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**SCHOOL OF ADVANCED INTERNATIONAL STUDIES
THE JOHNS HOPKINS UNIVERSITY
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REAGAN AND THE MIDDLE EAST: LEARNING THE ART OF THE POSSIBLE

Martin Indyk

FROM THE TIME OF THE CRUSADERS TO THE PRESENT, Western powers have discovered that engagement in Middle East affairs is a difficult and dangerous enterprise. For the most part, the region is unstable, ridden with conflict, and prone to crisis. Its inhabitants, moreover, tend to be schizophrenic toward outside intervention, on the one hand looking to the West for salvation, on the other hand quick to blame the West for all their ills.

The United States' experience in the Middle East, since it assumed the mantle of leadership of the Western world after World War II, has differed little from that of its predecessors. Drawn into the region by its importance to the superpower rivalry and alliance relations, the United States has found the ability to influence events a tall order at best and fraught with peril at worst. Almost every president since the war has faced at least one Middle East crisis, most of them threatening a superpower confrontation. All postwar presidents have had to cope with the same basic set of problems: how to protect and promote U.S. interests 6,000 miles from the continental United States but in the "backyard" of the Soviet Union; how to come to terms with the complexities of political interaction in a Hobbesian environment; how to live with intractable conflicts; and how to deal with mass-based, anti-American ideological movements, from the radical nationalism of Egypt's Gamal Abdel Nasser in the 1950s to the fundamentalism of Iran's Ayatollah Khomeini in the 1980s.

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Yet every U.S. president has also found himself drawn into diplomatic activity to deal with the challenges of the Middle East. None could afford to leave well enough alone. This is partly because of the importance of the region, given its vast oil reserves and its geostrategic location on NATO's southern flank. But it is also because of the opportunities for U.S. intervention that present themselves. Not only do the local elites tend to look to the West, and the United States in particular, to help them, but some of the most important states are resource-poor (Egypt, Syria, Israel, and Jordan), others are strategically vulnerable (Iran vis-à-vis the Soviet Union, Saudi Arabia, Israel, and Jordan), and most are engaged in conflicts that they cannot afford. The apparently unalterable dependence on outside powers that these factors generate—for example, Egypt and Israel alone consume more than half of the total U.S. foreign assistance budget—also provides the United States with leverage, the very stuff of diplomacy.

A new administration, confronted by such threats to, and opportunities for, the defense of U.S. national interests, therefore finds it extremely difficult to be inactive in the Middle East. Even if it does not choose to, sooner or later it will be forced to develop a diplomatic response to events in the region.

In doing so, it will invariably discover that one of its priorities—usually the top priority—will be an effort to settle the Arab-Israeli conflict. This long-standing dispute engages U.S. interests in a way unlike all the other conflicts in this volatile region. U.S. interests in the Middle East have come to be fairly well defined over the years: (1) denying and containing the regional influence of the *Soviet Union* (2) securing Western access to Middle Eastern oil at reasonable prices (3) supporting the security of *Israel* and (4) promoting the stability of friendly *Arab regimes*. Each of these interests is affected by developments in the Arab-Israeli conflict.

First, the continuation of the conflict provides the Soviet Union with great opportunities for spreading its influence in the region. And the fact that the United States and the Soviet Union support opposite sides of the conflict means that—as in 1967, 1970, and 1973—armed clashes between the two sides always contain the potential for an escalation to super-power confrontation.

Second, although most Middle East oil is produced in the Persian Gulf, some distance from the epicenter of the Arab-Israeli conflict, its supply and price is often dramatically affected by events there. Thus the Arab oil embargo that accompanied the Yom Kippur War in 1973 had a considerable impact on the supply and price of oil—actually, a greater impact than the interminable Iraq-Iran War, the attacks on tankers and oil installations in the Gulf notwithstanding.

Third, it is self-evident that U.S. interests in the security of Israel and in relations with friendly Arab regimes are directly affected by a conflict that generates tension between these objectives.

This is not to suggest that settling the Arab-Israeli conflict will always be the first priority of U.S. diplomacy in the Middle East. Regional developments will often require the United States to focus its energies elsewhere. For example, the Carter administration, which had become preoccupied with the settlement of the Arab-Israeli conflict, found its attention diverted to the Gulf following the overthrow of the shah of Iran and the Soviet invasion of Afghanistan. Its neglect of these other areas of conflict in the Middle East caused real damage to U.S. interests throughout the region.

Nevertheless, even with its attention focused elsewhere, the United States has found it necessary to develop a diplomatic strategy for coping with the Arab-Israeli conflict. The Nixon administration, for example, thought that it could safely leave the Arab-Israeli conflict on the back burner in 1970 after it had assisted in the negotiation of a cease-fire between Israel and Egypt and had helped rescue Jordan from Syrian-backed, Palestine Liberation Organization (PLO) challenge. When the Yom Kippur War erupted in October 1973, however, Nixon and his secretary of state, Henry Kissinger, discovered that the Arab-Israeli conflict has a way of reasserting its claim on the attention of U.S. policymakers.

IN THIS REGARD, THE REAGAN ADMINISTRATION'S EXPERIENCE with the Arab-Israeli conflict has been similar to that of its predecessors. Assuming office in 1981, the administration had no choice but to focus on containment of the Soviet Union in the Persian Gulf. The 1979 Iranian revolution and the 1980 Soviet invasion of Afghanistan had raised the specter of Soviet domination of Southwest Asia. By comparison, the Middle East heartland appeared relatively stable, mainly because the 1978 Egypt-Israel peace treaty had removed the largest and militarily most powerful Arab state from the conflict. In these circumstances, the argument that the "core" of instability in the Middle East was the failure to solve the Palestinian problem appeared self-evidently false. A policy that managed the Arab-Israeli conflict while the United States paid much needed attention to the Soviet challenge in the now more volatile Persian Gulf made a good deal of sense. Moreover, such a focus was consonant with the Reagan administration's anti-Soviet ideological predilections.

Nevertheless, like its predecessors, the Reagan administration soon found it necessary to develop a more active strategy for dealing with the Arab-Israeli conflict. But it is important to bear in mind that this was not its first concern—its peace diplomacy *derived* from its efforts to promote a "strategic consensus" directed at Soviet-sponsored threats to regional

security. It had hoped that the Arab states and Israel, despite their antipathy, would all favor such cooperation. Even if this was a naïve hope, the Arab-Israeli conflict would not have attained a high priority for the administration had it not been for the central role assigned to Saudi Arabia in its preferred policy of strategic consensus. But since the immediate threat presented itself in the Persian Gulf, Saudi Arabia became the linchpin of this policy. And as far as the Saudis were concerned, the immediate threat came not from the Soviet Union but rather from what they regarded as the failure of the United States to solve the Palestinian problem.

The centrality of Saudi Arabia in U.S. policy toward the Middle East was something the Reagan administration inherited from Jimmy Carter, but it found reinforcement in the Reagan administration's own ideological preferences. Carter had placed great emphasis on the role of Saudi Arabia because of the importance it had come to assume in his oil policy and diplomacy in the wake of the dramatic oil price increases of 1978-79. The Saudis were seen as the "swing producers" who could moderate increases in the price of oil. And they were regarded as influential in the Arab world by virtue of their huge financial resources. When the Carter administration found itself faced with the possibility of a Soviet invasion of Iran, following the invasion of Afghanistan, Saudi Arabia assumed even greater strategic importance.¹ Without access to Saudi facilities, it would be virtually impossible for the United States to react to such a contingency with conventional forces.

The Reagan administration was prone to view Saudi Arabia in the same terms: indispensable to a viable Gulf security policy, important as leader of the lesser Gulf states, influential in the Arab world as a moderate force, and capable of exerting downward pressure on oil prices.² This view of the centrality of the Saudis led to a solicitous policy on the part of the Reagan administration, manifested most clearly in its 1981 decision to sell the Saudis five highly sophisticated Airborne Warning and Command System (AWACS) aircraft. But it was also manifested in the new administration's sensitivity toward Saudi priorities, which appeared to start and end with "the Palestinian problem."

Put simply, what the Reagan administration wanted was Saudi cooperation against the Soviet Union, but what the Saudis wanted was U.S. activism on the Palestinian problem. Secretary of state Alexander Haig discovered this in April 1981 when he visited Riyadh. Haig explained

1. For evidence that suggests that the threat of a Soviet invasion of Iran was regarded as a very real possibility by the Carter administration, see Benjamin Schemmer, "Was the US Ready to Resort to Nukes for the Persian Gulf in 1980?" *Armed Forces Journal*, September 1986, 92-105.

2. For a more detailed exposition of this view see John C. Campbell, "The Middle East: A House of Containment Built on Shifting Sands," *Foreign Affairs*, 60:3 (America and the World, 1981), 604-5.

after his visit that "talking about strategic cooperation is not placing our emphasis on the peace process in a lower priority. . . it is high on our agenda."³ But it was only high on the agenda because the Saudis wanted it to be: the Arab-Israeli diplomacy of this first period in the Reagan administration's Middle East policy was derived from its desire to promote strategic cooperation in the Gulf rather than its desire to make peace.

The second feature of this diplomacy was that, precisely because it derived from other concerns, it tended to be *reactive*—a response to crises rather than a means for implementing a new vision of a solution. This tendency was reinforced by Carter's legacy and Reagan's own leadership style. Carter had assiduously pursued his vision of a "comprehensive" solution to the Arab-Israeli conflict, succeeding, in the process, in thoroughly discrediting this approach. Carter's 1977 efforts to convene an international conference at Geneva demonstrated that it was impossible to bring to the negotiating table with Israel all the Arab parties to the conflict. The differences, rivalries, and conflicts among the Arabs were too great to make such a comprehensive negotiation feasible. What emerged from that process was clear evidence that Syria would never participate in a negotiating forum that denied it the ability to veto agreements made by any other Arab party, while the other parties would never allow their negotiating position to become hostage to Syrian ambitions.⁴

Carter himself had turned from "comprehensiveness" to "step-by-step" diplomacy in his negotiation of the Camp David Accords and the Egypt-Israel peace treaty. Consequently, when the Reagan administration came to focus on the Arab-Israeli conflict, its diplomacy, by force of experience and circumstance, would have to concentrate on the next step—the negotiation of autonomy for the Palestinians in the West Bank, as provided for in the Camp David Accords. However, taking this next step was highly problematic. King Hussein wanted nothing to do with the Camp David Accords, Israel feared that any agreement on this issue would lay the foundation for a Palestinian state, and Egypt was both unwilling and unable to take sole responsibility for negotiating a deal for the Palestinians, especially after the assassination of Egyptian president Anwar Sadat in 1981.

