER-AGENCY MISSION ON EAST-WEST ECONOMIC
RELATIONS: SUMMARY ON PARIS CONSULTATIONS

1. (~~SECRET~~ - ENTIRE TEXT.)

2. SUMMARY: MISSION'S DAY IN PARIS BEGAN WITH FOREIGN MINISTER CHEYSSON, PROCEEDED THROUGH LENGTHY MEETING WITH FRENCH INTER-AGENCY TEAM HEADED BY FOREIGN MINISTRY ECONOMIC DIRECTOR PAYE AND CONCLUDED WITH SEPARATE MEETINGS BETWEEN INDIVIDUAL MISSION MEMBERS AND OFFICIALS OF MINISTRIES OF DEFENSE AND FINANCE, THE ELYSEE STAFF AND OECD SYG VAN LENNEP. ALTHOUGH SUBSTANCE OF CONVERSATIONS IN PARIS DID NOT DIFFER APPRECIABLY FROM WHAT WE ENCOUNTERED YESTERDAY IN BONN, MOOD AND ATMOSPHERE WERE MUCH MORE POSITIVE. WHEREAS GERMANS SPENT MOST OF THEIR TIME TELLING US STEPS WHICH WE WERE PROPOSING POSED ENORMOUS PROBLEMS FOR THEM, FRENCH STATED THEIR CASE WITH A LESS NEGATIVE CAST AND GAVE IMPRESSION OF TRYING TO FIND SOLUTIONS. MY INITIAL ANALYSIS IS THAT FRENCH: WILL AGREE TO ENHANCED INFORMATION EXCHANGE; SHARE OUR BASIC OBJECTIVE OF FINDING A WAY TO PUT ECONOMIC RELATIONS WITH SOVIET UNION ON A MORE RATIONAL FOOTING; AND ARE LARGELY UNCONCERNED ABOUT "POLITICAL ADVANTAGES" OF TRADE RELATIONSHIP WITH USSR. HOWEVER, THEY HAVE ENTERED INTO A FIVE YEAR PROTOCOL WITH SOVIETS WHICH THEY CLAIM COMMITS THEM TO CREDIT GUARANTEES AT CONSENSUS RATES FOR ALL INDUSTRIAL SALES; EXPECT "BURDEN SHARING" BY UNITED STATES OVER AND ABOVE UNILATERAL RESTRAINTS WE HAVE ALREADY UNDERTAKEN; BELIEVE THAT A PAUSE IN NEW CREDIT EXTENSIONS WILL BE EXTREMELY DIFFICULT IF NOT IMPOSSIBLE FOR THEM; AND WILL BE RELUCTANT TO GO ALONG WITH ANY STRUCTURED ORGANIZATIONAL FOLLOW-UP. THIS BEING SAID, FRENCH CLEARLY WANT TO WORK WITH US ON THIS ISSUE, AND THEIR CONCERNS OVER DIRECTIONS OF GERMAN POLICY, WHICH

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PAGE 02 OF 02 LONDON 5927

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WERE RAISED SEVERAL TIMES PRIVATELY BY MEMBERS OF FRENCH DELEGATION, WILL WORK TO OUR ADVANTAGE ASSUMING AREAS AVAILABLE FOR MEANINGFUL ACTIONS. END SUMMARY.

3. MEETING WITH CHEYSSON WAS GENERALLY POSITIVE. HE APPEARED VERY MUCH UNDER THE INFLUENCE OF HIS TALKS LAST FRIDAY IN WASHINGTON AND FULLY UNDERSTOOD IMPORTANCE WHICH THE PRESIDENT ATTACHED TO MISSION'S VISIT (THIS SAME POINT CAME UP ON SEVERAL OTHER OCCASIONS DURING OUR DAY IN PARIS ALTHOUGH NOT REFLECTED IN LEVEL OF FRENCH REPRESENTATION AT MOST MEETINGS). CHEYSSON WAS GENERALLY NON-COMMITTAL ON SUBSTANCE OF OUR PROPOSALS BUT HIS OVERALL APPROACH WAS QUITE POSITIVE AND A PLEASANT CONTRAST TO WAY GENSCHER TREATED THE ISSUES YESTERDAY.

4. AS IN BONN, I OPENED MEETING WITH PAYE BY PRESENTING OUR BASIC OBJECTIVES, EXPLAINING THAT WE SOUGHT AGREEMENT IN PRINCIPLE ON NECESSITY AND DESIRABILITY OF COMMON RESTRAINT ON CREDITS/GUARANTEES, AGREEMENT ON ENHANCED INFORMATION EXCHANGE TO MAKE THIS SYSTEM WORK AND A PAUSE IN NEW CREDITS UNTIL INTERESTED COUNTRIES CAN AGREE ON A MECHANISM WITHIN WHICH NEW POLICY WOULD BE DEVELOPED. UNDER SECRETARY IKLE FOLLOWED WITH PRESENTATION ON MILITARY/STRATEGIC CONSIDERATION. UNDER SECRETARY OLMER DISCUSSED U.S. TRADE SITUATION VIS-A-VIS USSR AND ASSISTANT SECRETARY LELAND GAVE RUNDOWN ON EASTERN EUROPEAN CREDIT/DEBT SITUATION. DR. BAILEY OUTLINED POSSIBLE SCENARIID FOR AGREEMENT LEADING THROUGH ADDITIONAL BILATERAL SESSIONS TO MULTILATERAL MEETING AND SUBSEQUENT CONFERENCE.

5. PAYE RESPONDED ON FRENCH SIDE, STRESSING FROM THE OUTSET THAT FRENCH SHARE OUR BASIC CONCERNS AND WANT TO WORK WITH US. IT WAS CLEAR THAT FRENCH, PARTICULARLY TREASURY REPRESENTATIVES, ARE BOTH CONCERNED ABOUT THEIR HEAVY EXPOSURE IN EASTERN EUROPE AND UNHAPPY ABOUT BUDGETARY IMPACT OF THEIR SUBSIDIES FOR CREDITS TO THE USSR (WHICH THEY ESTIMATE AT \$200 MILLION ANNUALLY).

FRENCH ALSO MADE CLEAR THAT DURING LAST TWO YEARS THEY HAD SUBSTANTIALLY TIGHTENED CREDIT TERMS FOR USSR AND HAD REFUSED SOVIET EFFORTS TO TIE THEM INTO MORE FAVORABLE, LONG-TERM INTEREST RATE COMMITMENT. AS IN BONN, FRENCH STRESSED NECESSITY FOR EQUAL BURDEN SHARING (WHICH IS BECOMING A CODE WORD FOR U.S. GRAIN SALES) AND NECESSITY THAT ALL KEY CREDIT COUNTRIES PARTICIPATE IN ANY EVENTUAL

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SECRET SECTION 02 OF 02 LONDON 05927

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ARRANGEMENT. THEY AGREE TO NEED FOR ADDITIONAL INFORMATION EXCHANGE BUT WONDER WHETHER ANY NEW STRUCTURE, HOWEVER INFORMAL, IS NEEDED TO ACCOMPLISH IT. ON PAUSE, THEY FEEL COMMITTED UNDER 1980 PROTOCOL WITH SOVIETS TO PROVIDE MEDIUM- AND LONG-TERM CREDITS AND GUARANTEES FOR CAPITAL GOODS SALES TO THE SOVIET UNION BUT PAYE UNDERTOOK TO CHECK WHETHER THERE WAS SIMILAR OBLIGATION FOR SHORT-TERM CREDITS/GUARANTEES. PERHAPS REFLECTING FACT THAT FRENCH ARE HOSTING SEVEN-NATION SUMMIT THIS JUNE PAYE RAISED POSSIBILITY OF FOLDING CREDITS INITIATIVE INTO THAT PROCESS. AS YOU KNOW, POSSIBILITY OF OBTAINING "BLESSING" OF CONCLUDED CREDITS EXERCISE BY THE SUMMIT WAS PART OF OUR ORIGINAL THINKING. WE WILL HAVE PROBLEMS WITH FRENCH ON ESTABLISHMENT OF FOLLOW UP MECHANISM. COCOM PARALLEL DOES NOT RAISE GREAT ENTHUSIASM IN PARIS. WE WILL HAVE TO KEEP OUR EVENTUAL PROPOSAL FOR A MECHANISM AS INFORMAL AS POSSIBLE IF WE ARE TO AVOID PROBLEMS WITH THE FRENCH.

6. UNDER SECRETARY IKLE AND I HAD POSITIVE MEETING WITH DEFENSE MINISTER HERNU WHO, WHILE NOT PREVIOUSLY AWARE OF OUR EFFORT, SEEMED WELL-DISPOSED TOWARD IT. UNDER SECRETARY IKLE AND HERNU AGREED PARTICULARLY ON THE NEED FOR A LONG-TERM APPROACH TO ECONOMIC RELATIONSHIP WITH SOVIET UNION, PARTICULARLY IN TECHNOLOGY TRANSFER AREA. FRENCH AND U. S. APPROACHES HERE APPEAR QUITE SIMILAR DUE TO COMMON PROBLEM OF DEVELOPING NEW WEAPONS SYSTEMS OVER FIVE- TO SEVEN-YEAR PERIOD AND DESIRE TO AVOID COMPROMISING THESE EFFORTS THROUGH TECHNOLOGY LEAKS TO THE SOVIET UNION.

7. ASSISTANT SECRETARY LELAND HAD VERY USEFUL MEETING WITH DIRECTOR OF THE TREASURY CAMDESUS WHO, MORE THAN ANY OTHER FRENCH OFFICIAL WITH WHOM DELEGATION MET, SHOWED CLEAR UNDERSTANDING OF DISTINCTION BETWEEN SOVIET AND EASTERN EUROPEAN CREDIT/DEBT PROBLEMS. CAMDESUS ADVISED THAT PRESIDENT MITTERAND SUPPORTS THIS APPROACH AND SEES POLITICAL BENEFITS IN ASSISTANCE, WHERE FEASIBLE, TO EASTERN EUROPEAN COUNTRIES.

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PAGE 02 OF 02 LONDON 5927

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8. UNDER SECRETARY OLMER AND DR. BAILEY MET WITH ELYSEE ECONOMIC POLICY DIRECTOR SAUTTER. ALTHOUGH HE WAS MORE SKEPTICAL THAN PAYE HAD BEEN REGARDING POSSIBILITY OF ELIMINATING SUBSIDIES AND RESTRUCTURING VOLUME OF CREDITS/GUARANTEES TO THE SOVIETS, SAUTTER STATED THAT MITTERAND GOVERNMENT HAD REJECTED "PISAR" APPROACH THAT MORE ECONOMIC RELATIONS WITH THE SOVIET UNION WOULD BRING POLITICAL BENEFIT. HE INDICATED THAT THE GOVERNMENT OF FRANCE NOW APPROACHES SOVIET ECONOMIC ISSUES ON A COLD, BUSINESS-LIKE BASIS.

9. COMMENT: ALTHOUGH FRENCH GAVE LITTLE MORE ON SUBSTANCE THAN GERMANS, THEIR CLEAR DESIRE TO WORK CLOSELY WITH THE REAGAN ADMINISTRATION ON EAST-WEST RELATIONS GAVE THE TALKS IN PARIS A WARMER ATMOSPHERE THAN WE ENCOUNTERED IN BONN. WHAT THIS MEANS IN PRACTICE REMAINS TO BE SEEN. EUROPEAN CONSULTATIONS ON FRINGES OF MARCH 22-23 FOREIGN MINISTERS MEETING WILL PROBABLY BE CRUCIAL IN THAT RESPECT. STREATOR
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E.O. 12065: RDS-1 3/16/92 (BUCKLEY, JAMES L.)

TAGS: EFIN, EEWT, UR

SUBJECT: INTERAGENCY MISSION ON EAST-WEST ECONOMIC
- RELATIONS: REPORT ON BONN CONSULTATIONS

1. (~~SECRET~~ - ENTIRE TEXT.)

2. SUMMARY: INTERAGENCY MISSION'S TALKS IN BONN WITH FRG COUNTERPARTS HEADED BY FOREIGN OFFICE STATE SECRETARY LAUTENSCHLAGER AND ECONOMIC MINISTRY STATE SECRETARY VON WUERZEN FEATURED LENGTHY AND INCONCLUSIVE TALKS ON WHETHER HERMES CREDIT GUARANTEE SYSTEM REPRESENTS ELEMENT OF STATE SUBSIDIZATION OF CREDITS. GERMANS INSISTED THAT RESTRAINTS ON FUTURE EXTENSION OF THESE GUARANTEES WOULD RESULT IN DECLINE IN FRG TRADE WITH THE SOVIET UNION. AS EXPECTED, GERMANS STRESSED NEED FOR "EQUITY" AND "BURDEN SHARING" IN ANY RESTRAINT REGIME, CLAIMING THAT THEY WERE ALREADY DISADVANTAGED BY CREDIT SUBSIDIES OF OTHER COUNTRIES. ALTHOUGH GERMANS RESISTED GIVING ANY COMMITMENT BEYOND AGREEMENT TO PROVIDE FURTHER INFORMATION ON THEIR CREDIT SYSTEM, GERMANS SHOULD BE UNDER NO ILLUSIONS THAT RESTRAINTS ON HERMES OPERATIONS WILL BE ESSENTIAL IF U.S. PROPOSALS ARE TO SUCCEED. GERMANS ALSO REVEALED MISUNDERSTANDING REGARDING NATURE OF U.S. POSITION ON "NO UNDERCUTTING." STATING THAT THEY ANTICIPATED U.S. WOULD NOT PUT RESTRAINT ON CONTRACTS IN BEING, THEY ASKED THAT THE U.S. AGAIN CONSIDER ALLOWING EXISTING CONTRACTS (AEG KANIS) TO BE FULFILLED BY APPROVING EXPORT LICENSE REQUESTS. REPORT ON GROUP MEETING WITH FOREIGN MINISTER GENSCHER SEPTEL.
END SUMMARY.

3. AFTER INITIAL WELCOME BY LAUTENSCHLAGER, UNDER SECRETARY BUCKLEY MADE INITIAL U.S. PRESENTATION IN WHICH HE STRESSED:

- A. WE ARE SEEKING SIGNIFICANT RESTRICTIONS IN OFFICIAL CREDITS AND GUARANTEES TO THE SOVIET UNION.
- B. THIS IS NOT PART OF CONFRONTATIONAL STRATEGY BUT RATHER REFLECTS THE PRESIDENT'S STRONGLY HELD VIEW THAT WESTERN SUBSIDIES OF SOVIET ECONOMIC DEVELOPMENT ARE FUNDAMENTALLY WRONG AND THAT ECONOMIC COMPONENT OF EAST-WEST RELATIONSHIP MUST BE BROUGHT INTO A COHERENT WESTERN

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PAGE 02 OF 02 LONDON 5926

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STRATEGY.

- C. EVENTS LAST FRIDAY IN MADRID SYMBOLIZED DIS-
APPOINTMENT OF WESTERN HOPES REGARDING SOVIET BEHAVIOR.

- D. FOR ECONOMIC, POLITICAL AND STRATEGIC REASONS,
FLOW OF SUBSIDIZED CREDIT TO THE SOVIET UNION MUST BE
CURBED.

- E. WE REALIZE THAT THIS MUST BE DONE ON MULTI-
LATERAL BASIS, AND MUST INCLUDE JAPAN, CANADA AND OTHER
KEY COUNTRIES.

- F. WE SEEK AGREEMENT ON A MECHANISM TO MONITOR
CREDITS, A TEMPORARY PAUSE IN FURTHER EXTENSIONS PENDING
ESTABLISHMENT OF THIS MECHANISM AND GREATER EXCHANGE OF
INFORMATION TO SET UP THE MECHANISM AND INSURE ITS GOOD
OPERATION.

- G. MISSION WILL REPORT ON ITS TALKS TO THE
PRESIDENT, WHO HAS DEFERRED A DECISION ON APPLICABILITY
OF HIS DECEMBER 30 DECISION TO PENDING CONTRACTS.