Thus, lacking both the desire and the opportunity to launch a U.S. initiative to "solve" the Arab-Israeli conflict, the Reagan administration found itself reacting to regional events as they unfolded: Sadat's assassination provoked a major effort by Haig to ensure that the last stage of the

3. Secretary of state Alexander Haig, cited in *The New York Times*, 11 April 1981.

4. For two accounts of that effort see William B. Quandt, *Camp David: Peacemaking and Politics* (Washington, D.C.: The Brookings Institution, 1985) and Martin Indyk, "To the Ends of the Earth": *Sadat's Jerusalem Initiative*, Harvard Middle East Papers, no. 1. (Cambridge, Mass.: Harvard University Center for Middle East Studies, 1984).

Egypt-Israel peace treaty was implemented, and the clashes between Israel and the PLO in 1981 generated a diplomatic effort by special envoy Philip Habib to achieve a cease-fire.

The Reagan Plan, launched on 1 September 1982, might be cited as the exception to this rule. But this "fresh start" initiative, as we shall see, was a reaction to Israel's invasion of Lebanon. And the notable lack of U.S. efforts to follow through on the plan indicated that the president's commitment to the pursuit of an elusive settlement of the Palestinian problem was very limited.

Reagan's presidential style reinforced this reactive tendency. Unlike Carter, Reagan avoided involving himself in the details of policymaking and was especially reluctant to make a decision when his senior advisers disagreed among themselves on the proper course to take. This meant that, while he would have liked to have his own Camp David, Reagan was not prepared to invest his energy in the major undertaking that would have been required unless he could be persuaded that there was a real chance for a breakthrough. As a skilled communicator, he was willing to make grand speeches and rhetorical flourishes, but when it came to the nitty-gritty of diplomacy he would prove to be uninterested.

This tendency on the part of the president to talk big but act small was also reflected in the third characteristic of the Reagan administration's Middle East diplomacy—a lack of willingness to back diplomacy with the threat or use of force. This was strange for an administration that prided itself on its realist approach to the world and placed great emphasis on rebuilding U.S. strength to balance Soviet power. In the Middle East such an emphasis on deterring Soviet-backed radicals by maintaining the balance of power in favor of the moderates was an essential prerequisite for any successful diplomacy. When it came to applying such principles in the Middle East, the Reagan administration proved to be divided between those who, like the secretary of state and the national security adviser, believed that diplomacy could only succeed if backed by force and those, ironically including the secretary of defense and the Joint Chiefs of Staff, who believed that the use of force would be counterproductive in the Arab world and unsupported in Congress and by U.S. public opinion. With the president unwilling to decide the matter, the United States found itself unable to make a credible difference in the balance of power of a region that, after the revolution in Iran and the subsequent Israeli and U.S. defeat in Lebanon, tipped increasingly in favor of radical forces. What is missing here, it must be emphasized, was not military means but rather *the will* to use or threaten to use them.

The two factions within the administration at least agreed on the need to sell sophisticated weapons to friendly regional states to enable them to do the job themselves. But arms sales would prove to be an

incomplete substitute for U.S. action. First, Jordan and Saudi Arabia were too vulnerable for such sales to increase significantly their willingness to defy their radical neighbors. And second, it became increasingly difficult to secure congressional approval for these arms transfers given their possible impact on Israel's security. In these circumstances U.S. diplomacy was backed by weakness. This severely limited its effectiveness.

These three characteristics of the Reagan administration's Middle East diplomacy—that it was derivative, reactive, and weak—were necessarily joined by a fourth, an *ambivalence* generated by the tension between the dictates of its strategic vision and the requirements of the peace process. Unlike its predecessor, the Reagan administration perceived the Middle East in East-West terms and set as its major priority the combating of Soviet expansionism there. Viewed through this anti-Soviet prism, Middle East politics became a contest between those who sided with the United States (Israel, Egypt, Jordan, and Saudi Arabia) and those who sided with the Soviet Union (Syria, Libya, and the PLO).

Similarly, ideology and circumstance had ensured that fighting terrorism would be a priority of the Reagan administration, particularly after what was seen by the U.S. public to be the Carter administration's weakness in handling the Iranian hostage crisis. But the promoters of terrorism also happened to be states and organizations aligned with the Soviet Union (Syria, Libya, and the PLO), a fact that reinforced the tendency to define friend and foe in the Middle East along East-West lines.

When the Reagan administration came around to reacting to Arab-Israeli developments then, this ideology should have generated a clear-cut answer to the immediate question of who to work with and who to work against. This was certainly true in the case of the Soviet Union. The idea of working with Moscow to achieve an Arab-Israeli settlement in the Middle East heartland was anathema to an administration bent on combating the spread of Soviet influence in the Gulf.⁵

5. This ideological predilection was reinforced by the Carter administration's experience in attempting to involve Moscow in the Arab-Israeli peace negotiations via the Soviet-American communiqué of 1 October 1977. Since the 1973 war the Soviet Union had been effectively excluded from the peace process because it had demonstrated that its interests lay in continuing the conflict and that it had neither the will nor the ability to persuade its radical clients (Syria and the PLO) to moderate their behavior and attitudes. Peacemaking in the Middle East had therefore become exclusively a U.S. domain.

Why, Carter's domestic critics asked, introduce the Soviet Union into the peace process in these circumstances? And why, the United States' regional friends asked, bring Moscow's influence to bear when it would be directed against their interests? The adverse reactions of Congress, Israel, and Egypt to this Carter administration initiative helped ensure that the Reagan administration would consistently avoid such an approach. See Steven Spiegel, *The Other Arab-Israeli Conflict: Making America's Middle East Policy, from Truman to Reagan* (Chicago, Ill.: The University of Chicago Press, 1985), *Sadat's Jerusalem Initiative*, and *Camp David: Peacemaking and Politics*.

It was also true for Saudi Arabia, since, as already argued, the administration's diplomacy was largely generated by a desire to be responsive to Saudi entreaties. Accordingly, it was predisposed to work with the Saudis in promoting the settlement on which they claimed to place so much store. And it tended to rely on the Saudis to play a helpful role in promoting moderation in the Arab world. This tendency was also reinforced by a need to emphasize Saudi helpfulness in the peace process as a means of securing congressional support for the sale of the AWACS.⁶

There was, however, no consensus within the administration on working with the Saudis for a settlement of the Palestinian problem. Cooperating with Riyadh enjoyed considerable support from the secretary of defense, the Joint Chiefs of Staff, and the Near East Bureau of the State Department, and from key elements within the White House, including Vice President Bush. But secretary of state Haig, elements in the National Security Council, and the State Department Policy Planning Staff were concerned that working with the Saudis would require the United States to abandon the Camp David framework.

Moreover, the Saudi prescription for a settlement required U.S. recognition of the PLO and U.S. support for the establishment of an independent Palestinian state. The president and the secretary of state, however, viewed the PLO as a terrorist organization and a Soviet proxy that helped to promote revolution not only in the Middle East but in Central America as well.

From the outset, then, tensions existed between the administration's desire to be solicitous toward Saudi Arabia and the urge to be true to the president's own anti-Soviet, antiterrorist instincts—tensions reflected in the division within the administration. This in turn generated an ambivalence in Reagan administration policy toward the PLO—at times opposing it, at times seeking its cooperation in the peace process.⁷

There was a similar ambivalence in Reagan administration policy toward Israel. The president regarded Israel as a strategic ally and intended to treat it accordingly. But Israeli prime minister Menachem Begin and defense minister Ariel Sharon took Reagan too literally. Israeli assertiveness in Lebanon on the Golan Heights (to which Israel extended

6. Reagan's victory in the Senate was a narrow one (51-49), secured only by the president's willingness to certify that progress would be made in the peace process "with the substantial assistance of Saudi Arabia." The effect on President Reagan of this constant reiteration of Saudi helpfulness was noticeable in his praise for the Fahd Plan a few days after the Senate vote on 29 October 1981. Previously, the Reagan administration had expressed opposition to the plan and found it necessary to reiterate that opposition in the wake of the president's endorsement. See Harvey Sicherman, "Europe's Role in the Middle East: Illusion and Realities," *Orbis*, 28:4 (Winter 1985), 814-15.

7. See Martin Indyk, "Faulty Assumptions, Failed Policy: The Arabists and the PLO During the First Reagan Administration," in Paul Marantz and Blema Steinberg, eds., *Superpower Involvement in the Middle East* (Boulder, Colo.: Westview Press, 1985).

its law in 1981) and the strike against Iraq's Osirak nuclear reactor, all in the Reagan administration's first year, angered the Arabs and surprised Washington. This in turn led Reagan to take a series of unprecedented, although short-lived, punitive measures against Israel, including the delay of deliveries of F-15 and F-16 aircraft, the suspension of the first U.S.-Israel Memorandum of Understanding on strategic cooperation, and the launching of a peace initiative without prior consultation with Israel (as there had been with the Arabs).

This ambivalence toward Israel and the PLO was the product of the tension between an ideologically based strategic vision and a Saudi-generated peace process. Israel was probably the most capable, and certainly the most willing, potential strategic partner of the United States in the region. But, as long as the Saudis were viewed as the linchpin of U.S. strategic policy, the Reagan administration would have to find a method for coping with Saudi opposition to Israel. Promoting the peace process appeared to be the only way. Strategically, the administration wanted to work with Israel and against the PLO, but diplomatically, it thought it necessary to work against Israel and, indirectly, with the PLO.

The tension between strategy and diplomacy was less evident when it came to Egypt's role. Strategically, Egypt could provide important staging facilities for any U.S. rapid deployment to the Gulf as well as helping to deter Soviet-supported, radical threats to friendly regimes in the region. Moreover, Egypt was already at peace with Israel and was therefore a natural Arab partner. However, while working with Egypt was a top priority of the program of strategic cooperation, particularly because of the unwillingness of the Saudis to cooperate openly, it became a lesser priority of U.S. peace diplomacy.⁸

Once the Reagan administration had overseen Israel's final withdrawal from Sinai in April 1982, any new peace effort would have to focus on those nations still at war. Accordingly, when it came to diplomacy, Jordan—not Egypt—would become the primary Arab partner because it was the logical candidate for the next step in the peace process. The Camp David Accords had stipulated a Jordanian role in the Palestinian settlement. Indeed, creating the conditions that might make it possible for Jordan to enter negotiations with Israel became the preoccupation of the Reagan administration's diplomacy. Conversely, Jordan was less significant than Egypt on the strategic level, although

8. This strategic cooperation was manifested in the "Bright Star" joint U.S.-Egyptian military exercises, which took place in November-December 1981, August-September 1983 and 1985, and August 1986. For details of the earlier exercises see Nimrod Novik, *Encounter with Reality: Reagan and the Middle East*, Jaffee Center for Strategic Studies, Study no. 1, copublished with Westview Press (Boulder, Colo.: Westview Press, 1985), 44-47.

who used Soviet arms, and the PLO was seen in Washington as an implicit triumph of the United States over the Soviet Union. In these circumstances Reagan and Haig supported Israel and protected it from UN censure.

The administration's second response was also a product of its strategic instincts. Lebanon had been assigned no place in the conceptualization of strategic consensus because it was wracked by civil war, lacked an effective government, and was, to a large degree, occupied by Syrian and PLO forces. But the Israeli invasion appeared to change all that. Suddenly there seemed to be the prospect of rebuilding Lebanon as a pro-Western, sovereign, democratic, and independent state, capable of a small but effective contribution to the grand U.S. strategic design. At least that was how special envoy Philip Habib portrayed the opportunities to the president and, given the appeal of this undertaking to Reagan's instincts, the president quickly endorsed this breathtaking conception of the reformation of Lebanon. Habib was thus dispatched to Beirut with an ambitious plan: negotiate the withdrawal of all foreign forces, beginning with the PLO but following with Israel and Syria; oversee the election of Maronite Christian strongman Bashir Gemayel to the presidency; use U.S. assistance to help Gemayel rebuild the Lebanese army as a force capable of uniting the country and asserting central authority over the entire country; and, finally, negotiate a settlement between Lebanon and Israel.

Given the anarchic nature of Lebanese politics, the plan had little hope of succeeding, particularly after the September 1982 assassination of Bashir Gemayel. But the lesser objective of securing the withdrawal of all foreign forces might have been attainable. By August 1982 Habib had been able to negotiate the evacuation of all PLO forces from Beirut. Syria was still reeling from the blow dealt it by Israel, whose forces were now within artillery range of Damascus. And the Soviet Union had demonstrated by inaction its lack of commitment to Syrian ambitions in Lebanon. The threat of Israeli force, which had helped persuade the PLO to depart Beirut, might have been used to good effect by the United States as a lever to hasten the withdrawal of Syrian troops.

However, at this crucial juncture, the Reagan administration's ambivalence asserted itself. From the beginning of the war Saudi Arabia had led the rest of the Arab world in expressing anger and frustration over the Israeli action to U.S. policymakers. Unwilling or unable to take action against Israel themselves, the Saudis urged Reagan to do so. Given the importance his administration attached to Saudi Arabia, these entreaties—together with growing domestic opposition to the Israeli moves—succeeded in turning Reagan's support for Israel's initial objectives into his opposition to its siege of Beirut. There was in Washington at the time a real sense that it was necessary to balance Reagan's support

it did possess a small but capable army, which the Reagan administration believed could be useful as an Arab interventionary force in the Gulf.⁹

Working with Jordan on the peace process and with Egypt on strategic cooperation may have seemed logical to the Reagan administration, but it was not sufficiently responsive to Egypt's desire for a leadership role in the peace process or to Jordan's desire for sophisticated weapons. This meant that Cairo and Washington would find themselves working at cross-purposes on the peace process, while Amman would find itself without the U.S. fighter aircraft that Egypt, Saudi Arabia, and Israel were acquiring. (If Jordan had assumed a higher priority in strategic terms, Reagan might have been more prepared to confront congressional opposition to a major arms sale—as he did with Saudi Arabia in 1981—than in the prevailing circumstances, in which the sale had to be justified in terms of encouraging Jordan to join the peace process.)

Syria's role should have been clear-cut. Its relationship with the Soviet Union marked it as a Soviet proxy on the strategic level, Moscow's main foothold in the region. Moreover, its strong stand in opposition to a U.S.-sponsored peace process made it a diplomatic obstruction. Here at least was a clear case of a regional actor that would have to be opposed. The question was how. This question was never answered effectively, as the administration vacillated between a policy of confronting Damascus, a policy of ignoring it, and a policy of praising it to gain its cooperation. Lebanon, on the other hand, did not figure at all in the administration's initial calculus. It was too small and too weak to play a role in either the strategic consensus or the peace process. It is therefore ironic, and yet symptomatic, of the tensions in the Reagan administration's policies that such a backwater should have become the scene for U.S. diplomatic and military intervention, that Lebanon should have been transformed into a strategic prize, a "vital" American interest. The Lebanon crisis became the crucible in which the Reagan administration's strategic vision was mixed with its reactive and ambivalent peace diplomacy, producing an unworkable solution.

WHEN ISRAEL INVADED LEBANON IN JUNE 1982, the Reagan administration's strategic prism determined its initial response. Israel was seen to be removing a terrorist threat from its borders and to be dealing a blow to Syria—a Soviet-backed radical state—in the process. The devastating victory of the Israel Defense Forces (IDF), using U.S. equipment, over the Syrians,

9. The Reagan administration planned to equip two Jordanian army brigades to serve as a special strike force for use in emergencies in the Persian Gulf. U.S. Special Forces helped train the brigades in 1981-82. Specialized equipment and transport planes were to be provided by a secret appropriation in 1983, but this was prevented when the plans were publicized. See *The New York Times*, 14 October 1983 and 22 October 1983.

its strategic and diplomatic policies. But it was an approach that would prove to be unworkable and short-lived. In Lebanon, where the administration was almost immediately forced to turn its attention because of the massacre of Palestinians in the Sabra and Shatila refugee camps, Habib had resolved to implement his grand strategy by pressuring the Israelis to withdraw while depending upon Saudi influence to ensure that the Syrians did the same. Yet the Reagan Plan had robbed both Israel and Syria of any incentive to cooperate with Habib's initiative. Israel perceived that U.S. diplomacy was now directed at denying it the fruits of victory, and Syria perceived that any settlement in Lebanon would be a prelude to a Palestinian settlement, both of which would occur at Syria's expense.

The Reagan administration was now relying on the weakest parties (Saudi Arabia and the Lebanese government of Amin Gemayel, who succeeded his brother after the latter's assassination) to impose its will on the strongest parties (Israel and Syria). Shultz did succeed in negotiating an Israeli withdrawal through the 17 May 1983 Israel-Lebanon Accord, but this agreement was not produced by the Reagan or Habib plans. On the contrary, it was the product of a change in the mood of the Israeli public, which, after Sabra and Shatila, desperately sought an exit from the Lebanese quagmire. And, more significantly for our purposes, it was the product of a change in U.S. diplomacy—a shift from confrontation to cooperation with Israel.

What caused this shift? First, once the Israelis decided to depart from Lebanon, Reagan administration officials began to appreciate the benefits of their continued presence there, as they realized that the Lebanese army was in no position to fill the vacuum that would be left. Second, at the end of 1982, Congress made clear that it would not support a campaign of diplomatic pressure by voting to increase foreign aid to Israel in the face of a lobbying effort by the president and the secretary of state. Third, Ariel Sharon and, subsequently, Menachem Begin were replaced by Moshe Arens and Yitzchak Shamir, whose personal styles were less confrontational and whose top priority was the restoration of U.S.-Israel relations.

Fourth, and probably most important, King Hussein announced in April 1983 that he would not enter peace negotiations with Israel on the basis of the Reagan Plan. This left the Reagan administration without an Arab partner for peace negotiations and therefore with little justification for continuing to work against Israel, since the original purpose of confronting Israel was to produce an Arab interlocutor.

In these circumstances, Shultz chose to resume closer cooperation with Israel, promising increased aid, releasing licenses for the technology needed to produce Israel's new fighter aircraft, and ending the suspension of F-16 deliveries. The Israel-Lebanon negotiations, which began in

for Israel's attack on the PLO with a more forthcoming attitude on the question of a settlement of the Palestinian problem. This was reflected most clearly after the president's July 1982 decision to replace secretary of state Alexander Haig with George Shultz. At his Senate confirmation hearings, Shultz made a point of arguing that he intended to pursue a settlement for the Palestinians. The time had come to allay Saudi concerns by demonstrating Reagan's sensitivity to the Arab world.

Thus, on 1 September 1982, a week after the PLO evacuated Beirut, the president unveiled his plan for peace in the Middle East in a televised address. In its broad conception the plan was well thought out. It focused on the next step in the peace process, bringing Jordan and the Palestinians into negotiations with Israel. It sought to create the conditions that would make this possible by going beyond the Camp David Accords to indicate, as an encouragement to King Hussein, that the United States would not support Israel's annexation of the West Bank or the creation of an independent Palestinian state but would rather seek a solution in which the territories were governed "in association with Jordan."

In timing and implementation, however, the Reagan Plan made no sense at all other than as a response to Saudi entreaties. It focused American attention on the wrong place at the wrong time. While the Lebanon crisis was fluid, the Palestinian problem was not. Yet the plan made only passing mention of Lebanon and ignored Syria completely. Moreover, Israel, whose cooperation would be essential, was not consulted about the initiative. It was sprung on Begin in a way that was bound to elicit a negative reaction (especially when he heard, in these circumstances, of Reagan's rejection of Israel's claim to the West Bank and his insistence on a freeze on new settlements in the occupied territories). Indeed, when Begin expressed his indignation, administration officials expressed satisfaction.¹⁰ His reaction, they argued, did much to convince the Arabs that there had to be something in the plan for them.

Two months before the plan's announcement, Israel was being treated by the Reagan administration as a strategic partner advancing the common interest by dealing forcefully with Soviet-backed radical forces. Now it was being treated as an obstruction to peace that had to be pressured into concessions. Over the next eight months the administration openly opposed increased aid to Israel, delayed the transfer of weapons and technology, magnified the frictions between the U.S. Marines and the IDF in Beirut, and made it clear that Begin was not welcome in Washington.

Confronting Israel and cooperating with the Saudis was, for the moment, the way the Reagan administration resolved the tension between

10. *The Washington Post*, 3 September 1982 and *The New York Times*, 3 September 1982.

December 1982, were brought to a quick conclusion as Israel responded to the Reagan administration's new approach. However, for U.S. diplomacy in Lebanon the agreement came much too late.