4. UNDER SECRETARY IKLE THEN PRESENTED OBJECTIVES OF THE
MISSION IN TERMS OF THE MILITARY STRATEGIC INTERESTS OF
THE ALLIANCE, NOTING THAT RESTRAINT ON CREDITS WAS AN
ESSENTIAL YET MISSING ELEMENT OF THE WESTERN STRATEGY.
REVIEWING THE POST-WAR ERA, HE NOTED THAT EFFORTS DURING
THE 60'S AND 70'S TO MODERATE SOVIET BEHAVIOR THROUGH
GREATER TRADE AND ARMS CONTROL HAD FAILED; INSTEAD, WE
HAD WITNESSED ENORMOUS SOVIET MILITARY BUILD UP. WITHOUT
A MORE COMPREHENSIVE ALLIANCE STRATEGY, HE WARNED, THE
ALLIANCE MIGHT NOT SURVIVE A PERIOD OF CRISIS WHICH LIES
AHEAD. UNDER SECRETARY IKLE SAID THAT A COHERENT NATO
STRATEGY SHOULD INCLUDE THREE ELEMENTS NAMELY:

- 1. DEFENSE BUILD-UP IN WHICH U.S. WAS TAKING THE
LEAD.

- 2. AN APPROACH EXEMPLIFIED BY THE TWO-TRACK INF
DECISION TO REINVIGORATE THE ARMS CONTROL EFFORT AND,
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3. A NEW APPROACH IN THE ECONOMIC AREA TO STOP
TRANSFER OF RESOURCES TO THE SOVIET UNION.
WITHOUT THIS LATTER ELEMENT, WE WILL BE UNABLE TO CLOSE
THE GAP IN THE EAST-WEST MILITARY BALANCE. HE ARGUED THAT
WESTERN SUBSIDIZATION OF TRADE WITH THE SOVIET UNION HAD
MADE IT EASIER FOR THE SOVIET LEADERS TO CARRY OUT THEIR
UNPRECEDENTED MILITARY BUILD-UP WHICH COULD BRING THE
DEFENSE SHARE OF THE SOVIET GNP TO 15 PERCENT BY 1985.
HE URGED THAT WESTERN COUNTRIES ALLOW MARKET FORCES TO
OPERATE AND RESIST SOVIET PRESSURE FOR CREDITS. WE DO
NOT SEEK ECONOMIC WARFARE, HE SAID, BUT ONLY AN EVEN-
HANDED NON-SUBSIDIZED TRADE POLICY. IN CONCLUSION,
UNDER SECRETARY IKLE DREW A COMPARISON BETWEEN WESTERN
ASSISTANCE TO POLAND AND TURKEY. WHILE HE ACKNOWLEDGED
SUBSTANTIAL FRG ASSISTANCE TO TURKEY HE SAID THAT
ASSISTANCE IN RECENT YEARS TO POLAND HAD IN FACT BEEN
TWICE AS GREAT AS THAT TO TURKEY.

5. UNDER SECRETARY HOLMER POINTED OUT THAT U.S., THROUGH
ACTION TAKEN BY THE PRESIDENT ON DECEMBER 29, 1981, HAS
LOST PERHAPS 500 MILLION DOLLARS IN EXPORTS ANNUALLY.
THIS HAS SUBSTANTIAL IMPACT ON JOB SITUATION IN U.S.,
BUT HE SAID THAT WE REGARD THIS AS PRICE WE MUST PAY FOR
SECURITY. HE ACKNOWLEDGED THAT U.S. HAS HAD TRADE
SURPLUS WITH SOVIETS IN RECENT YEARS, BUT HE SAID THIS
WAS DUE TO SOVIET AGRICULTURAL FAILURE AND NOT OUR MARKET
DEVELOPMENT. HE ALSO CALLED ATTENTION TO ONGOING U.S.
EFFORTS TO ASSIST IN WESTERN EUROPEAN ENERGY INDEPENDENCE
THROUGH FACILITATION OF GREATER COAL EXPORTS, THE CAPACITY
FOR WHICH MIGHT REACH 250 MILLION METRIC TONS IN 1983.

6. ASSISTANT SECRETARY LELAND NOTED THAT THERE ARE
DIFFERENCES BETWEEN U.S. AND EUROPEAN ASSESSMENTS OF EAST-
WEST RELATIONSHIP BUT ADDED THAT A COMPROMISE HERE SHOULD
BE POSSIBLE. HE EXPRESSED DISAPPOINTMENT WITH THE WAY
IN WHICH EC DECISION ON IMPORT RESTRICTIONS AGAINST SOVIET
UNION HAD BEEN IMPLEMENTED. THE CREDIT AREA, HE SAID,
STRIKES US AS A PARTICULARLY IMPORTANT AREA AT THIS TIME.
HE ACKNOWLEDGED THAT GERMANS HAD PROVIDED RELATIVELY
LOWER DEGREE OF SUBSIDIZATION THAN OTHER EUROPEAN
COUNTRIES BUT MAINTAINED THAT FACT OF GOVERNMENT INVOLVE-
MENT IN HERMES SYSTEM IS INDEED EQUIVALENT TO SUBSIDI-
ZATION. HE POINTED OUT THAT MUCH HAS CHANGED IN LAST 2/3

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PAGE 02 OF 02 LONDON 5926

DTG: 170838Z MAR 82 PSN: 000322

YEARS, AS SOVIET CREDIT RATING HAS FALLEN, AND PRIVATE BANKS HAVE BECOME EXTREMELY RELUCTANT TO LEND ON ANY TERMS. LELAND POINTED OUT THAT U. S. WAS EFFECTIVELY OUT OF THE SOVIET MARKET FOR INDUSTRIAL GOODS AND THAT OUR POST-AFGHANISTAN GRAIN EMBARGO HAD COST US A SUBSTANTIAL SHARE OF THE GRAIN MARKET, TAKEN UP BY ARGENTINA AND CANADA. HE SUGGESTED THAT IT WOULD BE RELATIVELY EASY FOR THE GERMANS TO ADOPT POSTURE SIMILAR TO OURS, I. E. NO GOVERNMENT GUARANTEES; IT WOULD BE MORE DIFFICULT FOR OTHER ALLIES. WHILE END OF HERMES GUARANTEES COULD RESULT IN SOME TRADE LOSS, ACTUAL OUTCOME HARD TO PREDICT. HE ACKNOWLEDGED THAT WESTERN PRESSURE WOULD NEVER CHANGE SOVIET SYSTEM; HOWEVER, WE COULD MAKE CHOICES MORE DIFFICULT FOR SOVIET LEADERS. HE STRESSED THE NEED FOR BETTER INFORMATION EXCHANGE ON CREDITS/GUARANTEES, WHICH COULD WORK TO THE ADVANTAGE OF FRG. (LELAND GAVE VON WUERZEN COPY OF FORMAT WHICH COULD BE USED TO REPORT GUARANTEES.) IN CONCLUSION, LELAND SAID HE HOPED THAT U. S. WOULD NOT HEAR ABOUT HOW 1978 FRG-SOVIET TREATY PREVENTED ANY ACTION RESTRICTING HERMES ACTIVITIES IN USSR. (FOR WHATEVER REASON, GERMANS DID NOT RAISE THIS TREATY, IN CONTRAST TO THEIR POST-AFGHANISTAN PERFORMANCE.)

7. MR. BAILEY NOTED THAT PRESIDENT REAGAN HAD DEFERRED ANY DECISION ON APPLICATION OF DECEMBER 29 DECISIONS, ADDING THAT THE PRESIDENT WAS CONFIDENT THAT THE ALLIES WOULD BE ABLE TO WORK OUT AN AGREEMENT WHICH WOULD PRUDENTLY REVERSE WEST-TO-EAST CAPITAL FLOW. HE EXPRESSED HOPE THAT THERE WOULD BE NO MORE "1.2 BILLION MARK SURPRISES" WHILE EFFORT TO DEVELOP SUCH A SYSTEM PROCEEDS, AND OUTLINED CONSULTATIVE PROCESS MOVING THROUGH FURTHER BILATERAL MEETINGS TO A CONFERENCE, PERHAPS IN WASHINGTON, WHERE WE WOULD HOPE THAT FINAL AGREEMENT COULD BE REACHED.

8. LAUTENSCHLAGER NOTED BROAD RANGE OF TOPICS RAISED BY U. S. SIDE. HE CHARACTERIZED TODAY'S MEETING AS ONE IN A SERIES BETWEEN JANUARY 11 NAC FOREIGN MINISTERS MEETINGS AND JUNE SUMMITS, IN PARTICULAR VERSAILLES, WHERE PRESENCE OF JAPAN WOULD MAKE DISCUSSION OF EAST-WEST TRADE PROBLEMS APPROPRIATE. AS REGARDS CONSIDERATIONS MENTIONED BY DR. IKLE, GERMANS HAVE SINCE JANUARY 11 TAKEN STEPS AGAINST SOVIET UNION, INCLUDING REFUSAL TO NEGOTIATE TECHNOLOGY AND MARITIME AGREEMENTS AND CUT IN IMPORTS FROM THE USSR. LATTER WAS NOT EASY, HE SAID, BT

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AND ADVISED U.S. NOT TO BE SO DISAPPOINTED WITH OUTCOME SINCE EC UNITY WOULD IMPRESS SOVIETS MORE THAN A HIGHER FIGURE, HE ARGUED. CONTINUING, LAUTENSCHLAGER NOTED THAT U.S. NOT PROPOSING TRADE WAR WITH SOVIETS BUT WAS SEEKING END TO OFFICIAL SUBSIDIZATION OF CREDITS, WHICH HE CHARACTERIZED AS A WORTHWHILE GOAL. HE ALSO NOTED US-FRG AGREEMENT THAT NO WESTERN SANCTIONS WOULD CAUSE SOVIETS TO CHANGE COURSE; WE COULD MAKE THINGS MORE DIFFICULT FOR THEM, HE SAID, BUT NO MORE. LAUTENSCHLAGER STRESSED NEED FOR CONSENSUS OF ALL KEY COUNTRIES ON BOTH OBJECTIVES AND PROCEDURES, AND HE RAISED QUESTION OF U.S. GRAIN SALES, REJECTING BY IMPLICATION OUR CONTENTION THAT THESE ARE PURELY COMMERCIAL AND SHOULD HAVE NO IMPACT ON CREDIT RESTRAINTS ISSUE. DUE TO DIFFERENT TRADE STRUCTURES, ANY CUT BACK IN CREDIT WOULD HAVE VERY ADVERSE AFFECT ON FRG EXPORTS. HE RECALLED FAMILIAR GERMAN ARGUMENT THAT HERMES GUARANTEES DO NOT CONSTITUTE SUBSIDIZATION OF CREDIT FLOWS, BUT NOTED THAT U.S. DOES NOT ACCEPT THIS REASONING. HERMES, HE SAID, WAS A TOTALLY NON-DISCRIMINATORY SYSTEM, WITH NO SPECIAL BREAKS FOR SOVIETS.

9. LAUTENSCHLAGER ALSO RAISED FRG SUPPORT FOR RAISING USSR FROM CATEGORY II TO I IN OECD CONSENSUS, AND ASKED FOR GREATER U.S. SUPPORT. (LELAND SAID WE SHARED OBJECTIVE BUT REGARDED IT AS "TOO LITTLE, TOO SOON.") GERMANS CONTINUED TO BELIEVE, HE SAID, THAT OECD WOULD BE APPROPRIATE FORUM FOR MULTILATERAL WORK ON CREDIT RESTRAINT MECHANISM; HOWEVER, GERMANS UNDERSTAND U.S. "ANXIETIES" REGARDING NEUTRALS AND WOULD BE PREPARED TO WORK IN A DE FACTO, SMALLER FORUM ON MARGINS OF OECD. HE MADE REFERENCE TO EXPERIENCE OF ESTABLISHMENT OF IEA AS EXAMPLE OF WHAT GERMANS BELIEVE MAY BE POSSIBLE. IN CONCLUSION, LAUTENSCHLAGER AGREED WITH NEED FOR GREATER TRANSPARENCY ON CREDITS/GUARANTEES, MAINTAINED THAT U.S. EFFORTS TO REDUCE LEVEL OF HERMES GUARANTEES WAS AIMED, IN PRACTICE, AT FRG EXPORTS, AND STATED FRG COMMITMENT TO FULFILL SIGNED CONTRACTS. ON LATTER POINT, LAUTENSCHLAGER CLAIMED THAT GERMANS HAD ORIGINALLY UNDERSTOOD THAT U.S. WOULD ALLOW FULFILLMENT OF SIGNED CONTRACTS CAUGHT BY OUR DECEMBER 29 MEASURES ONCE THE MEANING OF "NO UNDER-CUTTING" WAS PROPERLY DEFINED. SINCE THEN, U.S. HAD CHANGED COURSE AND WAS NOW SETTING CONDITION OF AGREEMENT ON CREDITS/GUARANTEES. U.S. PARTICIPANTS STRONGLY DENIED

SECRET

10
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PAGE 02 OF 02 LONDON 5926

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THAT THERE HAD EVER BEEN U.S. PROPOSAL TO LINK AGREEMENT ON "NO UNDERCUTTING" WITH U.S. RELEASE OF ROTORS, FOR EXAMPLE. IN FACT, THEY POINTED OUT, FRG FULFILLMENT OF CONTRACTS COULD BE SEEN AS UNDERCUTTING OUR MEASURES. (THIS SAME EXCHANGE WAS REPEATED LATER IN MEETING.)

10. STATE SECRETARY VON WUERZEN SUPPORTED LAUTENSCHLAGER'S PRESENTATION, AND STRESSED AT SEVERAL POINTS THAT ANY DECREASE IN HERMES GUARANTEES WOULD LEAD TO FALL IN FRG EXPORTS. HE REJECTED U.S. CONTENTION THAT HERMES CONSTITUTED EITHER A SUBSIDY OR A TECHNIQUE USED BY THE STATE ARTIFICIALLY TO DIRECT CREDIT FLOWS TO THE USSR. HE EXPLAINED NECESSITY OF HERMES ARRANGEMENTS ON GROUNDS THAT NON-STATE-OWNED AND RELATIVELY UNDERCAPITALIZED GERMAN BANKING SYSTEM COULD NOT OTHERWISE PROVIDE NECESSARY GUARANTEES FOR GERMANY'S HEAVY VOLUME OF EXPORTS. VON WUERZEN MADE STRONG PLEA, ON BASIS OF "MAINTAINING UNITY," THAT U.S. TAKE INTO ACCDUNT UNIQUE GERMAN SITUATION, IN PARTICULAR STRUCTURE OF EXPORT AND PARTICIPATION OF MANY SMALL FIRMS THEREIN. IF GUARANTEES FALL, HE REPEATED, TRADE WILL ALSO DECLINE. ON ENERGY COOPERATION, VON WUERZEN STRESSED FRG'S DESIRE TO COOPERATE WITH U.S. BUT ARGUED THAT U.S. COAL EXPORTS ALONE COULD NOT ELIMINATE NEED FOR SOVIET GAS.

11. RESPONDING TO FRG PRESENTATIONS, UNDERSECRETARY BUCKLEY OBSERVED THAT REFERENCE TO JUNE SUMMITS DOES NOT SUGGEST SENSE OF URGENCY WHICH WE ATTACH TO PRINCIPAL ISSUE UNDER DISCUSSION; WE NEED TO DISCOVER NOW WHETHER THERE IS A WILL AMONG KEY ALLIES TO REACH NEW CONSENSUS ON EXPORT CREDITS/GUARANTEES TO SOVIET UNION. US FAVORS, HE SAID, IMPROVED MECHANISM LIKE COCOM BECAUSE OF THE UNIQUENESS OF BOTH THE PROBLEM AND THE OBJECTIVES. WITH SUCH A SYSTEM, WE CAN HAVE TANGIBLE, THOUGH MARGINAL IMPACT ON THE SOVIET UNION WHICH WOULD BE OF REAL VALUE TO THE WEST. BUCKLEY OBSERVED THAT GERMANS HAD CITED ALL THE PROBLEMS WE MUST FACE IN REACHING AGREEMENT; WE ARE AWARE OF THESE OBSTACLES, BUT BELIEVE THEY CAN BE OVERCOME IF ALL INVOLVED COOPERATE. AN EQUITABLE ARRANGEMENT, IN WHICH NO PARTICIPANT SEES ITS INTERESTS SUFFERING IN RELATIVE TERMS, IS THE ONLY KIND WHICH WOULD WORK, HE ADDED, AND POINTED OUT THAT UNLESS GERMANS ARE PREPARED TO MAKE ADJUSTMENTS IN HERMES, THEY COULD NOT EXPECT UK AND FRANCE TO ELIMINATE ELEMENTS OF SUBSIDIZATION IN THEIR SYSTEMS. AS FAR AS THEORY OF HERMES IS CONCERNED, BUCKLEY ARGUED, FACT THAT GOVERNMENT STANDS BEHIND IT AS
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PAGE 01 OF 02 LONDON 5926
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~~SECRET~~ SECTION 04 OF 06 LONDON 05926

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GUARANTOR INVOLVES ELEMENT OF SUBSIDY. WHY NOT REMOVE THIS STATE GUARANTEE, HE ASKED. AND LET MARKET DECIDE WHETHER A GIVEN CREDIT IS SECURE? HERMES HAS QUOTAS, HE POINTED OUT, FOR COUNTRIES IN POOR FINANCIAL STRAITS. WHY NOTE DO THIS IN CASE OF USSR, PARTICULARLY SINCE WE ALL AGREE THAT USSR IS DIFFERENT FROM OTHER COUNTRIES. VON WUERZEN ACKNOWLEDGED THAT USSR AS A COUNTRY AND TRADE WITH USSR WERE DIFFERENT, BUT HE REJECTED CONTENTION THAT THIS REQUIRED ADJUSTMENTS IN HERMES, WHICH HAD BEEN APPLIED WITHOUT CHANGE FOR 30 YEARS. TO DEMONSTRATE ALLEGEDLY WEAK FRG TRADING POSITION, VON WUERZEN CITED (AND REPEATED SEVERAL TIMES LATER IN CONVERSATION) FACT THAT GERMANS APPEAR LIKELY TO RECEIVE ONLY 2.5 BILLION MARKS IN PIPELINE ORDERS ALTHOUGH 10 BILLION HAD BEEN ANTICIPATED. HE CONCLUDED WITH ARGUMENT THAT SINCE LIMITS ON HERMES MEAN LIMITS ON TRADE, WE SHOULD DISCUSS LATTER SUBJECT.

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12. IN REPLY, LELAND STRESSED NEED FOR EQUALLY SHARED BURDEN IN WHICH NO COUNTRY WOULD SUFFER IN RELATIVE SENSE. HE CHARACTERIZED GERMAN STATEMENT THAT FRG PREPARED GO TO MARKET RATES IN OECD YET RETAIN HERMES AS A BIT LIKE JAPANESE POSITION ON SALES OF U.S. CARS IN JAPAN. IF MARKET TO BE FOLLOWED, WHY NOT DISPENSE WITH HERMES, HE ASKED? AS FAR AS U.S. POSITION ON RECLASSIFICATION OF USSR IN OECD CONSENSUS, OUR ONLY PROBLEM WAS TO HAVE GENERAL RECLASSIFICATION WITHIN CONSENSUS SO THAT NEUTRALS WOULD GO ALONG. AS FAR AS FORUM FOR SEPARATED NEW CONSENSUS ON CREDITS/GUARANTEES TO THE USSR, LELAND ARGUED THAT OECD WOULD NOT WORK, DUE IN LARGE MEASURE TO ITS MEMBERSHIP. VON WUERZEN ACCEPTED THIS POINT AND SAID FRG PROPOSED TO WORK WITHIN A SMALLER CIRCLE ON MARGINS OF OECD. IN SOMEWHAT CONTRIDICTORY REMARK, HE SAID THAT IF U.S. WAS INTERESTED IN USE OF MARKET TO CUT AVAILABILITY OF CREDITS TO USSR, WE SHOULD BE PLEASED WITH WORKINGS OF EURO CURRENCY MARKETS, WHERE NO LENDING TO USSR IS NOW TAKING PLACE. THUS, HE SAID, CUTTING BACK ON HERMES IS NOT ONLY WAY TO PROCEED. HE ASKED THAT WE UNDERSTAND THAT HERMES IS TIME-HONORED SYSTEM AND GERMANS HAVE NO OTHER WAY OF DOING BUSINESS, AND CLAIMED THAT U.S. SALES TO USSR INCREASING. UNDERSECRETARY OLMER TOOK ISSUE WITH LATTER POINT, AND CITED IMPACT OF OUR DECEMBER 29 MEASURES ON

SECRET

12
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PAGE 02 OF 02 LONDON 5926

DTG: 170838Z MAR 82 PSN: 000328

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13. BUCKLEY SAID IT WAS CLEAR THAT ISSUES RAISED BY VON WUERZEN WERE AT HEART OF MATTER, AND RESTATED THREE BASIC OBJECTIVES, I. E.: 1) GREATER TRANSPARENCY, ON WHICH THERE SEEMS TO BE NO DISAGREEMENT; 2) AGREEMENT ON CONCEPT THAT SOVIET UNION IS "DIFFERENT" IN TRADE TERMS AND DOES REQUIRE SPECIAL TREATMENT AS WE GIVE IT IN HIGH TECHNOLOGY FIELD; AND 3) PENDING AGREEMENT ON OUTSTANDING ISSUES, WITHIN BRIEF TIME SPAN, THAT WE HAVE A PAUSE IN NEW GUARANTEES SO THAT WE HAVE TIME TO COME TO GRIPS WITH PROBLEMS. LAUTENSCHLAGER SAID THIS WAS A "SORT OF MORITORIUM," TO WHICH BUCKLEY REPLIED THAT WE HAVE IN MIND A "STRETCHING OUT" AND DELAY OF DECISIONS. VON WUERZEN SAID HE COULD AGREE TO OBJECTIVES ONE AND TWO; OBJECTIVE THREE GAVE HIM PROBLEMS, BUT AGREED IT COULD BE DISCUSSED. HE OBJECTED AGAIN TO "MANIPULATION" OF HERMES, AND ADDED THAT HE KNEW THERE WOULD BE NEW APPLICATIONS PRESENTED SHORTLY. LAUTENSCHLAGER SAID, RE OBJECTIVE TWO, THAT MORE DISCUSSION OF MECHANISM THE U. S. PROPOSES, ITS PARTICIPANTS AND PROCEDURES, WAS NEEDED. HE RAISED AT THIS POINT PROBLEM OF COMPETENCE OF EC COMMISSION IN TRADE FIELD, ARGUING THAT WHILE THIS WAS NOT INSUPERABLE PROBLEM, IT WOULD HAVE TO BE ADDRESSED. LELAND OBSERVED THAT GROUP WOULD MEET WITH COMMISSION.

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14. LOOKING AHEAD, LAUTENSCHLAGER SAID FRG SIDE WOULD INFORM INTERESTED MINISTERS OF U. S. VIEWS; THERE WOULD BE INTER-MINISTERIAL DISCUSSION MARCH 16, FOLLOWED BY CABINET MEETING MARCH 17. FRG WOULD DISCUSS ISSUES WITH UK AT MARCH 19-20 SUMMIT AND WITH OTHER EC-10 MEMBERS AT MARCH 22-23 FOREIGN MINISTERS' MEETING. GERMANS WANT TO BE HELPFUL, HE SAID. THEY UNDERSTAND IMPORTANCE OF MISSION; THEY WANT U. S. TO KNOW WHAT CAN AND CANNOT BE DONE, AND WHAT WILL TAKE TIME AND PATIENCE. HE STRESSED AGAIN GENSCHER'S GUIDING PRINCIPAL OF AVOIDING ANY BREACH IN WEST. HE IMPLIED THAT, IN INTEREST OF UNITY, U. S. SHOULD SHELVE SOME QUESTIONS WHICH WERE "TOO DIFFICULT." HE SUPPORTED VON WUERZEN'S CONTENTION THAT CURBING HERMES MEANS CURBING TRADE AND SUGGESTED THAT WE DISCUSS TRADE CURBS, WITH ALL SECTORS AND ALL COUNTRIES (I. E. U. S. GRAIN SALES) FAIR GAME. BUCKLEY DENIED THAT CUTTING TRADE WAS OUR OBJECTIVE; RATHER, WE SEEK RECOGNITION THAT CREDIT, IN ITS OWN RIGHT, IS A STRATEGIC COMMODITY WHICH WEST SHOULD CONTROL AS IT DOES HIGH TECHNOLOGY, SINCE SOVIETS CAN USE BOTH AGAINST US. OLMER NOTED
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PAGE 01 OF 02 LONDON 5926
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~~SECRET~~ SECTION 05 OF 06 LONDON 05926

EXDIS

EXTENSIVE SOVIET HARD-CURRENCY SUPPORT TO COUNTRIES SUCH AS CUBA, VIETNAM, ETC., WHICH IS MADE EASIER BY WESTERN CREDITS. IKLE SUGGESTED THAT IF SOVIETS CUT OIL DELIVERIES TO CASTRO, AS THEY HAVE DONE, IN ORDER TO SELL IT IN THE WEST, THIS COULD IMPEDE CASTRO ACTIVITIES IN ANGOLA, TO THE WEST'S BENEFIT. PERHAPS THEY WOULD BUY LESS GRAIN FROM U.S., HE ADDED, IF A REDUCTION IN WESTERN EUROPEAN CREDITS CUTS DOWN FOREIGN EXCHANGE AVAILABILITIES. LAUTENSCHLAGER SAID HE DOUBTED LATTER WOULD HAPPEN. LELAND SUGGESTED THAT SOVIETS WOULD CUT BACK FIRST ON GRAIN, THEN ON MACHINERY, AND ONLY LAST ON FOREIGN ADVENTURES, BUT WE WOULD FORCE THEM TO MAKE THE CHOICE. HE ALSO NOTED THAT EVENTUALLY, LARGE DEBTORS END UP "OWNING THE BANK," AND SAID WE WERE SEEKING TO HELP OUR ALLIES AVOID THIS SORT OF SITUATION WITH THE USSR. VON WUERZEN SAID GERMANS SAW TRADE GOING DOWN IN ANY CASE AND ASKED WHETHER GERMANS SHOULD ENCOURAGE BANKS TO CUT BACK EVEN MORE. LELAND NOTED THAT FRG HAD CLOSED HERMES WINDOW FOR ROMANIA DUE TO THAT COUNTRY'S WELL-KNOWN PROBLEMS; HOWEVER, IN CASE OF SOVIET UNION, REVERSE WAS HAPPENING, AS EVER GREATER SHARE OF FRG'S EXPORTS WERE HERMES GUARANTEED DESPITE FALL IN USSR'S CREDIT RATING. HE ASKED WHY THIS HAD HAPPENED. GERMANS DID NOT REPLY DIRECTLY, BUT VON WUERZEN OBSERVED THAT "FOR US TO CHANGE HERMES NOW WOULD BE A DISASTER; THERE IS AN EVER-GREATER DEMAND FOR HERMES." BAILEY OBSERVED THAT IF PRIVATE BANKS WERE OUT OF MARKET, EFFECT WAS THAT HERMES ALONE WOULD DETERMINE AMOUNT OF FINANCING AVAILABLE FOR EXPORTS TO USSR, AND LELAND TOLD GERMANS THAT UNLESS WE HAVE SOME MOVEMENT FROM THEM, WE CAN EXPECT NOTHING FROM BRITISH OR FRENCH. LAUTENSCHLAGER SUGGESTED THAT THE REVERSE WAS THE CASE, I.E. THAT GERMANS SHOULD WAIT FOR SOMETHING FROM BRITISH AND FRENCH, SINCE, AS LELAND HAD ADMITTED EARLIER, GERMANS WERE AMONG THE LEAST OF THE "SINNERS." LELAND SAID MOVES BY ALL WERE NEEDED AND THAT WE NEEDED TO KNOW WHAT PERCENTAGE OF FRG EXPORTS TO USSR WERE COVERED BY HERMES. (LELAND LEARNED SUBSEQUENTLY THAT APPROXIMATE FIGURES WERE ONE-THIRD FOR 1981 AND POSSIBLY AS MUCH AS 50 PERCENT IN 1982). AT CONCLUSION OF MORNING SESSION, VON WUERZEN OBSERVED THAT QUESTIONS OF EQUITY AND BURDEN SHARING WERE THE KEY AND EXTREMELY DIFFICULT. HE NOTED THAT U.S. HAD NOT BEEN SPECIFIC REGARDING HERMES, AND ASKED "WHAT DO YOU EXPECT OF US

SECRET

14
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PAGE 02 OF 02 LONDON 5926

DTG: 170838Z MAR 82 PSN: 000331

ON HERMES ? STAND STILL? CUT IT? KILL IT?" IKLE
SUGGESTED THAT WE WOULD PREFER SUBSTITUTION OF PRIVATE
INSURANCE SYSTEM IN WHICH MARKET WOULD DECIDE ON CREDITS.

15. FOLLOWING LUNCH AND MEETING WITH GENSCHER (SEPTTEL),
DELEGATIONS REASSEMBLED FOR BRIEF WRAP-UP SESSION.
WHEREAS MORNING SESSION HAD ENDED WITH WHAT APPEARED TO
BE HINTS OF MOVEMENT BY VON WUERZEN, GENSCHER WAS NOT
FORTHCOMING. IN FINAL SESSION, LAUTENSCHLAGER AND VON
WUERZEN APPEARED TO TAKE THEIR CUE FROM GENSCHER, AND
WERE GENERALLY EVEN MORE RESERVED THAN IN THE MORNING.

16. PICKING UP ON POINTS FROM GENSCHER MEETING, IKLE
NOTED THAT WE SHOULD LOOK AT TOTAL DEBT OF SOVIET BLOC,
WHICH IS IN THE \$80 BILLION RANGE, IN CONSIDERING SOVIET
UNION'S CREDIT-WORTHINESS. HE ALSO SUGGESTED THAT
GERMANS MAKE CLEAR TO GENSCHER THAT U.S. WAS NOT RPT NOT
SEEKING TO CUT TRADE, AS GENSCHER HAD NOT APPEARED AWARE
OF THIS POINT. BUCKLEY REPEATED ARGUMENT REGARDING
STRATEGIC NATURE OF CREDIT AND NEED FOR A MECHANISM
WHICH COULD LOOK AT CREDIT TO USSR IN THIS LIGHT. HE
SAID WE SOUGHT INDICATION FROM GERMANS THAT THEY SHARE
THIS CONCEPT AND WILL WORK WITH US ON IT. THE MECHANISM
WE ESTABLISH WOULD CHANGE WITH THE TIMES, HE SAID. IN
MEANTIME, IT WAS IMPORTANT THAT THE BUREAUCRACY MAKE NO
HASTE IN PROCESSING HERMES APPLICATIONS. WE WOULD LIKE
TO HEAR FROM THE GERMANS ON OUR IDEAS, HE SAID, PERHAPS
DURING THE WEEK OF MARCH 22 AFTER THEY HAVE CONSULTED
WITH THEIR EC-10 FRIENDS. LAUTENSCHLAGER PROTESTED
THAT SOME OF ISSUES RAISED WERE FAR REACHING; EVEN IF WE
AGREE ON ANALYSIS, HE ADDED, MUCH TIME WILL BE NEEDED
SINCE IMPACT ON TRADE IS INEVITABLE. HE SUGGESTED THAT
FRG AGREEMENT TO TRANSPARENCY IN REPORTING ON GUARANTEES
WAS A BIG STEP AHEAD. FURTHER DISCUSSIONS WOULD REVEAL,
HE SAID, WHETHER FRG SHARED BASIC U.S. ASSESSMENT. HE
SUGGESTED THAT THE FRG COULD GO ALONG UNDER TWO
CONDITIONS: 1) UNITY OF WEST IS PRESERVED; AND 2) SYSTEM
ADOPTED MUST MAKE SENSE FOR US, I.E. COST/BENEFIT RATIO
MUST BE IN OUR FAVOR. HE RECALLED IN THIS CONNECTION
SKEPTICISM WHICH GENSCHER HAD EXPRESSED. GERMANS WERE,
IN ANY CASE, PREPARED TO CONSULT FURTHER, AND HE SAID HE
HOPED U.S. DELEGATION LEFT BONN WITH FEELING THAT GERMANS
PREPARED WORK WITH US.