In the meantime, the Soviet Union had injected \$2.5 billion of new weapons into the Syrian arsenal, including SAM-5 missiles and a variety of other sophisticated equipment. The Phalangist forces had infiltrated the Shouf mountains east of Beirut, setting the stage for a new conflict between the Druze and the Christians. The U.S. Marines had taken the low ground at Beirut airport because the IDF held the high ground and they thought that any indication of cooperation with Israel would anger the Arabs.¹¹ And most significantly, Israel had officially decided to end its involvement in Lebanon, robbing the U.S. of the only effective leverage it might have had against the Syrians.

While the Reagan administration was working with the Saudis and Amin Gemayel, the balance of power on the ground had shifted in favor of Syria and the factions it supported (the Druze and the Shiites). They promptly declared war on the 17 May agreement and the Lebanese government because of its concessions to and recognition of Israel. The much vaunted Saudi influence on Syria evaporated, and the Reagan administration's diplomatic game plan vanished with it.

The rethinking of Reagan's approach to the Lebanon predicament was carried out by the new special envoy, Robert C. McFarlane. His primary objective was to cobble together an arrangement between the Lebanese government and the Syrian-backed factions, using Saudi influence to gain the cooperation of the Lebanese and the threat of both U.S. and Israeli force to gain the cooperation of Syria. The strategy appeared to work in the summer of 1983 during the battle for the Shouf. The use of the battleship *New Jersey* off the Lebanese coast helped to persuade Syria and the factions it supported to accept a Saudi-brokered cease-fire. But the concept of using force to back U.S. diplomacy in the Middle East had few supporters in the Congress or within the American body politic. In the bureaucracy, the Pentagon and the Joint Chiefs of Staff were adamantly opposed to the use of force in Lebanon, partly out

11. The reason for occupying the low ground was explained by General James Mead, the commander of the 32nd Marine Amphibious Unit: "General Mead said that in his initial planning he intended to occupy the high ground four to eight kilometers to the east of the airport. He found, however, that the selection of his position was not a simple military decision. If the marines had been located in the high ground as he had planned, the Israelis on the Sidon road would have been passing through marine positions, 'which to the Moslems shows the perception of cooperation between Multinational Force and the Israelis which was unacceptable from a political standpoint.' "

(From *Adequacy of U.S. Marine Corps Security in Beirut*, report of the investigations subcommittee of the Committee on Armed Services, House of Representatives, 98th Cong., 1st sess., 19 December 1983, 27.)

of concern for Arab reaction and partly for fear that the U.S. public would view any armed involvement as the start of another Vietnam. Moreover, from the viewpoint of the Reagan administration's diplomacy, Lebanon was a sideshow anyway, as the Reagan Plan had clearly demonstrated. Born as a reaction to Saudi concerns, that diplomacy hardly required a war between the United States and Syria.

Competing with this view, however, was Reagan's anti-Soviet strategic game plan, of which Lebanon had now become the centerpiece. If the Syrians had their way in Lebanon, a pro-Western government would be overthrown by Soviet-backed forces and a U.S.-sponsored peace treaty would be destroyed by the forces of rejectionism. From this viewpoint, Lebanon had suddenly become a vital U.S. strategic interest.

Confronted by divided counsel, President Reagan avoided a choice. Instead, the United States now pursued two contradictory policies simultaneously: one policy designed to extract the marines and end U.S. military involvement, the other designed to increase military involvement to force the Syrians to back down. Accordingly, when Syrian-backed terrorists tested the United States' military resolve by undertaking the tragic suicide bombing of the marine barracks at Beirut Airport, no retaliatory action was taken — despite the fact that Secretary of Defense Weinberger publicly charged the Syrians with complicity. And the marines stayed in their positions on the low ground at the airport despite efforts by McFarlane to deploy them in the mountains.

Yet when the Syrians fired on U.S. reconnaissance aircraft a few months later, the United States responded with air strikes on Syrian gun emplacements, losing two aircraft in the process. Meanwhile, on the level of rhetoric, the president declared that Lebanon was a vital interest of the United States. This combination of overwhelming rhetoric and underwhelming force made little impression on Damascus other than to convince Assad that the U.S. was, to paraphrase the Syrian foreign minister, "short of breath."

Unable to orchestrate the use of U.S. force to back up his negotiations, McFarlane turned to Israel in the hope of impressing Assad with surrogate forces. But the Israelis were no longer in any mood to confront Syria over the future of Lebanon — McFarlane's move came a year too late. And in the meantime, a confused U.S. public and Congress began questioning the purpose of the military presence in Lebanon, while the president's political advisers argued that he could not afford to enter an election year with the albatross of U.S. involvement around his neck. In the end, strategic vision gave way to political expediency, and the troops were withdrawn in February 1984. Over 240 American lives later, this left Lebanon back where it was before the Israeli invasion and the subsequent commitment of U.S. troops — a diplomatic backwater whose

to be willing to enter negotiations on the basis of the Reagan Plan and Mubarak to be ready to warm relations with Israel following his securing an Israeli commitment to withdraw from Lebanon. When none of these things came to pass, and these Arab leaders blamed the United States for the failures, the Reagan administration decided that its intervention and activism only made sense in the Middle East when the local parties demonstrated a willingness to engage. The United States could not be placed in the position of wanting a solution more than the regional actors; this risked only more damage to U.S. credibility. Henceforth, the Reagan administration would await the ripening of conditions for negotiations. This posture had the added advantage of sitting better with the administration's inherent tendency to react to events rather than initiate them.

The second lesson concerned the influence of Saudi Arabia and the wisdom of depending upon it. For just as the Saudis had been unable to deliver a Syrian withdrawal from Lebanon, so too had they been unwilling to provide support for King Hussein's entry into negotiations with Israel on the basis of the Reagan Plan. The first test of Saudi helpfulness came in November 1982 when the Arab League summit convened in Fez, Morocco. The Reagan administration had hoped that, in the wake of the Lebanon crisis and the unveiling of the Reagan Plan, the Saudis would work with Jordan and Morocco at the summit to gain a mandate for King Hussein. The Saudis, however, instead chose to broker a new Arab consensus based on their own Fahd plan, which they had launched unsuccessfully in 1981. The "Fez Plan," as the initiative now became known, provided no role at all for Jordan. Instead it reaffirmed the role of the PLO as "sole, legitimate representative of the Palestinians," called for the establishment of an independent Palestinian state, and made no mention of a solution "in association with Jordan."

Left without an Arab mandate, Hussein entered into negotiations with Yasir Arafat in an effort to gain a mandate via the PLO. Here again, the Reagan administration's hope that the Saudis would play a helpful role proved forlorn. In the early months of 1983 Hussein sought Arafat's agreement to a Jordanian-Palestinian delegation that would negotiate with Israel with the provision that the PLO would approve the Palestinian members of the delegation. In the midst of these negotiations with Arafat, however, the Saudis persuaded President Reagan to commit the United States in writing to a Jordanian-Palestinian "confederation" as one of the possible outcomes envisaged by the Reagan Plan. The PLO defined "confederation" as a federation between independent states and therefore interpreted Reagan's commitment in this regard, duly passed onto Arafat by the Saudis, as an indication that its minimum requirements might be met by the Reagan Plan. The net effect of this Saudi intervention,

problems seemed all the more intractable in the wake of the failed U.S. efforts to end the carnage and reconstitute a legitimate government.

What went wrong? In essence, the contradictions between the aspirations generated by the Reagan administration's strategic conception and the dictates of its Middle East diplomacy rendered U.S. policy ineffective. The strategic conception produced grandiose objectives that were unattainable in Lebanon; the dictates of peace diplomacy diverted the attention of the administration and led it to adopt means that rendered even lesser objectives—such as the withdrawal of foreign forces—unattainable; and the linking of the two ensured the failure of both policy on Lebanon and policy on the peace process. It was, to borrow a phrase, no end of a lesson.

FOR THE REAGAN ADMINISTRATION'S DIPLOMACY, the lessons were particularly important. Since Lebanon was of no great intrinsic value to the United States, the failure of policy there in itself meant surprisingly little. Dire warnings of the impact of a Soviet-backed, Syrian victory in Lebanon proved to be alarmist as Syria found it just as impossible as Israel had before it to achieve control of the fractious Lebanese. But the parallel collapse of the Reagan Plan was potentially more significant.

If the Reagan administration now failed to reconcile the competing demands of its strategic conception and its diplomacy, both strategic cooperation and the U.S.-sponsored peace process could suffer serious setbacks. The reliability of the United States had again been put in question, and pro-Western regimes had to wonder whether association with the United States did more to invite threats than deter them. By the same token, the reputation of the United States as the only outside party capable of promoting peace had been badly tarnished by the Reagan Plan's failure, the stillbirth of the Israel-Lebanon Accord, and the deterioration of the Egypt-Israel peace treaty negotiated by president Carter into a "cold peace" (the Egyptian ambassador to Israel had been recalled after the Sabra and Shatila massacre and relations had been chilled by Egypt). In its attempt to transcend Camp David, the Reagan administration appeared to have placed the achievements of Camp David in jeopardy. A reassessment of U.S. policy was sorely needed.

The first aspect of this reassessment concerned American prestige and reputation. The Reagan administration had invested a good deal of both in Lebanon and the peace process—to no avail. At Arab urging it had adopted an activist role only to discover that the Arabs viewed this as a substitute for their own activism. In a very real sense, the Reagan administration, and George Shultz in particular, felt that the Arabs had let them down. It was not just that they had expected the Saudis to be more helpful in Lebanon, it was also that they had understood Hussein

as King Hussein subsequently explained to *The Wall Street Journal*, was to convince Arafat that he could get a better deal through the Saudis than Hussein was offering.¹² The king's leverage on the PLO chairman was therefore significantly reduced. Within weeks, Arafat had slipped from the king's grasp, and his offer to negotiate for the PLO had been repudiated by both the Fatah Central Committee and the PLO Executive Committee.

The failure of the Saudis to deliver in Lebanon or for Hussein proved to be salutary for the Reagan administration. It was one thing to give the peace process a higher priority because of Saudi concerns, but it was quite another to depend upon the Saudis to play an influential role; the Reagan administration would not make that mistake again. This was especially true because the disillusionment with Saudi diplomacy coincided with changing circumstances both in the oil market and in the Persian Gulf. As the demand for and price of oil declined, so too did the perception of Saudi power and influence begin to converge with reality. And as the Iran-Iraq War escalated, threatening to involve the Gulf Arabs, so too did Saudi Arabia find its attention focused closer to home. Adopting a high profile in the peace process now generated more risks than benefits for Riyadh because by doing so, Saudi Arabia made itself a target of Arab and Iranian radicalism. Thus, by the end of 1983 experience and circumstance had changed the Reagan administration's conception of Saudi Arabia's role in U.S. diplomacy. And ironically, the administration was able to make this adjustment without jeopardizing its strategic arrangements with the Saudis because, in these changed circumstances, the Saudis needed U.S. assistance to deal with the threat of a radical Iran across the Gulf more than they needed U.S. activism on the Palestinian problem.