17. BAILEY SAID HE HOPED GREATER TRANSPARENCY APPLIED
TO EASTERN EUROPEAN COUNTRIES AS WELL AS USSR AND ASKED
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15
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PAGE 01
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~~SECRET~~ SECTION 06 OF 06 LONDON 05926

EXDIS

WHAT GENSCHER HAD MEANT WHEN HE REFERRED TO LACK OF IMPORTANCE OF FRG TRADE WITH USSR. ON LATTER POINT, LAUTENSCHLAGER SAID GENSCHER WAS CONCERNED THAT U.S. PRESS EXAGGERATED IMPORTANCE OF THIS TRADE FOR FRG. ON BAILEY'S FIRST POINT, GERMANS BALKED AND AVOIDED DIRECT REPLY, ARGUING THAT THEY HAD THOUGHT CONVERSATION WAS ON USSR ONLY. LELAND EXPLAINED THAT WE NEED OVERALL PICTURE IN ORDER TO MAKE CORRECT JUDGMENTS. THERE WAS GENERAL AGREEMENT THAT, AT LEAST AT OUTSET, FOCUS IN REPORTING WOULD BE ON USSR.

18. IKLE OBSERVED THAT GENSCHER HAD RAISED QUESTION OF IMPACT OF CREDITS TO USSR ON SOVIET MILITARY CAPABILITIES. HE UNDERTOOK TO GET INFORMATION ON THIS TO GERMANS WITHIN TWO WEEKS. HE ALSO CITED IMPORTANCE OF GENSCHER'S COMMENTS ON NEED TO HAVE AGREEMENT ON POLITICAL CONTEXT WITHIN WHICH ACTIONS TO RESTRICT CREDITS WOULD TAKE PLACE.

19. IN CONCLUSION, LAUTENSCHLAGER SAID GERMANS WOULD WORK WITH US, IF ONLY BECAUSE THEY WANT SOMETHING FROM US ON ITEMS OF INTEREST TO FRG (I.E. ROTORS FOR AEG-KANIS). QUESTIONS FORMED AN INSEPARABLE WHOLE, HE SAID, AND NO-ONE WAS INTERESTED IN DELAY.

20. COMMENT: LENGTHY AND OFTEN FRUSTRATING CONVERSATION WITH THE GERMANS WILL BE FAMILIAR IN SEVERAL IMPORTANT RESPECTS TO THOSE WHO PARTICIPATED IN SOMEWHAT SIMILAR EXERCISE IN POST-AFGHANISTAN PERIOD. COMPARISON OF THE TWO EXPERIENCES SUGGESTS, HOWEVER, THAT WE HAVE MOVED THE GERMANS A BIT IN OUR DIRECTION. MOREOVER, AS LAUTENSCHLAGER'S CONCLUDING REMARKS INDICATE, SITUATION HAS CHANGED SINCE MID-1980 (IN MORE RESPECTS THAN HE MENTIONED) AND OUTCOME OF DISCUSSION THIS TIME AROUND IS OPEN TO QUESTION. AS EXPECTED, ULTIMATE POSITIONS OF ALL FOUR KEY EUROPEAN ALLIES WILL EVOLVE AS PART OF EUROPEAN CONSENSUS-BUILDING PROCESS. STREATOR
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EXDIS
FOR THE SECRETARY FROM UNDER SECRETARY BUCKLEY
ALSO FOR USEC
E.O. 12065: RDS-1 3/18/92 (BUCKLEY, JAMES L.)
TAGS: EFIN, EEWT, UR
SUBJECT: INTER-AGENCY MISSION ON EAST-WEST ECONOMIC
- RELATIONS: SUMMARY REPORT ON LONDON STOP

1. (SECRET - ENTIRE TEXT.)

2. SUMMARY: AS EXPECTED WE ENCOUNTERED MOST FAVORABLE
REACTION THUS FAR IN OUR TALKS WITH BRITISH OFFICIALS ON
PROPOSAL TO LIMIT FURTHER OFFICIAL CREDIT AND CREDIT
GUARANTEES TO SOVIET UNION. ALTHOUGH BRITISH RAISED MANY
OF THE SAME QUESTIONS WE ENCOUNTERED IN OTHER CAPITALS
AND ARE CLEARLY NOT YET READY TO SIGN ON OUR PROPOSAL,
THEY GENERALLY SUPPORT OUR OBJECTIVES TO EXTENT THEY ARE
PART OF EFFORT TO DEVELOP MORE RATIONAL LONG-TERM
WESTERN POLICY TOWARDS SOVIET UNION AND NOT MERELY
PUNITIVE MEASURES TAKEN IN RESPONSE TO POLAND OR OTHER
SOVIET ACTIONS. WE USED FINAL MEETING WITH LORD
CARRINGTON YESTERDAY AFTERNOON TO URGE THAT HE ENCOURAGE
HIS EUROPEAN COLLEAGUES TO RESPOND POSITIVELY TO OUR
PROPOSALS, AND WE HAVE IMPRESSION THAT HE WILL DO SO
WITHIN LIMITS. END SUMMARY.

3. MISSION'S PROGRAM IN LONDON BEGAN WITH BRIEF MEETING
WITH PARLIAMENTARY UNDER SECRETARY LORD TREFGARNE
FOLLOWED BY MEETING WITH INTER-AGENCY BRITISH TEAM
HEADED BY FCO DEPUTY UNDER SECRETARY LORD BRIDGES.
MEETING WITH CARRINGTON CONCLUDED DAY'S ACTIVITIES.
BRITISH ARE CLEARLY SYMPATHETIC TOWARD OUR BASIC
OBJECTIVE OF CURBING SOVIET ACCESS TO SUBSIDIZED CREDITS
FROM THE WEST. THEIR STAKE IN TRADE WITH THE USSR IS
LESS THAN EITHER FRANCE, GERMANY OR ITALY AND HAS
STEADILY DECLINED IN IMPORTANCE. THEIR POLITICAL
RELATIONSHIP WITH MOSCOW HAS NEVER BEEN PARTICULARLY
WARM AND SKEPTICISM OF CURRENT GOVERNMENT REGARDING
SOVIET MOTIVES AND BEHAVIOR IS A MATTER OF RECORD. THIS

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17

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BEING SAID, BRITISH OFFICIALS MADE CLEAR YESTERDAY THAT THEY CAN SUPPORT OUR EFFORTS ONLY AS PART OF A COHERENT STRATEGY AIMED ULTIMATELY AT RESTRAINING AND MODERATING SOVIET BEHAVIOR.

4. BRITISH ALSO ARE VERY CONSCIOUS OF OBSTACLES WE FACE. THEY HAVE CLEARLY THOUGHT MORE ABOUT OUR PROPOSALS THAN EITHER FRENCH OR GERMANS. LORD BRIDGES PERHAPS PUT AT BEST WHEN HE SAID "IF WE ARE TO CREATE A CONSENSUS FOR THIS APPROACH, WE WILL NEED TO MAKE CLEAR THAT THIS IS A POLICY WHICH DESERVES SUPPORT. YOU ARE SEEKING SUBSTANTIVE MODIFICATIONS OF OSTPOLITIK AND THIS ALSO WILL REQUIRE A CAREFULLY PREPARED POLITICAL ANALYSIS FOR SUCCESS." BRITISH HAVE ALSO GIVEN SOME THOUGHT TO QUESTION OF ARRANGEMENTS FOR FOLLOW UP. THEIR TENTATIVE THINKING SEEMS TO BE THAT WE COULD USE VARIOUS ORGANIZATIONS TO ADVANCE SEPARATE ASPECTS OF OUR PROPOSAL. FOR FIRST TIME IN OUR TRIP, POSSIBILITY OF USING NATO AS FORUM FOR ALLIED DISCUSSIONS WAS RAISED. BRIDGES ALSO SUGGESTED THAT SOME WORK MIGHT BE DONE IN OECD AND THAT PREPARATIONS FOR PARIS SUMMIT MIGHT ALSO BE USED. BRITISH DID NOT SEEM TO HAVE A CLEAR IDEA AT THIS POINT OF HOW VARIOUS PIECES OF THE PUZZLE MIGHT BE DIVIDED BETWEEN THESE ORGANIZATIONS. THEY ALSO SEEM TO FEEL THAT MULTILATERAL DECISIONS, PERHAPS AMONG THE SUMMIT 7 GROUP, WOULD BE USEFUL AT AN EARLY STAGE, PERHAPS AT "WORKING LEVEL" (NOT OTHERWISE DEFINED). WHEN WE HAVE SUCH A MEETING, WE MIGHT WANT TO THINK ABOUT ASKING BRITISH TO PROPOSE LONDON AS A VENUE SINCE IT WOULD BE MUCH LESS LIKELY TO ATTRACT UNHELPFUL ATTENTION.

5. BANK OF ENGLAND REPRESENTATIVE AT INTER-AGENCY MEETING EXPRESSED SERIOUS CONCERN OVER IMPLICATIONS OF OUR EFFORTS FOR STABILITY OF INTERNATIONAL FINANCIAL SYSTEM, GIVEN CREDIT UNCERTAINTIES. HIS CONCERNS CENTERED ON BUT WERE NOT RESTRICTED TO EASTERN EUROPEAN COUNTRIES (PRESUMABLY IN ADDITION TO POLAND AND ROMANIA).

6. ALTHOUGH BRITISH DID NOT ABSOLUTELY RULE OUT POSSIBILITY OF A "PAUSE" IN NEW CREDITS/GUARANTEES PENDING AGREEMENT ON LONG-TERM ARRANGEMENT, THEY SHOWED NO ENTHUSIASM FOR THIS PROPOSAL. AS EXPECTED, REPRESENTATIVE OF BRITISH EXPORT CREDIT ORGANIZATION
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EXDIS
FOR THE SECRETARY FROM UNDER SECRETARY BUCKLEY
ALSO FOR USEC
(CDG) CRITICIZED "PAUSE" AS UNPRECEDENTED USE OF
CREDIT POLICY FOR POLITICAL PURPOSES. BRIDGES CONCLUDED
THAT THE PROPOSAL FOR A "PAUSE" WAS "A RATHER DIFFICULT
STEP FOR US TO CONTEMPLATE, PARTICULARLY IN ISOLATION."
HE ADDED THAT BRITISH WILL EXAMINE FURTHER BUT COULD NOT
BE TOO ENCOURAGING AT THIS POINT.

7. COMMENT: WE LEAVE LONDON ENCOURAGED THAT BRITISH
UNDERSTAND WHAT WE ARE SEEKING, INSTINCTIVELY SUPPORT
OUR OBJECTIVES ALTHOUGH THEY ARE SKEPTICAL REGARDING
OUR PROSPECTS, AND CAN BE COUNTED UPON TO PROVIDE SOME
SUPPORT IN UPCOMING EUROPEAN MEETINGS. TO BRING BRITISH
MORE FIRMLY TO OUR SIDE WE WILL HAVE TO DEMONSTRATE TO
THEM THAT OUR PROPOSALS IN THIS CREDITS AREA ARE PART OF
A CLEAR WELL-THOUGHT OUT STRATEGY FOR EAST-WEST RELATIONS
WHICH MAKES SENSE FOR THEIR INTERESTS. RABIN
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19

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EXDIS
ALSO FOR USEC
E.O. 12065: RDS-1, 3/18/92 (BUCKLEY, JAMES L.)
TAGS: EFIN, EEWT, UR
SUBJECT: INTER-AGENCY MISSION ON EAST-WEST ECONOMIC
- RELATIONS: REPORT ON TALKS IN PARIS

1. (~~SECRET~~ - ENTIRE TEXT.)

2. SUMMARY:
FOCUS OF MISSION'S TALKS IN PARIS WAS THREE-HOUR-SESSION WITH FRENCH INTER-AGENCY TEAM HEADED BY QUAI ECONOMIC DIRECTOR PAYE INCLUDING MOUTON, ALSO FROM THE QUAI, SCHNEITER OF DREE AND TRICHET OF THE TREASURY. PRIOR TO THAT MEETING, SENIOR MEMBERS OF MISSION AND AMBASSADOR GALBRAITH MET WITH FOREIGN MINISTER CHEYSSON WHO WAS GENERALLY POSITIVE BUT NON-COMMITTAL TOWARD THE MISSION'S OBJECTIVES. FOLLOWING LUNCH AT QUAI, MEMBERS OF MISSION MET SEPARATELY WITH FINANCE, DEFENSE AND ELYSEE OFFICIALS AS WELL AS WITH OECD SEC-GEN VAN LENNEP. OVERALL IMPRESSION OF TALKS WITH FRENCH IS THAT WHILE GOF SHARES MANY OF OUR BASIC CONCERNS AND WOULD LIKE TO WORK WITH US IN CREDITS AREA, THIS WILL HAVE TO BE DONE WITHOUT PREJUDICE TO FRENCH ECONOMIC INTERESTS. POLITICAL INCENTIVE FOR MAINTAINING CLOSE ECONOMIC RELATIONSHIP WITH USSR SEEMS LESS PRONOUNCED IN PARIS THAN MISSION FOUND TO BE THE CASE IN BONN. THIS BEING SAID, HOWEVER, MOVING FROM GOOD FRENCH INTENTIONS TO CONCRETE UNDERTAKING WILL BE VERY DIFFICULT.
END SUMMARY.

3. UNDER SECRETARY BUCKLEY OPENED MEETING WITH OUTLINE OF U.S. OBJECTIVES, NOTING: THE PRESIDENT'S UNDERSTANDING OF EUROPEAN CONCERNS OVER DECEMBER 29 MEASURES AND HIS DECISION TO HOLD FURTHER MOVES PENDING MISSION'S VISIT; FAILURE OF "DETENTE POLICY" TO PRODUCE HOPED-FOR IMPACT ON SOVIET UNION; DISAPPOINTED HOPES FROM CSCE, MOST DRAMATICALLY REVEALED LAST FRIDAY IN MADRID; NEED TO FOCUS ON STRATEGIC ROLE OF CREDITS IN FACE OF SOVIET BUILD-UP; THREAT TO WESTERN FINANCIAL STABILITY OF SOVIET/EASTERN EUROPEAN DEBT; AND NEED FOR COMMON ALLIED APPROACH. BUCKLEY SAID WE WERE AWARE OF COMPETITIVE

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PAGE 02 OF 02 ROME 6645

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PRESSURES BUT BELIEVED THAT IF WE COULD AGREE ON BASIC OBJECTIVE WE COULD FIND WAYS TO DEAL WITH THIS PROBLEM. HE NOTED THAT WE HAD ALREADY APPROACHED JAPANESE, WHO, TOGETHER WITH FOUR COUNTRIES ON MISSION'S EUROPEAN ITINERARY WERE RESPONSIBLE FOR 90 PERCENT OF CREDITS EXTENDED TO USSR. HE ASKED WHETHER FRENCH COULD:

- A. AGREE ON NECESSITY OF DEVELOPING COMMON APPROACH ON OFFICIAL CREDITS AND GUARANTEES TO SOVIET UNION;
- B. AGREE TO GIVE MUCH MORE INFORMATION TO OTHER PARTICIPATING COUNTRIES ON THEIR CREDIT OPERATIONS WITH SOVIET UNION;
- C. JOIN IN A "PAUSE" ON FURTHER EXTENSIONS OF CREDITS/ GUARANTEES TILL KEY ALLIES AGREE ON ESTABLISHMENT OF A MECHANISM FOR FURTHER POLICY COORDINATION.