If working with Saudi Arabia on the diplomatic level had been a failure, so too had working against Israel. Not only had the confrontation between the United States and Israel in Lebanon undermined American leverage over all the parties there, but the antagonism over the Reagan Plan had helped to ensure its demise. The failure to coordinate peace initiatives with Israel while consulting extensively with the Arabs, the call for a freeze on new settlements on the West Bank and Gaza, and the indication to Hussein that he would not have to enter negotiations until the freeze was in place and until Israel had withdrawn from Lebanon, all reinforced the sense in the Arab world—especially in Jordan—that the role of the United States was to deliver Israeli concessions and that their negotiations should thus be with Washington, not with Israel. Instead of persuading King Hussein to come forward, this

12. *The Wall Street Journal*, 20 April 1983.

approach encouraged him to hang back and wait for a demonstration of U.S. leverage on Israel.

Of course that demonstration never came. By demanding a settlements freeze and by making it a precondition for negotiations, the Reagan administration in effect guaranteed that there would be no settlements freeze. By making such a demand, Reagan succeeded only in transforming a controversial issue in Israeli domestic politics into a nationalist demonstration of resolve to stand up to outside pressure. Begin's rejection of the Reagan Plan was thus followed by a flood of announcements of new settlements on the West Bank, including a fanciful five-year plan for fifty-seven additional settlements and 100,000 new settlers—for which neither the money nor the settlers existed. Similarly, the U.S. announcement that Israel's withdrawal from Lebanon was a precondition for negotiations on the Reagan Plan provided the Begin government with a disincentive to cooperate because it forewarned the Israelis that agreeing to U.S. demands in Lebanon would only encourage further demands on the ideologically and strategically more vital West Bank.

While the Reagan administration discovered too late that cooperation with Israel could better serve its interests in Lebanon, the lesson was not too late to apply to the conduct of its diplomacy in the peace process. After experiencing how negative Israel's reaction to pressure from the United States could be, Shultz personally discovered, in his negotiation of the Israel-Lebanon Accord, how cooperative Israel could be when reassured of U.S. support. Thus, by the end of 1983 the Reagan administration had learned that treating Israel like the strategic ally the president had originally proclaimed it to be served a number of related purposes. First, on the diplomatic level, a close and strong relationship with Israel made it possible for the United States to maximize its leverage over Israeli behavior and thereby maximize its influence in an Arab world that looked to the United States to perform the role of pressuring Israel for concessions. Second, on the strategic level, the United States could benefit from Israeli cooperation in Lebanon, in the eastern Mediterranean, and against terrorism and its radical Arab supporters. And third, on the domestic political level, ending the counterproductive tensions in the relationship could help with the pro-Israel community as the 1984 presidential elections approached. Accordingly, in November 1983, President Reagan announced the establishment of strategic cooperation between the United States and Israel.

Strategic cooperation and a closer relationship had become a thesis that no longer had an antithesis. After all, working against Israel had not generated greater benefits or influence in the Arab world. Working with Israel had the advantage of reconciling the administration's diplomatic and strategic policies. And, despite protests to the contrary,

United States in May 1985, could not counteract this image of U.S. weakness in the face of Syrian action.

Syria was clearly an obstruction to U.S. objectives in the peace process but not enough of an obstruction to justify a confrontation. On the other hand, Syria's insistence on a veto over any Jordanian or Palestinian moves in the peace process made involving it in negotiations carry too high a price. And the Syrians showed no interest in entering into even tacit understandings with Israel to stabilize the situation in southern Lebanon. Under these circumstances, beyond deterring Syria through strategic cooperation with Israel, the Reagan administration chose simply to ignore Damascus while occasionally praising it for its "helpfulness" in Lebanon.¹⁴ This would prove to be an inadequate response to Syria's role as a spoiler because it signaled Damascus that it could subvert the peace process with impunity.

WILLIAM QUANDT HAS ARGUED CONVINCINGLY that the best time for a U.S. administration to promote peace in the Middle East is at the beginning of its second term. With four years under its belt to learn about the region's complexities, and domestic politics no longer so constraining a factor for a president fresh from a reelection victory, the second-term administration is in a good position to promote its peace diplomacy.¹⁵ As we have seen, all of this was certainly true for the Reagan administration as it entered 1985. But given its chastening first-term experience, caution rather than activism would be the dominant characteristic of its second-term Middle East diplomacy.

Many have maintained that such caution was inappropriate because of the auspicious circumstances then prevailing in the Middle East. On 11 February 1985 King Hussein had taken advantage of the split in the PLO to form an alliance with Arafat designed to give him the legitimacy he needed to negotiate on behalf of the Palestinians. On the other side, prime minister Shimon Peres was keen to engage Jordan and the Palestinians in negotiations both to secure his vision of Israel's future and to ensure his own survival as prime minister. There was, these critics suggest, a window of opportunity that the Reagan administration could have exploited for a breakthrough in the peace process.

What this argument overlooks, however, is the fundamental weakness of the local parties to the peace process. Shimon Peres was prime minister of a National Unity government, which included a Likud party strongly

14. Assistant Secretary of State Richard Murphy told a congressional subcommittee that Syria was playing a "helpful" role in restoring stability to Lebanon a mere nine months after the bombing of the marine Barracks in Beirut that killed 239 U.S. servicemen. *The New York Times*, 26 July 1984.

15. *Camp David: Peacemaking and Politics*, chapter 1.

this new approach did not prevent both old and new Arab friends from beating a path to the White House door.¹³

Waiting for the local actors to take the lead, downgrading Saudi Arabia's role, and pursuing closer ties with Israel did much to eliminate the contradictions in the Reagan administration's policies. But the experience of the first three years had left one important lesson still to be learned. The collapse of the Reagan Plan had done nothing to end the administration's ambivalence toward the PLO. While on the strategic level the PLO remained as much a terrorist adversary as it had been in the past, on the diplomatic level, at the behest of Jordan, Egypt, and Saudi Arabia, a role was still to be preserved for it in the peace process. Thus, in early 1983, President Reagan rationalized the PLO's rejection of King Hussein's role as Arab interlocutor with Israel by arguing that radical elements within the PLO had prevented the moderates from modifying the organization's position. And when Arafat found himself besieged again, this time by Syrian-backed forces in the northern Lebanese port of Tripoli in late 1983, the Reagan administration intervened to provide him with safe passage to Cairo. The open split within the PLO now generated the hope in Washington, encouraged by Egyptian lobbying, that Arafat and the Fatah faction he led would no longer be subject to the veto of the more radical factions and would instead be prepared to enter into an alliance with Jordan. On this uncertain presumption, the Reagan administration would resurrect its diplomacy following the presidential elections.

Finally, the Reagan administration remained confused and ineffective in its approach to Syria. Assad had played a bold and shrewd game in Lebanon, forcing the withdrawal of U.S. troops and destroying the United States' handiwork on the Israel-Lebanon accord. The Syrians had demonstrated rather easily that their will to prevail in Lebanon was greater than Reagan's. This could not but have an adverse effect on regional perceptions of the balance of power. If the mightier superpower could be forced to abandon the Lebanese government in such short order, what Arab regime could rely safely on U.S. protection if it chose to defy Syria's rejectionism and enter negotiations with Israel?

U.S. strategic cooperation with Israel would help deter Syria from launching an attack on either Israel or Jordan. But it would do little to protect Jordan from the threat of Syrian subversion. U.S. assurances to King Hussein, which had been provided in abundance during his visit to Washington in December 1982 and repeated when he returned to the

13. The announcement of strategic cooperation with Israel in November 1983 was followed by the reestablishment of diplomatic relations with Iraq and the improvement of relations with Algeria.

capabilities in this regard had been highly constrained by its first-term involvement in Middle East diplomacy. Lebanon had sapped the administration of the will to back its diplomacy with force and had robbed U.S. assurances of their credibility. Now Reagan's advisers were more concerned with avoiding failures than encouraging the parties to achieve a breakthrough. They wanted to rebuild U.S. credibility through cautious diplomacy rather than expend what was left on yet another Middle East initiative.

Moreover, the task of strengthening local parties was in itself highly problematic. Hussein was looking for tangible evidence of support in the sale of advanced fighter aircraft to the kingdom. This would be a test of the president's willingness to confront a pro-Israel Congress. Reagan's advisers, aware that they could not win congressional approval of such a sale in advance of Hussein entering into direct negotiations with Israel (or at least declaring Jordanian nonbelligerency toward Israel) were opposed to the president making any such commitment. But Reagan chose to ignore this advice, promising the planes during the king's visit in May 1985. As expected, congressional opposition proved to be overwhelming and the arms sale had to be deferred. Instead of strengthening the king, the episode only further eroded his faith in U.S. assurances.

Had the sale gone through, however, the administration would have weakened Shimon Peres in the eyes of the Israeli electorate by leaving him open to the charges of hard-liners that he had undermined Israel's security through his flexibility. And if the United States would have strengthened Hussein politically by helping him to gain PLO approval for Jordan's entry into negotiations with Israel, it would have simultaneously risked weakening Peres politically because he would be seen as having failed to prevent the erosion of the long-standing U.S. opposition to the PLO.

While the administration would make some efforts, all of them ultimately unsuccessful, to do what it could in this regard, it clearly preferred a policy that put the onus on the local parties to demonstrate their willingness to enter into direct negotiations, with the United States ready to assist them when they did so.

What the administration discovered in the process was that King Hussein had an elaborate plan for negotiations, which first involved a meeting between the United States and a Jordanian-Palestinian delegation whose Palestinian members would be selected by the PLO.¹⁶ In this meeting the United States would be expected to endorse the principle of self-determination for the Palestinians in the context of a confederation

16. For a more detailed account of the diplomatic interaction in 1985 see "Searching for Peace," *Strategic Survey, 1985-1986* (London: International Institute for Strategic Studies, 1986) 102-13.

opposed to territorial compromise on the West Bank. His room for maneuver was therefore severely constrained. He could risk the breakup of the government and new elections if he had a clear-cut offer to negotiate from King Hussein, but any offer short of that, especially one that involved the PLO, would be politically unacceptable to Peres—not to mention his coalition partners. Moreover, he was limited in what he could do to encourage such an offer.