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4. UNDER SECRETARY IKLE STRESSED STRATEGIC IMPLICATIONS OF CREDITS ISSUE, POINTING TO THREAT WHICH GROWTH OF SOVIET MILITARY POTENTIAL POSED TO ALLIES. FRENCH AND U.S., HE SAID, ARE ENGAGING IN MAJOR BUILD-UP OF THEIR FORCES. HOWEVER, THIS EFFORT TO CLOSE GAP WOULD BE IN VAIN IF WE CONTINUE TO ASSIST, THROUGH CREDITS AND GUARANTEES, CONTINUING SOVIET BUILD-UP. HE ACKNOWLEDGED THAT OUR IMPACT ON SOVIET ECONOMY WOULD ALWAYS BE MARGINAL BUT ARGUED THAT ANY GAIN WOULD BE WORTH THE EFFORT. HE ALSO STRESSED NEED TO AVOID "REVERSE LEVERAGE" SITUATION IN WHICH SOVIETS USE WESTERN CREDIT EXPOSURE TO THEIR ADVANTAGE. UNDER SECRETARY OLMER CALLED ATTENTION TO SELF-IMPOSED RESTRAINTS ON ACTIVITIES OF U.S. BUSINESS IN SOVIET UNION GOING BACK TO 1974. RECENT U.S. LOSSES IN SALES, HE SAID, AMOUNTED TO ABOUT \$500 MILLION.

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5. ASSISTANT SECRETARY LELAND ALSO NOTED DANGER OF "REVERSE LEVERAGE" SITUATION. HE SUGGESTED THAT GENERAL ISSUE OF EXPORT CREDIT SUBSIDIES, WHICH WAS BEING DISCUSSED ELSEWHERE, CONTINUE TO BE HANDLED SEPARATELY.

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HE CHARACTERIZED CREDITS ISSUE AS OF STRATEGIC NATURE AND THEREFORE NOT SUITABLE FOR OECD DISCUSSION AND NOT, STRICTLY SPEAKING, ISSUE FOR EC COMPETENCE. LELAND SAID
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SECRET SECTION 02 OF 06 ROME 06645

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U. S. UNDERSTOOD NEED FOR EQUITY IN ANY RESULTING SYSTEM AND ADDED THAT NO COUNTRY COULD BE EXPECTED TO SUFFER DISPROPORTIONATELY. COMPETITIVE PRESSURES COULD BE HANDLED, HE SAID, ALTHOUGH HE ADMITTED THIS WOULD BE DIFFICULT. UNDER SECRETARY BUCKLEY MENTIONED THERE WERE THREE OTHER SUBJECTS WHICH MISSION WISHED TO DISCUSS BRIEFLY, NAMELY:

- 1. DEFAULT SAFETY NET;
 - 2. HOW POSSIBLE DEPENDENCY OF WESTERN EUROPE ON SOVIET ENERGY COULD BE AVOIDED; AND
 - 3. RESTRICTIONS ON IMPORTS FROM SOVIET UNION.
- DR. BAILEY OUTLINED POSSIBLE SCHEDULE FOR FOLLOW UP CONSULTATIONS ON CREDITS ISSUE LEADING THROUGH FURTHER BILATERAL MEETINGS TO A MULTILATERALIZATION AND AGREEMENT ON ESTABLISHMENT OF A COCOM-TYPE MECHANISM.

6. OPENING FOR THE FRENCH SIDE, PAYE SAID FRANCE SHARED U. S. PREOCCUPATIONS REGARDING ECONOMIC RELATIONS WITH USSR, WHICH HE LISTED AS: A) TECHNOLOGY TRANSFER, WHERE HE EXPRESSED SATISFACTION WITH STEPS TAKEN TO STRENGTHEN COCOM; AND B) FINANCIAL PROBLEMS, WHERE FRENCH WERE AWARE OF HAZARDS OF GIVING MORE CREDITS TO SOVIETS AND EASTERN EUROPEAN COUNTRIES WHEN THEY WERE RUNNING INTO DEEP TROUBLE. FRENCH HAVE BEEN TRYING FOR 2/3 YEARS TO REDUCE EXPOSURE IN EAST; FOR LAST 18 MONTHS, FRENCH HAVE HAD "TENSE" DISCUSSIONS WITH SOVIETS OVER CREDIT ISSUE AND INTEND TO CONTINUE TO TIGHTEN TERMS. FRENCH ARE READY, HE SAID, TO EXCHANGE INFORMATION ON THE DEBT PROBLEM AND CONTINUE WORK IN OECD. ON POLITICAL FRONT, FRENCH SHARE OUR DISAPPOINTMENT WITH RECENT TRENDS, BUT BELIEVE CONTINUATION OF DIALOGUE NONETHELESS ESSENTIAL. FRENCH WANT TO MAKE TRADE MUTUALLY BENEFICIAL, BUT MODIFICATIONS TO THAT END SHOULD BE MADE GRADUALLY. TOUGHER CONDITIONS FOR CREDITS ARE DESIRABLE, HE SAID, BUT WE SHOULD BE AWARE THAT THIS WILL NOT CHANGE SOVIETS, AND FRENCH FEEL "DESTRUCTION OF TRADE PATTERNS" WITH EAST WOULD ONLY HELP SOVIETS INCREASE CONTROL OVER EASTERN EUROPE.

7. PAYE SAID FRENCH WERE PLEASED THAT U. S. WAS NO LONGER FOLLOWING SANCTIONS APPROACH BUT WAS SEEKING TO DEVELOP LONG-TERM POLICY TOWARD USSR, AS FRENCH HAD LONG

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PAGE 02 OF 02 ROME 6645

DTG: 181112Z MAR 82 PSN: 001990

SOUGHT. HE WARNED AGAINST SEEKING TOO RAPID CHANGE AND GIVING SOME COUNTRIES IMPRESSION THAT BURDEN WAS NOT EQUALLY SHARED. PAYE SAID FRENCH COULD AGREE TO COMMON CONSIDERATION OF JOINT APPROACH AND TO MODIFICATION OF PATTERN OF TRADE AND CREDITS, AS LONG AS THIS DIDN'T MOVE TOO FAST OR CREATE CONTENTION AMONG ALLIES.

8. SCHNEITER (DREE) NOTED IMPORTANCE OF CAPITAL GOODS/ COMPLETE PLANTS IN FRENCH EXPORTS TO USSR, ALTHOUGH FRENCH SIDE INDICATED THAT IN THEIR 1981 EXPORTS OF 10 BILLION FRANCS, THESE ITEMS ACCOUNTED FOR ONLY 18 PERCENT OF THE TOTAL (85 PERCENT OF WHICH OR 15 PERCENT) WAS COVERED BY MEDIUM- AND LONG-TERM CREDITS. THIS LOW SHARE WAS DUE TO SMALL NUMBER OF CONTRACTS CONCLUDED IN 1977-79. IN 1982, SHARE OF CAPITAL GOODS SHOULD RETURN TO "NORMAL" 30-35 PERCENT RANGE AS MORE RECENT CONTRACTS BEGIN TO SHOW UP IN STATISTICS. DISCUSSING FRANCE'S LARGE AND GROWING TRADE DEFICIT WITH USSR, SCHNEITER SAID FRENCH WERE NOT INCLINED TO SEEK BILATERAL BALANCE SINCE OIL AND GAS ACCOUNTED FOR 85 PERCENT OF SOVIET EXPORTS, AND REDUCTION OF THESE PURCHASES WOULD WORK AGAINST FRENCH GOAL OF MAXIMUM DIVERSIFICATION. TURNING TO CREDIT POLICY, SCHNEITER CLAIMED THAT GOVERNMENT ROLE IN CREDIT SYSTEM IS "ONE OF CLAREST IN WEST" BECAUSE SUBSIDIES ARE GIVEN ON VERY CLEAR AND REGULAR BASIS. IN CASE OF USSR, SCHNEITER STRESSED THAT FRENCH HAD TERMINATED, AS OF SEPTEMBER 30, 1981, SPECIAL ARRANGEMENT ON INTEREST RATES. FRENCH CREDITS WERE NOW EXTENDED ONLY ON BASIS OF OECD CONSENSUS, AS OPPOSED TO PREVIOUS RATES OF 7.45 BT

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SECRET SECTION 03 OF 06 ROME 06645

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PERCENT (2-5 YEARS) AND 7.84 PERCENT (5-8 YEARS). SOVIETS
WERE SEEKING DISCUSSIONS ON NEW INTEREST RATE ARRANGEMENT,
IN WHICH THEY WOULD ASK FOR LONG-TERM COMMITMENT TO GO NO
HIGHER THAN CURRENT OECD CONSENSUS, BUT FRENCH WOULD
REFUSE THIS DEMAND. SCHNEITER OBSERVED THAT FRENCH HAVE
CALCULATED THAT TOTAL COST TO ALL WESTERN COUNTRIES OF
INTEREST RATE SUBSIDIES TO SOVIETS AMOUNTS TO ABOUT \$400
PER YEAR, WITH FRENCH SHARE OF ABOUT \$200 MILLION.
LELAND ASKED WHAT PERCENT OF TOTAL FRENCH EXPORTS TO
USSR WAS COVERED IN ONE WAY OR ANOTHER BY OFFICIAL CREDITS
OR GUARANTEES. SCHNEITER SAID THIS WAS LESS THAN 64 PER-
CENT.

9. CLARIFYING SCHNEITER'S PRESENTATION, PAYE NOTED THAT
WHILE FRENCH WERE NO LONGER COMMITTED TO GIVE SOVIETS
ANY PARTICULAR INTEREST RATE, THEY WERE COMMITTED, UNDER
FIVE-YEAR AGREEMENT WHICH EXPIRES IN 1985, TO GIVE
CREDITS AND GUARANTEES. THE TERMS OF INDIVIDUAL CREDITS,
I.E. RATES AND MATURITIES, DEPEND UPON SIZE AND NATURE
OF CONTRACT. ASKED WHETHER IRON/STEEL PRODUCTS COVERED
BY OFFICIAL CREDITS, PAYE SAID SOVIETS HAD DEMANDED THIS
BUT FRENCH HAD REFUSED. IKLE SUGGESTED THAT FRENCH
COMMITMENT TO SOVIETS WOULD NOT SEEM TO RULE OUT ARRANGE-
MENT WE HAVE IN MIND, BUT PAYE REPEATED THAT FRENCH
REGARD THEMSELVES COMMITTED TO GIVE CREDITS. MOUTON
RECALLED THAT LOWER RATES CHARGED THROUGH SEPTEMBER 30,
1981 HAD BEEN ESTABLISHED IN AN ANNEX TO THE FIVE-YEAR
PROTOCOL WHICH HAD A STATED LIFE OF 18 MONTHS. LELAND
ASKED WHY FRENCH COULD NOT NOW CHARGE SOVIETS RATES
HIGHER THAN THOSE IN OECD CONSENSUS, SINCE THEY WERE
CLEARLY LOSING MONEY ON BUSINESS. PAYE NOTED THAT
"EVERYONE IS LOSING MONEY."

10. ON SHORT-TERM CREDITS, FRENCH INDICATED THEY CHARGED
ANY RATE THE MARKET WOULD BEAR. MOUTON SAID ALMOST ALL
OF THE 1981 EXPORTS NOT IN CAPITAL GOODS CATEGORY (I.E.
ABOUT 82 PERCENT OF TOTAL) WAS COVERED BY SHORT-TERM
CREDITS AT MARKET RATES. THE SUBSIDY ELEMENT, HE SAID,
APPLIED ONLY TO MEDIUM/LONG TERM CREDITS FOR CAPITAL
GOODS.

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PAGE 02 OF 02 ROME 6645

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11. TRICHET NOTED THAT FRENCH HAVE CALCULATED THAT \$8 BILLION IN EXPORT CREDITS EXTENDED TO USSR ANNUALLY INVOLVES SUBSIDY TO SOVIETS OF \$400 MILLION, A SUM WHICH HE DESCRIBED AS SUBSTANTIAL BUT NOT OF THE MAGNITUDE TO HAVE A GREAT IMPACT ON THE USSR. HE ALSO MADE POINT THAT FRENCH REGARD CREDITS/GUARANTEES VERY IMPORTANT TO THEIR TRADE WITH USSR, RAISING POSSIBILITY OF SOVIET "RETALIATION" IF FRENCH TOOK STEPS AGAINST SOVIET ECONOMIC INTERESTS. TRICHET ADDED THAT FRENCH BANKS CONTINUE TO REGARD USSR, AS OPPOSED TO EASTERN EUROPE, AS GOOD RISK; LELAND REJECTED THIS ASSERTION, POINTING OUT THAT NEITHER FRENCH NOR U. S. BANKS WOULD LOAN MONEY TO SOVIETS BEYOND VERY SHORT TERMS WITHOUT GUARANTEES. TRICHET OBJECTED THAT AT LEAST HALF OF FRG'S EXPORTS TO USSR WERE COVERED BY NON-GUARANTEED CREDITS, TO WHICH LELAND POINTED OUT THAT THIS FIGURE WAS FALLING FAST AS HERMES GUARANTEES WERE BEING USED MORE AND MORE. LELAND ALSO OBSERVED THAT SINCE MARCH 1981, SOVIETS HAD BEEN UNABLE TO RAISE MONEY IN EUROCURRENCY MARKETS, AND BAILEY NOTED THAT SOVIETS WERE EVEN SEEKING LOANS FOR DOWN PAYMENTS (SUCCESSFULLY IN CASE OF FRANCE).

EXDIS

12. FRENCH THEN TURNED TO QUESTION OF U. S. GRAIN SALES, WHICH THEY SAID WAS VERY IMPORTANT IN TERMS OF BURDEN SHARING. PAYE SUGGESTED THAT SOVIETS HAD ACHIEVED SOME "REVERSE LEVERAGE" IN CASE OF U. S. GRAIN SALES. LELAND ACKNOWLEDGED THAT THERE WERE STRONG FORCES IN U. S. WHICH OPPOSED ANY EMBARGO, BUT POINTED OUT THAT REAL QUESTION WAS EFFECTIVENESS OF ANY U. S. ACTION IN ABSENCE COOPERATION OF CANADA AND ARGENTINA, WHICH CUT SUBSTANTIALLY INTO U. S. SHARE OF SOVIET MARKET DURING LAST EMBARGO. BUCKLEY POINTED OUT THAT IF SOVIET HARD CURRENCY AVAILABILITY SHRINKS DUE TO CREDIT RESTRICTIONS, THEY WILL PROBABLY CUT BACK ON PURCHASES OF U. S. GRAIN. OLMER

EXDIS

NOTED LIMITED IMPACT OF PARTIAL EMBARGO AND CALLED ATTENTION TO U. S. SACRIFICE OF LARGE VOLUME OF CAPITAL GOODS SALES TO USSR. RETURNING TO DANGER OF SOVIET BT

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SECRET SECTION 04 OF 06 ROME 06645

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COUNTERMEASURES, TRICHET SUGGESTED THAT CUT OFF IN WESTERN CREDITS WOULD CAUSE SOVIETS TO DECLARE MORITORIUM ON SERVICING OF EXISTING DEBTS. LELAND SAID THIS WAS CLASSIC CASE OF REVERSE LEVERAGE IN ACTION, AND SAID SMART THING WOULD BE TO CUT OFF FURTHER CREDITS BEFORE THE WEST FALLS EVEN DEEPER INTO THIS DANGER. EVEN PAYE SUGGESTED THAT TRICHET'S COMMENTS INDICATED THAT SOVIETS HAD SUBSTANTIAL LEVERAGE OVER FRANCE, BUT TRICHET CLAIMED THAT LEVERAGE IN FACT WAS OVER COMMERCIAL BANKS.