The king, on the other hand, was too weak to make such an offer to Israel. Syria was adamantly and violently opposed to the Jordan-PLO accord, and Saudi Arabia was not prepared to offer any visible support. In these circumstances, Hussein was again dependent upon Arafat to provide him with the Arab cover he needed to enter negotiations with Israel. But with the PLO still deeply divided, Arafat was himself too weak to provide such cover. Not only was he faced with a Syrian-backed assault on his leadership from an anti-Arafat alliance of PLO factions, but his own supporters remained deeply suspicious of the king's motives. In these circumstances Arafat was hardly likely to allow Hussein to usurp the title of "sole, legitimate representative of the Palestinians," nor was he prepared to give his opponents ammunition by compromising on the PLO's long-standing refusal to renounce terrorism and accept UN Resolution 242.

Egyptian President Mubarak was prepared to give Hussein support, but he too was constrained by Egypt's weakness. Cairo's isolation in the Arab world as a result of its peace treaty with Israel made it incapable of mustering additional Arab support. And in the case of the PLO, Mubarak was as much a competitor with Hussein as a supporter because he too sought the mantle of Arab legitimacy that came from promoting the Palestinian cause. The one useful contribution that Egypt could have made was to instill new life into the peace treaty with Israel, thereby strengthening the Israeli constituency for peace, which had been greatly discouraged by the failure of the treaty with Egypt to usher in warmer relations. But here too Mubarak's weakness made him unwilling to countenance the risks such an action might have involved for his strategy of rebuilding Egypt's position in the Arab world. Instead, the long-standing dispute between Israel and Egypt over a tiny piece of Sinai territory known as Taba became an excuse for Egyptian foot-dragging.

In these circumstances a reinvestment of U.S. prestige and credibility held out the dangerous prospect of yet another failure. Better, the argument in the administration went, to test the parties and determine their willingness to enter into direct negotiations before becoming actively engaged as the broker.

Some have argued that this caution was inappropriate for the United States and that it should have counteracted the weakness of the local parties with its own strength and activism. But the Reagan administration's

with Jordan. The PLO was then supposed publicly to accept UN Resolution 242, which would be followed by U.S. recognition of and dialogue with the PLO. After that, an international conference was to be convened. Finally, under the auspices of this conference, a Jordanian-Palestinian delegation would negotiate with Israel.

Hussein's plan was to involve the PLO as a partner in the process, taking its legitimacy for himself and paying in the coin of U.S. recognition. This was hardly the clear-cut offer of negotiations that Peres was looking for, but Shultz discovered, on his trip to the region in May 1985, that the Israeli prime minister was prepared to be flexible. Israel's position would be determined by context and timing. If the U.S. meeting with the joint delegation took place in the context of direct negotiations and if the next step would involve a meeting with Israel, then Peres was prepared to accommodate the king. He would also countenance an indirect role for the PLO, in the form of selecting the Palestinians in the delegation, provided that the representatives selected were not themselves PLO members.

For its part, the Reagan administration was prepared to accept an indirect role for the PLO because Hussein insisted upon it. But Shultz and national security adviser McFarlane were hardly interested in Hussein's intermediate steps, only the last one. They were looking for direct negotiations between Israel and a Jordanian-Palestinian delegation, not a meeting between Yasir Arafat and Ronald Reagan.

For their part, however, Arafat and the PLO factions he led were interested only in U.S. recognition and had no desire to allow Hussein to negotiate in their stead. Accordingly, Arafat selected prominent members of the PLO to join the Jordanian-Palestinian delegation, forcing Peres to state in no uncertain terms his opposition to a U.S. meeting with the Palestinians named.

Shultz, however, was prepared to go ahead if Hussein would be willing to commit Jordan to direct negotiations with Israel after the meeting took place. But Hussein would not make such a commitment in the face of a Syrian-sponsored campaign of terror against Jordan and in the absence of any Arab support.¹⁷

Had the United States gone ahead with the meeting in these circumstances—as the Near East Bureau of the State Department recommended—it would have found itself engaged in a dialogue with the PLO

17. The Syrian campaign began in late 1984 and involved the assassination of Jordanian diplomats, the hijacking of a Jordanian airliner, and bombings of Jordanian offices abroad. In July, under Syrian pressure, Kuwait cut back its financial subsidies to Jordan. And in August Syria led a boycott of an emergency Arab summit called to endorse support for the Jordan-PLO accord. Not only did Libya, Algeria, South Yemen, and Lebanon join the boycott, but Saudi Arabia's King Fahd and Iraq's Saddam Hussein also stayed away. The summit chose to endorse the Fez Plan rather than the Jordan-PLO accord.

but much further away from the negotiation that was its objective. First, the dialogue itself could not have laid the basis for negotiations with Israel because of the PLO's insistence on U.S. recognition of a Palestinian right to self-determination before it accepted UN Resolution 242. This is something the Reagan administration explicitly ruled out in the Reagan plan because self-determination in the Middle East context has become a code word for an independent Palestinian state, the creation of which the United States has no interest in promoting. What would have resulted from the meeting, however, was *de facto* recognition of the PLO by the United States. This in turn would have put an end to the Jordan option because Arafat would have had no incentive to delegate authority to King Hussein once he had succeeded in engaging the United States in dialogue. And it would have generated a crisis in U.S.-Israel relations and within the Israeli political system that would have severely weakened Shimon Peres. The result: the PLO would have been brought into the negotiations, but Jordan and Israel would have been forced out.

At the time some argued that such a process of U.S. recognition of the PLO was worth it for its own sake. But they would have been hard-pressed to maintain that position in the aftermath of the events of September and October 1985, when Arafat's Force 17 murdered three Israelis on a yacht in Larnaca, Cyprus, and a faction of the Palestine Liberation Force loyal to Arafat hijacked the Italian cruise ship *Achille Lauro* and killed a wheelchair-bound American. Had the Reagan administration pursued negotiations with the PLO, these terrorist incidents, perpetrated not by radical Palestinian groups supported by Syria or Libya but by the supposedly "moderate" PLO groups led by Arafat, would have left the administration's Middle East diplomacy in complete disarray.

Instead of this dead-end process, the Reagan administration tried to put the PLO to the test through a meeting between PLO officials and Sir Geoffrey Howe, the British foreign secretary. But that meeting never took place because the officials, under Arafat's orders, refused to endorse a statement that would have been issued after the meeting committing them personally to acceptance of Resolution 242 and Israel's right to exist. Subsequently, Hussein himself put the PLO to the test in February 1986 when, with the acquiescence of the United States and a yellow light from Peres, he offered the PLO a seat at an international conference if it accepted 242 and renounced terror (the PLO was no longer formally required to recognize Israel's right to exist). But Arafat refused the terms, insisting that the United States recognize Palestinian rights to self-determination before participating in any meeting with U.S. officials.¹⁸

18. For some interesting details of the negotiations as well as the U.S. and PLO positions, see the correspondence between Lee H. Hamilton (D-Ind.) and the Department of State, reprinted in *The Congressional Record*, 5 June 1986, E 1967-69.

A year of diplomatic maneuvering ended without any progress toward a settlement, but not because of a lack of American activism. As King Hussein was quick to point out, the failure was caused by the PLO's refusal to accommodate the other parties, not by the Reagan administration's lack of interest.

Although the Reagan administration's second-term diplomacy had failed to produce a new Camp David, it had at least avoided any further damage to U.S. credibility. That was probably the most that could have been achieved given the weakness of the local actors and their unwillingness to take the necessary steps to produce a negotiation—the PLO would not accept 242 and renounce terror, Jordan would not negotiate without the PLO, and Israel would not negotiate with the PLO. And in the process, the Reagan administration resolved the ultimate ambivalence in its diplomacy. The PLO had demonstrated that it was neither willing nor able to be a serious party to peace negotiations, and Hussein no longer insisted on a role for Arafat. As George Shultz explained, "They don't deserve a place at the peace table."

DIPLOMACY HAS LONG BEEN CALLED THE ART OF THE POSSIBLE. But in the Middle East it is a special art that each new U.S. administration seems fated to have to learn for itself. The Reagan administration took a particularly long time because its learning process has been influenced by a strategic vision that contradicted the dictates of Middle East diplomacy. In the first administration this produced the dramatic failures of the Reagan Plan and the Lebanon imbroglio. In the first two years of the second administration, diplomacy was brought into line with the strategic vision, producing, in the end, a more effective diplomacy. The test of this diplomacy lies not in the fact that no new peace agreement has been negotiated by the Reagan administration—by that criterion it was a failure—but rather in the assessment of whether American interests in the Middle East are more secure today than they were six years ago.

By that measure the Reagan administration can claim some success. The Soviet Union has made no new inroads and faces some serious problems with its traditional proxies, Libya, South Yemen, and Syria. No Arab state has turned to the Soviet Union out of disillusionment with U.S. diplomacy. On the contrary, Algeria and Iraq are turning increasingly to the United States, while traditionally friendly Arab regimes are in greater need of U.S. assistance today than previously. At the same time, the United States enjoys a stronger and closer relationship with Israel than ever before, while the supply and price of oil seems assured for the medium term.

In terms of U.S. diplomacy the Reagan administration also has some worthwhile achievements to its credit. First, the Egypt-Israel peace treaty was successfully implemented after the assassination of Sadat and then

successfully resurrected following the Lebanon crisis and the dispute over Taba. Assiduous U.S. diplomacy made a significant contribution to those developments and, while much more needs to be done to revitalize the peace, the Egypt-Israel peace treaty is stronger today for having survived those crises.

Second, sensitive U.S. diplomacy as well as significant economic assistance has helped place the battered Israeli economy on the road to recovery. A similar process is now under way in Egypt, although the problems there are far greater.

Third, with U.S. encouragement and backing, Jordan and Israel are now engaged in a process of constructing the building blocks of cooperation on the West Bank that may increase the possibility of an eventual negotiation there. This process consists of an effort to rebuild Jordanian influence in the territories at the expense of that of the PLO leadership and, in the process, provide the Palestinian inhabitants with the prospect of a better economic and political future. Breaking the intimidatory stranglehold of the PLO will be a difficult task, but for the first time in more than a decade the United States has resolved to end its pursuit of the mirage of PLO moderation in favor of the construction of a true Jordan option.