13. LELAND, IKLE AND BAILEY URGED GREATER INFORMATION SHARING ON STATUS OF LENDING TO THE EAST IN INTEREST OF MORE EFFECTIVE WESTERN COOPERATION AND CONTINGENCY PLANNING. FRENCH AGREED GREATER TRANSPARENCY WAS NEEDED BUT QUESTIONED WHETHER ANY SPECIAL GROUP WAS REQUIRED TO CARRY THIS OUT. OECD WOULD BE FINE, THEY SAID. LELAND SAID OECD WAS FINE FOR SHARING OF INFORMATION ON CREDITS; WHAT WE HAD IN MIND WAS INFORMAL GROUP WHICH WOULD NOT ONLY SHARE INFORMATION BUT CONSIDER AND AGREE ON HOW TO ACT.

14. PAYE ASKED HOW U.S. PROPOSED TO PROCEED AFTER FIRST ROUND OF BILATERAL CONSULTATIONS. BUCKLEY SAID WE HAD NO FIXED IDEAS BUT WERE THINKING IN TERMS OF INTENSIVE BILATERAL FOLLOW-UP, ASSUMING FIRST ROUND DEVELOPS CONSENSUS IN SUPPORT OF OUR BASIC STRATEGIC ANALYSIS, WITH MULTILATERAL MEETING AT END OF APRIL OR FIRST OF MAY. PAYE DISPLAYED CONTINUING SKEPTICISM REGARDING NEED FOR ANY NEW GROUP, SUGGESTING THAT EXISTING BODIES COULD BE USED. HE ALSO RAISED QUESTION OF EC COMPETENCE, TO WHICH LELAND POINTED OUT THAT WE ARE RAISING A SECURITY, NOT A TRADE, ISSUE; AS CONSEQUENCE, EC WOULD NOT BE DIRECTLY INVOLVED, ALTHOUGH MISSION PLANNED TO CONSULT WITH COMMISSION. PAYE ASKED WHETHER WE WERE THINKING IN TERMS OF "CREDIT COCOM." BAILEY SAID WE BELIEVE THE MORE INFORMAL A STRUCTURE SELECTED, THE BETTER. THIS WAS WHY PARALLEL WITH COCOM HAD BEEN MENTIONED.

15. TURNING TO THE U.S. PROPOSAL FOR A PAUSE IN APPROVAL OF NEW CREDITS, PAYE SAID HE DID NOT SEE HOW FRENCH COULD SQUARE THIS WITH COMMITMENTS OF THEIR FIVE-YEAR AGREEMENT

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PAGE 02 OF 02 ROME 6645

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WITH SOVIETS. BUCKLEY ASKED WHETHER CREDITS AND GUARANTEES WERE BEING GIVEN FOR NON-CAPITAL GOODS EXPORTS. COULD THIS BE AN AREA OF FLEXIBILITY, HE ASKED? PAYE AND SCHNEITER ACKNOWLEDGED THAT SHORT-TERM CREDITS WERE NOT UNDER THEIR FIVE-YEAR AGREEMENT WITH SOVIETS; HOWEVER, BOTH ARGUED THAT STOPPING CREDITS AND GUARANTEES FOR THESE ITEMS WOULD KILL THE TRADE, WHICH IS PARTICULARLY ATTRACTIVE SINCE NO SUBSIDIES ARE INVOLVED. IN ADDITION, A PAUSE IN THIS AREA WOULD BE PARTICULARLY DIFFICULT, THEY SAID, WITHOUT PARTICIPATION OF OTHER "EUROPEAN PARTNERS." PAYE ALSO RAISED POSSIBILITY THAT GOF MIGHT BE "OBLIGED" TO GRANT THESE CREDITS UNDER SOME BILATERAL "STATEMENT" WITH SOVIETS OF WHICH HE WAS UNAWARE; HE UNDERTOOK TO CHECK ON THIS POINT. FINALLY, HE NOTED THAT THERE MIGHT BE SOME REGULATION UNDER WHICH FRENCH EXPORTER WOULD HAVE LEGAL "RIGHT" TO CREDITS; FRENCH HAD NOT, HE SAID, PREVIOUSLY DENIED CREDITS/GUARANTEES ON POLITICAL GROUNDS. ASKED WHETHER FRENCH WERE CONTINUING TO GRANT CREDITS/GUARANTEES TO ROMANIA, TRICHET BURST OUT THAT "ROMANIA HAS NOTHING," DOUBTLESS DISPLAYING TREASURY'S EXASPERATION WITH THAT COUNTRY'S FINANCIAL PRACTICES.

16. LELAND ASKED HOW FRENCH HANDLE HIGH-RISK SITUATIONS. SCHNEITER SAID FRENCH HAVE "RISK-MANAGEMENT" SYSTEM FOR POLITICAL RISKS. RATES FOR COVERAGE OF THESE RISKS ARE UNIFORM, WORLD-WIDE; COMMERCIAL RISKS, ON THE OTHER HAND, ARE REFLECTED IN VARIABLE RATES DEPENDING UPON THE BORROWER. MOUTON RETURNED TO QUESTION OF WHETHER FRENCH EXPORTER HAD "RIGHT" TO COFACE GUARANTEES, SUGGESTING THAT WHILE THIS IS NOT "AUTOMATIC," ONCE APPROVAL OF COFACE ITSELF IS SECURED, SUBSEQUENT TREASURY APPROVAL WAS "AUTOMATIC." TRICHET REMARKED THAT ANY HALT IN SHORT-TERM GUARANTEES WOULD BE A SHATTERING SIGNAL; THERE WOULD BE A TOTAL STOP IN LENDING. SUMMING UP ON PAUSE, PAYE REITERATED THAT GOF'S ONLY FLEXIBILITY OF MEDIUM- AND BT

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PAGE 01 OF 02 ROME 6645
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SECRET SECTION 05 OF 06 ROME 06645

EXDIS

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LONG-TERM CREDITS IS IN AREA OF RATES; CREDITS THEMSELVES CANNOT BE REFUSED DUE TO FIVE-YEAR AGREEMENT WITH SOVIETS. LELAND ASKED HOW FRENCH HAD HANDLED THEIR CREDIT AGREEMENTS WITH ROMANIA AND POLAND WHEN FINANCIAL PROBLEMS OF THOSE COUNTRIES BECAME ACUTE. AFTER SOME DISCUSSION WITHIN FRENCH DELEGATION, WE WERE TOLD THAT AGREEMENT WITH USSR IS UNIQUE; ONLY SIMILAR AGREEMENT IS ONE WITH GDR, BUT FRENCH OBLIGATIONS IN THAT CASE WERE LESS SPECIFIC. PAYE SAID HE WOULD LOOK INTO STATUS OF SHORT-TERM CREDITS/GUARANTEES, WHERE HE THOUGHT THERE MIGHT BE MORE FLEXIBILITY, ALTHOUGH HE RAISED QUESTION AS TO WHETHER GOF WOULD WANT "THIS TRADE TO FALL VERY FAST." BUCKLEY SUGGESTED THAT SOVIETS WOULD PAY CASH, BUT PAYE REJOINED THAT ONLY A SMALL PERCENTAGE OF CURRENT DEALS WOULD GO THROUGH ON THIS BASIS. IN RESPONSE TO LELAND'S QUESTION AS TO WHO BEARS THE RISK, TRICHET SAID THAT, "PSYCHOLOGICALLY," THE RISK IS SHARED BETWEEN BANKS AND EXPORTERS, BUT HE ADDED THAT THE BANKS WOULD NOT LEND IF COFACE WERE OUT OF THE PICTURE.

17. PAYE TURNED TO QUESTION OF "SAFETY NET" IN EVENT OF EASTERN EUROPEAN DEFAULTS, AND ASKED WHAT U.S. HAD IN MIND. LELAND AND BAILEY EXPLAINED THAT ACTUAL MECHANISMS (BIS AND SWAP LINES) WERE IN PLACE. WE WERE THINKING OF BETTER INFORMATION EXCHANGE TO ANTICIPATE WHERE "NET" MIGHT BE NEEDED. LELAND SUGGESTED THAT "AUTOMATIC" SOVIET ACCESS TO FRENCH CREDIT WAS QUITE DANGEROUS, AND HE NOTED WIDESPREAD VIEWS IN THE UNITED STATES THAT ANY EFFORTS TO STAVE OFF POLISH OR ROMANIAN DEFAULTS CONSTITUTED INDIRECT ASSISTANCE TO SOVIETS. TRICHET NOTED REPORTS THAT U.S. WAS CONSIDERING PUSHING FOR POLISH DEFAULT, FEELING THAT ANY NEGATIVE SIDE EFFECTS COULD BE CONTAINED. LELAND NOTED PRESIDENT'S DECISION ON THIS ISSUE BUT SAID THAT THERE WAS A WIDE VARIETY OF VIEWS ON SUBJECT IN U.S. THERE WAS GENERAL AGREEMENT IN U.S., HOWEVER, THAT WEST HAD CREATED ENORMOUS PROBLEM FOR ITSELF WITH EXTENSION OF EASY CREDIT TO SOVIETS AND EASTERN EUROPEANS AND THAT FURTHER CREDIT TO SOVIETS IN PARTICULAR HAD TO BE CAREFULLY CONTROLLED. LELAND NOTED THAT IN HIS OWN CONGRESSIONAL TESTIMONY ON POLISH DEBT ISSUE, HE HAD CITED FACTS THAT CURRENT FLOW WAS FROM EAST

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28

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PAGE 02 OF 02 ROME 6645

DTG: 181112Z MAR 82 PSN: 001999

TO WEST AND THAT PRACTICALLY NO NEW LENDING WAS GOING TO USSR AS REASONS FOR AVOIDING DEFAULT. BAILEY REFERRED TO GERMAN CLAIM THAT SOVIETS WERE BORROWING IN WEST AND PASSING FUNDS TO POLES FOR USE ON LATTER'S 1981 COMMERCIAL BANK INTEREST. QUAI SOVIET/EE DIRECTOR MASSET INDICATED THAT FRENCH ASSUMED THIS WAS THE CASE.

18. ON ENERGY SECURITY ISSUES, PAYE SAID FRANCE SHARED U.S. CONCERNS ON "DEPENDENCY" ISSUE AND WAS PREPARED TO WORK WITH US. OLMER AND IKLE CALLED ATTENTION TO ENORMOUS INCREASE IN U.S. COAL EXPORT CAPACITY AND CHANGING VIEWS IN NORWAY ON GAS EXPORTS. PAYE SAID FRANCE WAS PREPARED TO INCREASE COAL IMPORTS "CAUTIOUSLY" (TO AVOID PROBLEMS WITH UNEMPLOYED FRENCH MINERS) PROVIDED IT WAS ECONOMIC. HE ALSO NOTED EFFORTS UNDERWAY IN FRANCE AND ELSEWHERE IN EUROPE TO CREATE "SAFETY NET" IN EVENT GAS SUPPLY CUT-OFFS. UNDER THESE CIRCUMSTANCES, FRANCE WOULD BE FOOLISH NOT TO BUY SOVIET GAS IF THE PRICE WERE RIGHT. ON MATTER OF EC CUTS IN IMPORTS FROM USSR, PAYE ACKNOWLEDGED OLMER'S EXPRESSION OF DISAPPOINTMENT WITH REMARK THAT THE "MOUNTAIN WAS BOILED DOWN TO A MOUSE." HE ADDED, HOWEVER, THAT OBJECTIVE HAD BEEN UNDERSTOOD FROM OUTSET TO BE "SYMBOLIC," AND SUGGESTED THAT THIS HAD BEEN ACHIEVED.

19. FOLLOWING LUNCH AT QUAI, U.S. TEAM SPLIT UP. BUCKLEY AND LELAND MET AT THE TREASURY WITH TRESOR DIRECTOR DE CABINET LAGAYETTE, JURGENSEN AND TRICHET. MESSRS. BUCKLEY AND LELAND REITERATED OUR BASIC OBJECTIVES. SOME FRENCH EXPRESSED SURPRISE AT U.S. VIEW THAT BANKS WERE LOOKING AT USSR AS LESS CREDITWORTHY NOW THAN A YEAR AGO. MR. DE LAGAYETTE STATED THAT ONE HAD TO SEPARATE ESSENTIALLY POLITICAL AND SYMBOLIC STEPS--SUCH AS THE RECENT EC ACTION TO RESTRICT IMPORTS OF CERTAIN GOODS FROM THE USSR--FROM "TRUE ECONOMIC AND TRADE MEASURES" SUCH AS OUR PROPOSALS TO RESTRICT EXPORT CREDITS. HE EVINced LITTLE INTEREST IN ANY MULTILATERAL EFFORT IN THIS AREA AND INDICATED HE SAW NO PURPOSE IN SEEING THEIR
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TRADE EFFECTED AS IT WOULD BE BY CURTAILING CREDIT.
FOLLOWING MR. BUCKLEY'S DEPARTURE FOR ANOTHER MEETING,
MR. LELAND HAD A MEETING WITH DIRECTOR DE TRESOR
CAMDESSUS. THIS MEETING WAS EXTREMELY USEFUL. MR. LELAND
RENEW THE CONNECTION BETWEEN EUROPEAN WILLINGNESS TO MOVE
FORWARD WITH US ON THE ISSUE OF RESTRICTING CREDITS TO
THE USSR AND OUR ABILITY TO WORK WITH THEM ON OTHER EAST-
WEST FINANCIAL AND DEBT PROBLEMS. THIS CONNECTION WAS
CLEARLY UNDERSTOOD BY MR. CAMDESSUS AND, IT IS
BELIEVED, ITS IMPORTANCE APPRECIATED.

20. OLMER, BAILEY, NILES AND DENYSYK MET SEPARATELY WITH
ELYSEE ECONOMIC DIRECTOR SAUTTER AND OECD SECGEN VAN
LENNEP. RECALLING THAT PRESIDENT REAGAN HAD TOLD
PRESIDENT MITTERRAND LAST FRIDAY OF MISSION'S VISIT AND
IMPORTANCE HE ATTACHED TO IT, SAUTTER WAS QUITE EN-
COURAGING ON GOF'S OVERALL POLICY TOWARDS USSR IN
ECONOMIC AREA, NOTING THAT MITTERRAND GOVERNMENT HAD
ABANDONED "PISAR" THEORY THAT THE MORE TRADE WITH THE
USSR, THE BETTER EAST-WEST POLITICAL RELATIONS WOULD
BECOME. FRANCE NOW APPROACHED ECONOMIC RELATIONSHIP
WITH USSR ON BASIS OF COOL ECONOMIC CALCULATIONS. UNDER
THE MITTERRAND GOVERNMENT, SAUTTER ADDED, THE USSR WAS
TREATED AS JUST ANOTHER COUNTRY, I.E., NO "SPECIAL
RELATIONSHIP." AT THE SAME TIME, HOWEVER, THIS MEANT
IN HIS VIEW THAT THE USSR COULD NOT BE SINGLED OUT AMONG
FRANCE'S TRADING PARTNERS FOR DISCRIMINATORY TREATMENT
AND EXCLUDED FROM EXPORT CREDITS AND GUARANTEES. OLMER
AND BAILEY PRESENTED U.S. VIEWS ON NEED FOR ACTION NOW
TO RESTRICT FLOW OF SUBSIDIZED OFFICIAL CREDITS AND
CREDIT GUARANTEES TO USSR. SAUTTER EXPRESSED SKEPTICISM
REGARDING MISSION'S OBJECTIVES BUT TOOK THOROUGH NOTES
AND SAID HE WOULD INFORM ELYSEE SECGEN BEREGOVVOY OF
MISSION'S PRESENTATIONS. HE CHARACTERIZED FRANCE'S
REACTION, THUS FAR, TO POLISH CRISIS AS CONSISTING OF
"SYMBOLIC" STEPS; RESTRICTION OF EXPORT CREDITS AND
GUARANTEES, HE SAID, WOULD BE A "SUBSTANTIVE" STEP.

21. BRIEF CALL ON OECD SECGEN VAN LENNEP, IN WHICH
MISSION MEMBERS WERE JOINED BY AMBASSADOR KATZ, FOCUSED
ON OECD'S ONGOING WORK ON EAST-WEST ECONOMIC RELATIONS,

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PAGE 02 OF 02 ROME 6645

DTG: 181112Z MAR 82 PSN: 002001

INCLUDING CREDIT/DEBT ISSUES. VAN LENNEP SAID HE BELIEVED
THAT MAY 10-11 OECD MINISTERIAL WOULD PROVIDE VERY
IMPORTANT OPPORTUNITY FOR MEMBERS TO LAUNCH NEW POLICY
IN AREA OF EAST-WEST ECONOMIC RELATIONS. HE SAID HE
BELIEVED MISSION'S VISIT WAS TIMELY IN TERMS OF OECD'S
WORK IN THAT IT CALLED HIGH-LEVEL ATTENTION TO THIS ISSUE.
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31

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EXDIS, BRUSSELS FOR USEC; PASS TO BUCKLEY MISSION
E. O. 12065: GDS 3/19/88 (HOLMES, H. ALLEN)

TAGS: EFIN, EEWT

SUBJECT: FOLLOW-UP ON INTERAGENCY MISSION ON EAST/WEST
ECONOMIC RELATIONS

REF: STATE 66358

1. ~~SECRET~~ - ENTIRE TEXT.

2. CHARGE SHOULD SEEK AN IMMEDIATE APPOINTMENT AT THE
HIGHEST APPROPRIATE LEVEL TO MAKE THE POINTS IN PARAGRAPH
4 AS FOLLOW-UP TO THE INTERAGENCY MISSION LED BY UNDER
SECRETARY BUCKLEY. THE MOST URGENT HANDLING IS REQUIRED
IN ORDER TO HAVE AN EFFECT IF THIS TOPIC IS DISCUSSED AT
THE EC FOREIGN MINISTERS MEETING, MARCH 22-23.

3. (STRICTLY FYI: THE POINTS BELOW WERE MADE TODAY TO
THE FRENCH CHARGE BY UNDER SECRETARY EAGLEBURGER. THE
UNDER SECRETARY WOULD HAVE MADE THE SAME PRESENTATION ?D
THE GERMANS, IF A SUITABLE EMBASSY OFFICER HAD BEEN
AVAILABLE. FOLLOW UP WITH OTHER GOVERNMENTS IS PLANNED,
BUT NOT WITH SIMILAR URGENCY. END FYI).

4. TALKING POINTS:

--I WANT TO THANK YOU FOR THE RECEPTION IN BONN OF THE
INTERAGENCY MISSION SENT BY PRESIDENT REAGAN, AND HEADED
BY UNDER SECRETARY BUCKLEY.

-- MY GOVERNMENT CONSIDERS IT VITALLY IMPORTANT TO WORK
WITH YDURS TO FOLLOW THAT EXCHANGE OF VIEWS WITH CONCRETE
AND MULTILATERAL ACTION ON OFFICIAL CREDIT AND GUARANTEES
TO THE SOVIET UNION.

-- THE FOCUS OF THE BUCKLEY MISSION WAS TO PRESENT OUR
VIEWS ON THE PROBLEM. WE BELIEVE IT IS IN THE WEST'S
STRATEGIC AND ECONOMIC INTEREST TO ESTABLISH CONTROL OVER

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32

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PAGE 02 OF 03 SECSTATE WASHDC 3623

DTG: 191827Z MAR 82 PSN: 003955

THE VOLUME OF OFFICIAL CREDITS AND GOVERNMENT GUARANTEES ACCORDED THE SOVIET UNION, AND TO REDUCE THE SUBSIDIZATION OF CREDIT.

-- WHILE WE DID NOT EXPECT TO REACH FINAL AGREEMENT ON MEASURES TO RESTRICT THE VOLUME OF SUBSIDIZED CREDIT, WE DID ASK FOR A PAUSE IN THE GRANTING OF OFFICIAL CREDITS AS AN INTERIM MEASURE UNTIL AGREEMENT ON JOINT ACTION CAN BE REACHED.

-- I CAN SAY THAT WE ARE IN APPARENT AGREEMENT ON THE UNDESIRABILITY OF COMPETING TO PROVIDE SUBSIDIZED CREDITS TO THE SOVIET UNION.

-- WE AGREE THAT:

O WE NEED MORE TRANSPARENCY AMONG OURSELVES ON CREDIT PRACTICES AND THINKING;

O THE SOVIET UNION IS "DIFFERENT" IN TRADE AND STRATEGIC TERMS;

O JOINT ACTION IS PREFERABLE, FOR THE SAKE BOTH OF EFFECTIVENESS AND ALLIANCE UNITY;

O AND ACTIONS TO RESTRAIN CREDITS SHOULD BE TAKEN IN ACCORD WITH THE PRINCIPLE OF EQUITY AND BURDEN-SHARING.

-- WE NEED TO DECIDE ON AN ACTION AGENDA AND A FORUM. THE U.S. THINKING IS THAT, AT SOME POINT, WE WILL NEED AN ORGANIZATIONAL VEHICLE CENTERED AROUND THE EC-10, THE U.S., CANADA AND JAPAN.

-- PRESIDENT REAGAN'S PURPOSE IS NOT "ECONOMIC WARFARE" NOR THE REDUCTION OF EAST/WEST TRADE, BUT RATHER A NEEDED

DEPARTURE FROM "BUSINESS AS USUAL" IN DEALING CORRECTLY WITH A PRESSING PROBLEM. BRINGING THIS PROBLEM UNDER CONTROL IS IMPORTANT TO A STRATEGY OF DEALING WITH THE SOVIET UNION.

-- WE MUST MAINTAIN MOMENTUM IN MOVING TO THE ACTION-STAGE. THE SOVIET-INSPIRED REPRESSION IN POLAND, THE BLOODY OCCUPATION OF AFGHANISTAN AND OTHER SOVIET ACTIONS LEND A SENSE OF URGENCY. THE CONGRESS AND AMERICAN PEOPLE ARE CONCERNED ABOUT THE SUFFICIENCY OF ALLIED ACTIONS IN THE FACE OF THIS CHALLENGE.

-- WE HAVE DONE MORE THAN OUR SHARE IN THE ECONOMIC SPHERE. WE ACTED EARLY. SINCE 1974, WE HAVE SUSPENDED ALL OFFICIAL GOVERNMENT FINANCING TO THE SOVIETS. MORE RECENTLY, THE U.S. HAS GIVEN UP HUNDREDS OF MILLIONS OF DOLLARS WORTH OF EXPORT SALES THROUGH UNILATERALLY-TAKEN SANCTIONS IN RESPONSE TO THE SOVIET-INSPIRED REPRESSION IN POLAND.

-- AS WE HAVE SOUGHT TO MAKE CLEAR, IF OUR COLLECTIVE RESPONSE IS NOT SUFFICIENT, PRESIDENT REAGAN WILL BE COMPELLED TO CONSIDER HOW THE SANCTIONS HE ANNOUNCED DECEMBER 29 WILL BE IMPLEMENTED OR POSSIBLY EXTENDED.

-- THE U.S. POSITION ON "NO UNDERCUTTING" WAS NOT CLEARLY APPRECIATED IN BONN. IN FACT OUR UNILATERAL CONTROLS MAY BE EXPANDED, RATHER THAN NARROWED AS EXPECTED BY THE FRG IN AEG KANIS CASE.

-- WE EARNESTLY SOLICIT YOUR GOVERNMENT'S VIEWS ON HOW TO PROCEED JOINTLY IN CREDIT RESTRAINT, BEYOND THE FIRST TENTATIVE STEP TAKEN BY THE EC TO SEEK A RAISE IN THE

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33

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PAGE 03 OF 03 SECSTATE WASHDC 3623 DTG: 191827Z MAR 82 PSN: 003955

OECD CONSENSUS INTEREST RATE APPLIED TO THE SOVIET
UNION. IN WHAT MANNER SHOULD THE LEADING NATIONS MEET?
WHAT MECHANISM WOULD BEST GET CONTROL OVER THE FLOW OF
THESE FINANCIAL RESOURCES TO THE SOVIET UNION?

-- I CAN ASSURE YOU THAT PRESIDENT REAGAN AND HIS
ADMINISTRATION WILL GIVEN THE FULLEST ATTENTION TO YOUR
GOVERNMENT'S PROPOSALS ON HOW TO PROCEED. STOESSEL
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SECRET SECTION 01 OF 02 BRUSSELS 04039

EXDIS
FOR THE SECRETARY FROM UNDER SECRETARY BUCKLEY
E.O. 12065: RDS-1 3/19/92 (BUCKLEY, JAMES L.)
TAGS: EFIN, EEWT, UR
SUBJECT: INTER-AGENCY MISSION ON EAST-WEST ECONOMIC
RELATIONS: SUMMARY OF ITALIAN TALKS

1. (SECRET - ENTIRE TEXT.)
2. SUMMARY: MISSION SPENT SUCCESSFUL DAY IN ROME, CONCLUDING WITH 2-HOUR MEETING WITH FOREIGN MINISTER COLOMBO WHO MADE CLEAR THAT ITALIANS ARE PREPARED TO WORK WITH US TO ACHIEVE COMMON WESTERN POLICY ON OFFICIAL CREDITS/GUARANTEES TO THE USSR. SUCCESSFUL MEETINGS WITH THREE OTHER ITALIAN MINISTERS ALSO REVEALED BROAD AREA OF AGREEMENT, ALTHOUGH ITALIANS DID NOT EXPLICITLY AGREE TO SPECIFIC PROPOSALS. I AM CONFIDENT THAT COLOMBO WILL SUPPORT OUR PROPOSAL WHEN SUBJECT COMES UP ON MARGINS OF MARCH 22-23 EC-10 FOREIGN MINISTERS MEETING. TOGETHER WITH BRITISH, ITALIAN SUPPORT SHOULD BE SUFFICIENT TO SECURE GO-AHEAD FROM BOTH FRENCH AND GERMANS ON FURTHER BILATERALS TO BUILD TOWARD A CONFERENCE, BUT WE DO NOT YET HAVE COMMITMENT TO A CONFERENCE. ALTHOUGH SIBERIAN GAS PIPE LINE REMAINS CONTROVERSIAL WITHIN ITALIAN GOVERNMENT, I HAVE IMPRESSION THAT ITALIANS WILL JOIN THE PROJECT WITHIN THE NEXT MONTH UNLESS SOME EXTRAORDINARILY FAVORABLE RELATED DEVELOPMENT, SUCH AS PRICE BREAKTHROUGH IN ALGERIAN NEGOTIATIONS, INTERVENES. DUE TO UNIFORMLY NEGATIVE REACTION TO OUR PROPOSAL FOR A "PAUSE" IN NEW OFFICIAL CREDITS/GUARANTEES, MISSION MENTIONED "PAUSE" BUT DID NOT PUSH FOR ITS ACCEPTANCE. THE ITALIANS INDICATED THAT THEY DID NOT ENVISAGE ANY NEW CREDITS BEING GRANTED IN THE NEAR FUTURE. END SUMMARY.
3. IN ADDITION TO FOREIGN MINISTER COLOMBO, MISSION MET WITH MINISTER OF STATE PARTICIPATION DE MICHELIS, FOREIGN TRADE MINISTER CAPRIA AND TREASURY MINISTER ANDREATTA. ALTHOUGH THERE WERE NUANCES OF DIFFERENCES IN EACH MINISTER'S APPROACH, BASIC MESSAGE WAS THE SAME: ITALIANS FIND CURRENT SITUATION IN WHICH WEST SUBSIDIZES SOVIET ECONOMIC DEVELOPMENT THROUGH CREDITS/GUARANTEES ABSURD, DANGEROUS AND ECONOMICALLY UNJUSTIFIED. COMMON

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PAGE 02 OF 02 BRUSSELS 4039

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POSITION ADOPTED BY MINISTERS SUGGESTS THAT ITALIANS HAD TAKEN CONSCIOUS DECISION PRIOR TO OUR ARRIVAL TO SUPPORT OUR PROPOSALS. I USED ALL OF OUR MEETINGS TO STRESS GREAT APPRECIATION OF U. S. FOR FIRM SUPPORT WHICH WE RECEIVED FROM ITALY ON CRUCIAL ISSUES SUCH AS INF AND MFO. ITALIANS CLEARLY PLEASED BY THESE STATEMENTS AS WELL AS BY FACT THAT MISSION CAME TO ROME.

4. IN OUR MEETINGS, ITALIANS RAISED SAME PROBLEMS WHICH WE HAVE ENCOUNTERED ELSEWHERE I. E. NEED FOR EQUITABLE BURDEN SHARING, PROBLEM OF INCLUDING JAPAN AND CANADA, DIFFERING INTEREST RATES IN VARIOUS COUNTRIES, ETC. HOWEVER, THESE ISSUES WERE PRESENTED AS PROBLEMS WHICH WILL HAVE TO BE RESOLVED RATHER THAN AS REASONS FOR NOT MOVING AHEAD WITH OUR PROPOSAL. COLOMBO APPEARED SOMEWHAT SKEPTICAL REGARDING USE OF SUMMIT 7 MECHANISM BECAUSE IT DID NOT INCLUDE KEY NEUTRALS SUCH AS AUSTRIA, SWITZERLAND AND SWEDEN. HOWEVER, HE SEEMED SATISFIED WITH MY EXPLANATION THAT POSSIBLE AGREEMENT ON NEW SYSTEM AT THE JUNE 4-6 SUMMIT WOULD BE STARTING POINT FOR EFFORT TO BRING OTHER COUNTRIES ON BOARD.

5. ON PIPE LINE, WE EXPRESSED APPRECIATION FOR ITALIAN "PAUSE FOR REFLECTION" AND HOPE THAT IT WOULD CONTINUE. WE ALSO NOTED RECENT DEVELOPMENTS WHICH COULD CHANGE EUROPEAN GAS SUPPLY/DEMAND PICTURE INCLUDING CHANGE IN NORWEGIAN GOVERNMENT, DISCOVERY OF NORWEGIAN NORTH SEA GAS FIELD 31/2, UK DECISION TO PERMIT GAS SALES TO THE CONTINENT AND CONSIDER TRIANGULAR RELATIONSHIP INCLUDING NORWAY PLUS FALLING GAS DEMAND PROJECTIONS. ITALIANS LISTENED POLITELY AND EXPRESSED APPRECIATION FOR ADDITIONAL INFORMATION ON ALTERNATIVES. COLOMBO WAS FIRMEST IN SUPPORT FOR SOVIET PIPE LINE, NOTING THAT BOTH ALGERIAN AND SOVIET PROJECTS WERE ESSENTIAL FOR ITALY. CAPRIA SAID HE GAVE PRIORITY TO ALGERIAN PROJECT BUT BELIEVED

ITALIAN PARTICIPATION IN SOVIET PIPE LINE WAS NECESSARY WHILE DE MICHELIS SUPPORTED BOTH PROJECTS AND INDICATED THAT "PAUSE" WOULD NOT LAST MORE THAN A FEW WEEKS. OUR JUDGMENT AT THIS POINT IS THAT ITALIANS WILL SIGN UP FOR SOVIET GAS WITHIN NEXT MONTH UNLESS SOMETHING REALLY DRAMATIC INTERVENES. THEY CLEARLY FEEL UNCOMFORTABLE BY THEMSELVES, AND FACT THAT SMALLER COUNTRIES SUCH AS NETHERLANDS AND BELGIUM HAVE NOT AGREED TO BUY GAS FROM SOVIET UNION IS LARGELY IRRELEVANT.