Moreover, in the process the Reagan administration has quietly succeeded in achieving much of its strategic vision as well. The rhetorical aim of "strategic consensus" has long disappeared from the administration's lexicon. But the United States now has effective relationships of strategic cooperation with Morocco, Egypt, Oman, Saudi Arabia, and Israel.

To be sure, the United States is still not well liked by the Arab man in the street. But this has been true throughout the history of U.S. involvement in the Middle East. What matters is not whether U.S. diplomats get invited to dinner in Arab capitals, but whether Arab governments are willing to cooperate and work with Washington. Judged on that scale, the Reagan administration has fared better than most of its predecessors.

To be sure, the challenges to friendly regimes are growing as the downturn in oil prices brings economic recession to the Middle East and radical Islam threatens to spread from Iran across the Gulf. And this comes at a time when the U.S. Congress is much less willing to vote the economic and military assistance that has in the past provided the means for the United States to assist friendly governments in countering these threats. But these developments present new kinds of challenges to U.S. diplomacy—challenges that the long-standing emphasis on pursuing a settlement of the Palestinian problem cannot possibly hope to counter.

Syria presents the one persistent challenge to American interests that the Reagan administration has not effectively contended with. The Lebanon experience has shown that dealing with Damascus is a formidable

task. Syria is building its army for a future war with Israel, is promoting instability in southern Lebanon, is effectively blocking the path to a negotiation between Jordan and Israel, and is one of the primary backers of international terrorism. But Assad's minority regime is also beset by a bankrupt economy, a Sunni fundamentalist challenge, isolation in the Arab world, a Lebanese quagmire, and an unwinnable war with the PLO's Fatah faction. And Assad himself is in poor health. In these circumstances the most effective U.S. diplomacy may involve simply deterring Syria until the current regime collapses under the weight of its own ambitions. Here too, however, the Reagan administration has learned from its experience in Lebanon to have no illusions about the nature and objectives of the Assad regime. It now has a better understanding of the necessity to back diplomacy by force when dealing with Syria. In these circumstances deterring Syria should also be within the capabilities of the Reagan administration's Middle East diplomacy.

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AIPAC

BARBARA AMOUYAC

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May 18, 1987

SPEECH AND Q&A SESSION
THE HONORABLE GEORGE P. SHULTZ
SECRETARY OF STATE
BEFORE
AMERICAN ISRAEL PUBLIC AFFAIRS COMMITTEE (AIPAC)
WASHINGTON HILTON HOTEL
WASHINGTON, D.C.
May 17, 1987

(Introduction and sustained applause)

Thank you all very much. I appreciate it. Thank you. Thank you very much.

At approximately 2:10 p.m., Washington time, the United States Navy frigate, the U.S.S. Stark, was hit by two missiles fired from an Iraqi F-1 Mirage aircraft. At the time of the attack, the Stark was located about 70 miles northeast of Bahrain. The ship at last report was dead in the water, and the entire crew was being taken off. There have been serious casualties.

The United States regards this attack with grave seriousness. The President was informed at once, of course, and is following the situation closely. I've been in touch with Secretary Weinberger, White House Chief of Staff Baker, and National Security Adviser Carlucci.

We have called in the Iraqi Ambassador here in Washington and issued the strongest protest and demanded a full accounting. Our Ambassador in Baghdad has been instructed to deliver our protest there, and we are in continuous contact with our Embassies in Baghdad and Bahrain.

This event underscores once more the seriousness of the Iran-Iraq war, not only to the countries directly involved, but to others. It shows how easily it escalates, and it underlines once more the seriousness of the tensions that exist in the Middle East, and the importance of trying to do something about them.

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But I want to assure you, my fellow Americans, that we take this event with the utmost seriousness. We know the source of this missile that hit our ship, and we demand a full accounting, and as we have more information, of course, we will be meeting on it and seeing what further action may be necessary.

I hate to start on such a sober note, but perhaps it is the right note, because I am deeply honored to be here. You said the first to be invited back twice, or maybe you said the first to be invited and accepted to come back twice. (Laughter) That's a difference. (Laughter) But I accepted, because we've gotten to know each other over the past five years, and I feel one of the warmest and best things that's happened to me in this job is the expansion of my already, at the time, wide list of Jewish friends.

And so I've come here -- and I have a few notes -- but I'm not going to read something to you. I've come here to talk to you as friends, informally but very seriously, about two related problems. One involves the world we have ahead of us and America's role in it. The other involves our role in the Middle East, especially in the light of recent developments. Both these problems are important to us as Americans, and they are both important to Israel. So let me spell them out for you, and I hope that you can help me with both of them.

First, the world ahead of us and the U.S. role in it: I think we are at a moment of tidal change in world affairs. There are plenty of problems out there, and some of them have to do with the fact that we have a determined and strong adversary in the U.S.S.R., an adversary with global scope. But basically the situation is most promising for our system of values and for our pattern of interest.

So we should be engaged as never before in a sophisticated, energetic, and knowledgeable way, because there are problems, because we have adversaries, and because there are great opportunities. But just at this opportune moment we are, I fear, in the process of drawing away -- of drifting, stumbling, perhaps unconsciously -- out of phase, I believe, with the outward-looking citizens of our country and their wide-ranging interests.

We have a winning hand, but we are not positioning ourselves to be able to play it. So that's problem one, and let me spell it out to you, and, as I say, this winning hand is held by us, it's held by Israel, it's held by the countries that believe in freedom, that believe in openness.

It's a changing world. We're moving into a new age, and it can be our age if we're willing to engage in it, because it's an age based on openness and freedom, on knowledge, on information that's widely shared and moves around, a genuine information

age, knowledge age. So here are some of the things that I think we have learned that are going to characterize the world ahead of us if we play our cards right.

We have learned once again that freedom is the most revolutionary force in the world. We have learned how much people value democracy and the rule of law if only they have access to it, and we have seen how people all over the world are ready to resist totalitarianism. We have learned that freedom and economic progress are related. We see how well the market can work if we'll let it. People all around the world see that if you build your economy on incentives, on the market, on enterprise, you're going to be much better off.

The countries of East Asia have been a glowing example, but the message has been spreading to Africa. It's interesting to see the Chinese and the Soviets beginning to struggle with this problem, because they see that a highly centralized, highly compartmented economic system is not producing. I have the impression that even Israel's getting the message -- (laughter) -- the market, incentives, private enterprise. We have learned about the power of information technology as we move from an agricultural age that's long since in our past, through an industrial age -- the industrial age is over in this country -- to an information and knowledge-based economy and society.

We can see right now that this kind of new technology has revolutionized financial markets. The only way to think about financial markets is in world terms. There is a world financial market, and it's open 24 hours a day. We have seen how the meaning of raw materials has been changed. Processes are being substituted for materials.

To take an example, in the telecommunications industries now fiber optics are replacing copper at a very rapid rate. Fiber optics, in a sense, come out of the mind instead of out of the ground, and I could cite you a lot more examples. We see the implications across many areas, including agriculture, of biotechnology. Malthus is being turned on his head.

We also can see, as the gross national product of the world grows, that its distribution is spreading out, and we see that more and more countries around the world, or sections of countries even, have the economic size to give an account of themselves in some particular field. And I might say with the existence of deep ethnic tensions in many parts of the world -- look at Sri Lanka right now with its Tamil insurgency; I use that example because it has nothing to do with East-West problems -- we see religious fundamentalism which, among other things, has a tendency to be intolerant. So we see those things combined with the existence, very widespread, of weaponry that -- even though it may not be the most sophisticated and up to date by the standard of our military or the Israeli military, but was considered up to date 10 or 15 years ago -- still can be very lethal and is widely available. So that has some big implications.

So what are we doing as a country to face up to these opportunities and these challenges? Well, we have before had the experience of swinging from involvement to a kind of isolationism. I hope that's not happening to us, but let me tick off some of the danger signs to you.

A big one is protectionism, and we are riveted on various trade barriers which we must knock down. But, nevertheless, we have to agree, I'm sure, analytically that those trade barriers are not the source of our trade deficit. It has other sources. But look what protectionism will do. It is, of course, a threat to our economy and to the world economy. It also is a message about freedom, because if you say we believe in economic freedom except we're going to protect our markets, people wonder if you really do believe in it. And it has a strategic message, just as we saw before World War II when the world got compartmented by the extreme protectionism of the 1930s and, while this was not the cause of the war, it contributed. The object of political movement, military movement, strategic movement to break out of those boundaries was a contribution.

We should learn from the contrasts between what happened to us in the 1930s and its outcome, and what happened to us in the post-World War II world where some great statesmen, most of them from this country, convinced that we had to have international institutions that were better than what we had in the 1930s, put together a structure that opened trade, that had a world view, that recognized our economy was part of the world economy -- which was much less so then than it is now -- and for those efforts what we got was an expanding world, not just for us but including us and for everybody. Whereas we all know about the Thirties, and, of course, I don't have to remind this audience of the tragic consequences that flowed from a disengagement by the United States in the 1930s.

We also see abounding in this country a kind of self-righteous moralism which also leads to withdrawal rather than involvement. I'll stand here with anybody and denounce apartheid. There is nothing good to be said for it, at all! (Applause) So we know what we're against in South Africa, and we know what we're for -- a different kind of governmental structure where everybody has a chance to participate. But it doesn't make any sense -- I don't think -- to say because we don't like it, and we think there should be change, therefore we should disengage ourselves and go away. On the contrary, we should stay there. We should state our views. We should work for our views. We should be engaged, not throw up our hands in self-righteous moral indignation and leave, which is what is happening to us right now. (Applause)

Now, probably you knew I'd get around to money sooner or later. But let me tell you what is happening to our foreign affairs budget. This is the money that we use to support our

security, our prosperity, our ideals, to fight terrorism, to fight drug trafficking, to represent ourselves around the world. Here's what's happened to it.

In the fiscal year 1985, the amount of money allocated to all those functions, all the security assistance and economic assistance all over the world, managing the State Department, the Voice of America, Export-Import Bank, and so on -- all in -- was \$23 billion. In fiscal year 1986, it was \$19 billion. In the fiscal year we're now in, it's a little above \$17 billion.