6. COMMENT: ITALIAN RECEPTIVITY REFLECTS BOTH THEIR ACCEPTANCE OF OUR OVERALL ASSESSMENT OF SITUATION REGARDING OFFICIAL CREDITS AND GUARANTEES TO SOVIETS AS BT

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USMISSION USNATO 9053

SECRET SECTION 02 OF 02 BRUSSELS 04039

EXDIS
FOR THE SECRETARY FROM UNDER SECRETARY BUCKLEY
WELL AS HOPE THAT EFFORT WHICH WE HAVE PROPOSED WILL
RESULT IN IMPROVEMENT OF ITALY'S COMPETITIVE POSITION.
CRITICAL COMMENT OF TREASURY MINISTER ANDREATTA
REGARDING U.S. INTERVENTION POLICY, COUNTERED BY LELAND,
AS WELL AS HIS AND COLOMBO'S REFERENCES TO
SOVIET CONTRACTS TO AUSTRIA, INDICATES THAT ITALIAN
SENSITIVITIES WILL HAVE TO BE KEPT IN MIND. ITALIAN
ENTHUSIASM FOR OUR PROPOSAL WAS INDICATED BY FACT THAT
FOREIGN MINISTRY ECONOMIC DIRECTOR BUCCI, WHO WILL
PROBABLY COORDINATE EXERCISE ON ITALIAN SIDE, WAS
ALREADY THINKING ABOUT WAYS TO BRING THE GERMANS AROUND
(HE THINKS THE BEST WAY WOULD BE TO WORK THROUGH GERMAN
BANKS). END COMMENT.

EXDIS
7. RECOMMENDATION. WITH COMPLETION OF OUR INITIAL ROUND
WITH FOUR KEY ALLIES AND WITH AN EYE TO MARCH 22-23 EC
FOREIGN MINISTERS MEETING, I BELIEVE THAT BRIEF MESSAGES
FROM THE SECRETARY TO HIS FOUR COLLEAGUES WOULD BE USEFUL.
ALL FOUR MESSAGES COULD EXPRESS THE SECRETARY'S APPRECIATION
TO GENSCHER, CHEYSSON, CARRINGTON AND COLOMBO FOR
HAVING MET WITH MISSION. MESSAGES TO COLOMBO AND
CARRINGTON COULD EXPRESS APPRECIATION FOR THEIR FAVORABLE
REACTION AND HOPE THAT THEY WILL ENCOURAGE THEIR
COLLEAGUES GENSCHER AND CHEYSSON TO JOIN IN THE EFFORT WE
HAVE IN MIND. MESSAGES TO CHEYSSON AND GENSCHER COULD
REITERATE IMPORTANCE WHICH THE PRESIDENT ATTACHES TO THIS
PROBLEM AND OUR HOPE THAT ALLIES WILL JOIN WITH US IN
COMMON EFFORT. VEST
BT

SECRET

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LINDIS GREENBACK
USEEC
BRUSSELS PASS DALLARA WITH BUCKLEY PARTY
TREASURY FOR LELAND AND CORNELL
DEPARTMENT FOR HORMATS AND CONSTABLE
GENEVA FOR MEISSNER
EO 12065: RDS-1, 3/19/02 (GORDON, EDGAR J.) OR-T
TAGS: EFIN, FR, PL
SUBJECT: CREDITORS' MEETING ON POLAND

1. C - ENTIRE TEXT

2. INTRODUCTION AND SUMMARY. THE PURPOSE OF THE MEETING, HELD IN THE MINISTRY OF FINANCE, WAS TO CONSIDER WHAT RESPONSE CANDESSUS, AS CHAIRMAN OF THE CREDITORS' GROUP, SHOULD GIVE TO THE KARZ FEBRUARY LETTER. THE DOMINANT FEELING WAS THAT THE NATO REQUIREMENTS FOR THE IMPROVEMENT OF POLAND'S INTERNAL POLITICAL SITUATION WERE CONTROLLING AND THEREFORE THE GROUP SHOULD RECONFIRM THE LETTER SENT JANUARY 14 WHICH POSTPONES NEGOTIATIONS FOR THE 1982 OFFICIAL DEBT MATURITIES UNTIL "CONDITIONS CHANGE." BUT THE UK DID ARGUE RATHER FORCEFULLY, IN ADDITION, THAT THERE WERE NEW ELEMENTS IN THE SITUATION, I.E., A) THE EXPECTED SIGNATURE OF THE 1981 PRIVATE BANK CREDIT RESCHEDULING; AND B) POLAND WAS INCREASINGLY GETTING A "FREE RIDE" BY NOT PAYING ANYTHING ON THE 1982 OFFICIAL DEBT. HE FELT THAT AT SOME POINT IN THE NOT-TOO-DISTANT

FUTURE WE SHOULD CONSIDER RESCHEDULING, BUT NOT NEW CREDITS. HE CALLED FOR ANOTHER CREDITORS' MEETING IN APRIL, A PROPOSAL THAT WAS REJECTED BY MOST OTHER DELEGATES FOR BOTH POLITICAL AND TACTICAL REASONS. (COMMENT. WE MAY GET INCREASING PRESSURE TO RECONSIDER ONCE THE PRIVATE BANKS SIGN IN APRIL.) THE NEUTRAL COUNTRIES -- FINLAND, AUSTRIA, AND SWEDEN -- WERE PREPARED TO GO AHEAD NOW. ALL COUNTRIES REPORTED THAT THE POLES WERE LIVING UP TO THEIR 1981 OBLIGATIONS, THAT THEIR BANKS WERE BEING PAID OFF UNTIL THE SUMMER, AND THAT THERE WAS NO PROSPECT THAT THEY WOULD OFFER NEW CREDITS. THE IMF REPRESENTATIVE PREDICTED FURTHER ECONOMIC DETERIORATION UNTIL THE SUMMER AND THE COMPLETION OF A NEW REPORT BASED ON THE MOST RECENT MISSION IN MAY OR JUNE. IT IS EXPECTED TO TAKE NO FURTHER ACTION ON POLAND'S APPLICATION FOR MEMBERSHIP FOR THE TIME BEING. END SUMMARY.

3. CANDESSUS, AFTER RAISING THE PROBLEM OF HOW TO ANSWER THE KARZ LETTER, STATED HIS IMPRESSION THAT THERE WAS NO CONSENSUS TO RESUME NEGOTIATIONS. IN THE SUBSEQUENT GO-AROUND AMONG DELEGATIONS, THE GERMAN DELEGATE (KUHN), WHO WAS THE FIRST SPEAKER, STATED THAT CONDITIONS HAD NOT CHANGED AND THAT, THEREFORE, THE JANUARY LETTER SHOULD BE RECONFIRMED. BUT THE BRITISH (CARY) WHO WAS NEXT, NOTED THAT THERE WERE NEW ELEMENTS IN THE SITUATION. THE FIRST WAS THE 1981 PRIVATE BANK RESCHEDULING AGREEMENT WHICH HE EXPECTED WOULD BE SIGNED APRIL 6. THE SECOND WAS THE BUILD-UP OF ARREARS WHICH, IN THEIR CASE, ALREADY AMOUNTED TO 40 MILLION POUNDS. IF IT CONTINUED, IT WOULD DO MORE DAMAGE TO THE CREDITORS THAN TO THE POLES. THE GROUP SHOULD THINK ABOUT THE POSSIBILITY OF RESCHEDULING. HE WAS, HOWEVER, OPPOSED TO NEW CREDITS. CANDESSUS INTERJECTED THAT

WE SHOULD AT LEAST WAIT UNTIL THE BANKING AGREEMENT WAS SIGNED BEFORE MAKING SUCH A PROPOSAL, A STATEMENT TO WHICH THE U.K. ASSENTED. THE DUTCH BT

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38

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~~C O N F I D E N T I A L~~ SECTION 02 OF 03 PARIS 09933

DELEGATE STRESSED THE NATO CONDITIONS AS THE DETERMINANTS OF HIS COUNTRY'S POSITION. HE FURTHER DOUBTED WHETHER THE POLES WOULD ACCEPT THE DISTINCTION BETWEEN RESCHEDULING AND NEW CREDITS. THE CANADIANS MADE THE SAME POINT ON NATO, WHILE EXPRESSING SOME SYMPATHY FOR THE U.K. POSITION, AND REPEATING THE DISTINCTION BETWEEN NEW CREDITS AND RESCHEDULING. CANADA WAS IN THE UNUSUAL POSITION OF BEING IN THE THIRD YEAR OF THE THREE-YEAR GRAIN SALES AGREEMENT WHICH MEANT THAT NEW CREDITS WERE BEING OFFERED AND OVERALL CANADIAN EXPOSURE WAS RISING.

4. THE U.S. DEL (GORDON) EMPHASIZED THAT THE THREE NATO CONDITIONS CONTROLLED OUR POSITION ON RESCHEDULING. HE NOTED FURTHER THAT HE DID NOT SEE HOW RESCHEDULING AND NEW CREDITS COULD REALLY BE SEPARATED. IN THE FIRST PLACE, RESCHEDULING WOULD MAKE POLAND ELIGIBLE FOR NEW CREDITS IN THE WAY IT WAS NOT NOW. SECOND, RESCHEDULING IN 1982 ON 1981 TERMS WAS PROBABLY NOT VIABLE, GIVEN THE POLISH BALANCE-OF-PAYMENTS SITUATION. RESCHEDULING, THEREFORE, WOULD NOT LEAD TO A REDUCTION OF EXPOSURE (BECAUSE THE POLES WOULD HAVE TO PAY SOMETHING ON 1982 MATURITIES) AS THE U.K. DEL IMPLIED, BUT MOST LIKELY TO A SITUATION IN WHICH THE OVERALL EXPOSURE OF THE WESTERN CREDITOR GROUP WOULD RISE.

5. ITALY TOOK A POSITION SIMILAR TO CANADA, AS DID NORWAY AND BELGIUM. JAPAN ALSO ACCEPTED THE NATO

POSITION. AUSTRIA AND FINLAND SAID THAT CREDITOR ACTIONS SHOULD BE BASED ON FINANCIAL CONSIDERATIONS ALONE, WHILE SWEDEN TOOK THE FURTHER STEP OF SUGGESTING THAT WE ASK THE POLES TO COME TO A MEETING IN APRIL TO EXPLAIN THEIR PLANS FOR REFORMS. SWITZERLAND THOUGHT THAT POLITICAL CONDITIONS WERE RELEVANT, AS WAS, IN ADDITION, THE PROBLEM OF ECONOMIC CONDITIONALITY. SPAIN WAS PREPARED TO GO ALONG WITH THE MAJORITY.

6. IN THE SECOND GO-AROUND, THE U.K. DEL EMPHASIZED THAT HE RECOGNIZED THE IMPORTANCE OF THE NATO CRITERIA BUT THOUGHT THAT A DE FACTO MORATORIUM WAS NOT PUNISHMENT BUT A SOFT OPTION, ALTHOUGH THAT CONCLUSION DID DEPEND ON THE RELATIONSHIP BETWEEN RESCHEDULING AND NEW CREDITS. HE THOUGHT THE CREDITORS SHOULD MEET AGAIN, PERHAPS IN APRIL TO DISCUSS THE SITUATION. THE GERMAN AND NORWEGIAN DELS OPPOSED THIS SUGGESTION, STATING THAT ANY PLANNING FOR A NEW MEETING WOULD GIVE THE WRONG SIGNAL TO THE POLES THAT WE WERE PREPARED TO NEGOTIATE. MOREOVER, WE HAD BEEN NEGOTIATING FOR A YEAR ON CONDITIONALITY WITHOUT MAKING ANY PROGRESS. THE U.S. DEL SUPPORTED THE FRG, POINTING OUT THAT, IN ANY CASE, APRIL WOULD BE TOO EARLY, SINCE THE FUND WOULD NOT FINISH ITS REPORT UNTIL MAY OR JUNE.

7. CANDESSUS SUMMED UP DISCUSSION AS FOLLOWS:
A) THE GROUP SHOULD PRESERVE ITS UNANIMITY;
B) THE MAJORITY CONSIDER SOMETHING MAY HAVE TO BE DONE BETWEEN MAY AND SEPTEMBER; AND
C) WE SHOULD, HOWEVER, NOW CONFIRM OUR LETTER OF JAN. 14 (WHICH POSTPONED NEGOTIATIONS UNTIL THE SITUATION CHANGED). (A TEXT TO THAT EFFECT WAS WORKED OUT OVER DINNER AND WILL BE TRANSMITTED SEPTEL).
POLAND WILL ALMOST CERTAINLY ASK FOR A MEETING JUST

AFTER THE PRIVATE BANK MEETING IS SIGNED. THEY MIGHT PROPOSE AN EXCHANGE OF INFORMATION WHICH WOULD BE DIFFICULT TO REFUSE. WE OUGHT, THEREFORE, TO BE PREPARED TO REACT ALTHOUGH NOTHING SHOULD BE SAID NOW.
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39

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~~C O N F I D E N T I A L~~ SECTION 03 OF 03 PARIS 09933

8. THIS DISCUSSION WAS PRECEDED BY A REVIEW OF PERFORMANCES ON 1981 MATURITIES, THE PROSPECTS FOR NEW PRIVATE BANK CREDITS IN 1982 AND THE IMF REPORT. WITH RESPECT TO 1981 OFFICIAL RESCHEDULING AGREEMENTS, EVERYONE REPORTED THEM TO BE IN OPERATION WITH THE POLES PAYING WHAT WAS DUE. WITH RESPECT TO THE BANKS, DELEGATES HAD EITHER SPECIFIC KNOWLEDGE THAT THEY WERE BEING PAID OR THE ABSENCE OF COMPLAINTS THAT THEY WERE NOT. THE GENERAL ASSUMPTION WAS THAT INTEREST ON 1981 CREDITS WOULD SOON BE COMPLETELY PAID OFF.

9. CAMDESSUS ASKED WHAT THE PROSPECTS WERE FOR NEW PRIVATE BANK CREDITS IN 1982. THE U.K. DEL REPLIED THAT THE POLES, WHO HAD GOTTEN WIND OF THIS MEETING, HAD COME TO SEE HIM WITH THE AFFIRMATION THAT THE BANKS WOULD, AFTER THE 1981 AGREEMENT WAS SIGNED, EXTEND SOME NEW CREDITS. HE WAS SKEPTICAL. THE ITALIAN DEL THOUGHT HIS BANKS WERE WAITING FOR THE GOVERNMENT TO MOVE FIRST AND THE GERMAN THAT HIS BANKS WERE STILL TOO WRAPPED UP IN WORKING OUT 1981 TO THINK ABOUT 1982.

10. THE IMF REPORT. THE IMF REPRESENTATIVE GAVE A BRIEF BUT POINTED REPORT. A TWO-MAN MISSION HAD JUST RETURNED TO WASHINGTON WITH A LARGE AMOUNT OF DOCUMENTATION, SOME OF WHICH WAS IN POLISH. THEY WOULD NOT BE ABLE TO FULLY ANALYZE IT BEFORE MAY OR EARLY JUNE. THE TWO BASIC PROBLEMS WHICH WOULD HAVE

SERIOUS POLITICAL REPERCUSSIONS WERE THE EFFECT OF PRICE RISES ON CONSUMPTION AND THE OVERMANNING OF ENTERPRISE. ON THE FORMER, LOWER INCOME GROUPS WERE PARTIALLY PROTECTED AND OTHERS WERE PROBABLY USING UP THEIR SAVINGS. THE OTHER ISSUE HAD NOT YET BEEN TACKLED, BUT PROBABLY THREE QUARTERS OF A MILLION WOULD HAVE TO BE LET GO IF INDUSTRIAL ENTERPRISES WERE TO BE REORGANIZED PROPERLY. HE EXPECTED THE SITUATION TO WORSEN UNTIL EARLY SUMMER. THERE WOULD BE NO FURTHER MISSIONS FOR 2-3 MONTHS AND NO ACTION WAS NOW CONTEMPLATED ON THE POLISH APPLICATION FOR MEMBERSHIP.
GALBRAITH
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