The Congress is now jockeying around in the budget resolution process with numbers approximating \$16 billion. 23, 16. Now, there has been inflation here, and there has been a big decline in the value of the dollar over that period, so it doesn't go as far. And running through that is about \$8 billion that doesn't get cut at all. I'm not saying it should get cut. Personally, I support those items, most particularly aid to Israel and Egypt. (Applause)

But when you cut from 23 to 16, and you have eight, say, going through as a constant, then everything else is brutalized. And we are in the process of depriving ourselves of the eyes and the ears and the hands necessary to represent ourselves, and it makes no sense in the kind of world I described to you -- no sense at all. The changing world favors us, and that's good news for us, and it's good news for the world in general, and it's good news for Israel. The larger the democratic community of nations, the closer Israel's dream of a secure and peaceful existence. And the more influential and involved America is, the more effective a partner we can be for Israel.

So we have a winning hand, but will we play it? I don't want to have America turn inward, and I'm sure you don't want to see that either. You know that this is a dangerous world. You recognize that the United States has enemies, that Israel has enemies, and that our adversaries will be quick to exploit any signs of American disengagement from our international responsibility, so let's not do it! (Applause)

Now, we're never going to walk away from Israel or Egypt when it comes to the budget, but when we fail to meet our obligations elsewhere, it affects everything, including Israel. So you in AIPAC have a big stake in keeping America engaged. As I have come to ask for your help to keep us on the right track, I want you to help us avoid a retreat from our global responsibilities, including our responsibilities in the Middle East. It cannot serve Israel's interest if America withdraws and the Soviet Union moves into the vacuum.

Today, America's support for Israel has never been stronger or more steadfast, and I promise you -- I know the President would promise you, and it's a bipartisan matter in the Congress -- that we will be working closely with Israel to see that this strong and steadfast relationship remains. (Applause)

Last night I was in New York, and I made a few remarks about David Ben-Gurion, and I was honored there. And looking back, we can see that he knew what was basic. Israel had to be true to its roots, its religion, its heritage. Israel had to be a democracy, because it had to be free. Only a democracy could give tolerance and justice to the great diversity of the Jewish people that gathered in from all over the place to the new State of Israel.

Israel had to be strong, unwaveringly strong, because it would have to fight for its life, not once but continually, and to endure, Israel had to search and work for peace at every opportunity. I think those were the basics that I pulled out of my study of Ben-Gurion, and I believe most people would identify those as fundamentals.

So now there seems to be discussion of a possible new opening toward peace. So I am going to spend some time with you looking at it from a U.S. point of view, and saying, "Let's evaluate it," and let's ask ourselves, "What is making peace all about?" Well, to me it's really simple. It's sitting down with people who want to make peace, and who are qualified and ready to negotiate. That's how you make peace. So you have to look for people who are qualified and ready, so let's ask a few questions.

Is the PLO qualified?

AUDIENCE: No.

SECRETARY SHULTZ: Hell, no! (Sustained applause) Let's try that on for size. PLO?

AUDIENCE: Hell, no!

SECRETARY SHULTZ: You got it! (Applause) Look at what they've just done. Their alliance involves the most violent and radical elements around, and they just put it together again. They showed once again that they don't want peace; they want the destruction of Israel, so they're not qualified.

Palestinians? Certainly. They have to be part of peacemaking. There are Palestinians who know that the only answer is through a non-violent and responsible approach to direct negotiations for peace and justice. We have to continue to find them, help them, and support them.

How about the Soviet Union?

AUDIENCE: No. No.

SECRETARY SHULTZ: Could it be a constructive presence?

AUDIENCE: Hell, no.

SECRETARY SHULTZ: Yes. It could be. (Laughter) And there have been some interesting developments recently, but are they now a constructive presence?

AUDIENCE: No.

SECRETARY SHULTZ: No. Look what they do. They encourage the PLO to turn ever more radical and rejectionist. They align themselves with the worst terrorists and tyrants in the region. They refuse to re-establish diplomatic recognition to Israel. Their treatment of Jews and the practice of the Jewish religion in the Soviet Union is not acceptable by any standard, let alone the Universal Declaration on Human Rights and the Helsinki Final Act, to which they are bound by their own signature. (Applause)

We can all welcome the release of heroes like Natan Shcharansky, but as he is the first to say, the emigration of Soviet Jews is in no way proportionate to the desire and the right of Jews to leave. So if the Soviets want to be a part of the peace process, as they say, let them step forward and qualify themselves. (Applause)

King Hussein has qualified himself. He is serious and committed to peace. He has rejected the rejectionists. He has stated his readiness to pursue -- these are his words -- "a negotiated settlement in an environment free of belligerent and hostile acts." He has dealt straightforwardly with Israel. He has courageously established relations with Egypt, enhancing the welcome process by which Egypt's role in the Arab world grows even as Egypt solidifies its peace with Israel.

He has recognized that only bilateral, face-to-face negotiations, can do the job. The name of the game is direct, face-to-face negotiations. (Applause) He has shown great concern and solid support for the Palestinian people. He is for including Palestinians in the Jordanian delegation -- not independent, include them with Jordan. (Applause) And he has said that the international conference he advocates will not impose any solution or veto any agreement made by the negotiating parties. All this undeniably represents progress. We welcome it, and we are for it.

Now, let me say a little more, from the standpoint of the United States, what we are for and what we make of all this. First of all, we are for a strong Israel, and for the strongest, permanent link possible between the United States and Israel. (Applause) We believe, among other things, that the underpinning of movements toward peace is to make it crystal clear to everybody that there is no military solution as far as the enemies of Israel are concerned. They can't get there that way. (Applause)

We are for, in the strongest terms, the treaty of peace between Egypt and Israel. With the passage of time and serious efforts on both sides, that relationship, born of Camp David, represents the brightest hope for peace in the Middle East. Egypt is our friend, and we honor the role it has taken for peace and justice. I think we made a further step in the Taba agreement. (Applause)

We are for the President's September 1 initiative. It's not a plan -- it's an initiative. That is our position, and we will take it to the table as our view; just as we recognize, when we get to those face-to-face negotiations, others will come with their own views and no doubt differing views. But that represents the view the United States will take unto that table.

We are for the effort to achieve real improvement in the quality of life on the West Bank and Gaza. This program has made progress in recent years. It draws sustenance from the diplomatic activity in the peace process and contributes to creating an atmosphere in which negotiations can take place. And we consistently stand for the principle that the only reliable way to achieve peace is through face-to-face negotiations between Israel and its Arab neighbors.

The United States believes it is important to explore all possible approaches to this objective, to see whether any of these approaches, including an international conference, would lead immediately to direct negotiations.

I might say we are also careful not to intervene in domestic Israeli politics. I have the highest regard for and the closest relationship with both Prime Minister Shamir and Foreign Minister Peres, and for that matter many other Israeli leaders. We are working with all of them to reach an agreed position on recent developments, and I want to say that I know, knowing them all as I do, that all of them are dedicated to peace. (Applause) All of them are.

Now, this Administration remains committed to helping Israel in its quest for peace and security, as we always have. That has been a steady, constant commitment of the United States, and it has helped time after time after time. We are still here. The same steady friends, working together with Israel, and you on the basis of the same principles.

But important developments have in fact occurred that have led us, consistent with our established policies, to look carefully at the idea of an international conference. I say carefully, cautiously, skeptically, but nonetheless with open minds and willing spirits. The answers are worth working through, even if this idea fails, like so many others on which we have worked. No one should ever be able to claim that a failure to advance the cause of peace resulted from the lack of effort on the part of the United States. (Applause) For any approach to warrant consideration, we would have to insist that, in

addition to leading promptly and directly to face-to-face negotiations, it also would not interfere with, impose its will on, or veto work of the bilateral negotiating parties; include Palestinians in the negotiations, only in a Jordanian-Palestinian delegation; (applause) and require all of the negotiating participants to accept UNSC Resolutions 242 and 338, and to renounce violence and terrorism. (Applause)

Now, sometimes in our policy about the PLO, we use the words, "and recognize Israel's right to exist." Frankly, I cringe a little bit when anybody says that or when I say it, although it is part of our policy. Of course, Israel has a right to exist. It exists. It has a right to prosper. It has a right to peace. (Applause)

Now, if such a conference were ever to take place, only states would be represented and involved. They should have diplomatic relations with all of the parties that come to the table. (Applause) And it should be clear that the right of any party to remove itself from the conference or the negotiations is there if such rules or understandings are not observed. Now, there recently has been progress towards such a negotiating format which would offer serious prospects of reaching an agreement between the parties on peace. So, as far as we are concerned, we have to, as I said, look this over carefully, skeptically, but look it over. It may be that there is a genuine opportunity to bring about direct talks. If so, we have all been striving for that.

I might say all across the spectrum of Israeli politics there is a desire to have direct talks. Everybody is in favor of that. Once direct talks have been achieved, an important psychological obstacle would have been overcome, irrespective of the results. We have to insist that there is no predetermined result or plan, so each party can advocate its preferred approach, including the approach that is represented in the Camp David Accords.

As far as the Soviets are concerned, it's impossible to know whether they want to be spoilers or whether they want to be constructive. I must say they couldn't do a lot worse than they're doing now -- encouraging the PLO and the radicals to reunite. So we'll have to see about that.

And, of course, I think we also need to remind ourselves, as the statement I made at the outset underlines, that a lack of progress has its own dangers, including increased and deepening bitterness and the continued and potentially explosive tension that we know is there in the region. I believe that as we look at this, as I said, carefully and skeptically, we need to take out an insurance policy, in terms of the close working relationship which is there between Israel and the United States, as long as we agree on that basic structure -- and we're ready to walk away from the idea or walk away from a conference, if it fails -- then, we can pursue this road

without too great a risk. But we can only pursue it if we are able to do so in partnership with the Government of Israel, and we will make no moves unless we are assured of that.

So let me summarize the present initiative accurately. The President and I are not committed to an international conference, and we are not asking others to commit themselves now to the idea. We believe, however, that Jordan is sincere and that a real opportunity has been presented for progress. We are not interested in disrupting Israeli politics in the process. To the contrary, as I said, we will proceed only with the support of the Government of Israel. We have our own views, however, and we will state them in the same spirit in which we have worked with Israel for many years. We believe the present circumstances clearly call for a fair and thorough effort to develop an acceptable plan, however dubious we may be of the general idea. If no acceptable understanding emerges, so be it. We will try again another way, but let us try. Let us use our ingenuity and courage so that we accomplish whatever progress toward peace is achievable.

Israel has fought many wars in its short history. Let us continue to do everything we can to avoid another while safeguarding forever Israel's security and prosperity.

Thank you.

(Applause)

MR. EDWARD LEVY: (Moderator) Mr. Secretary, thank you very, very much. We've asked that this audience put down some of their questions on three-by-five cards, and if you could get them to AIPAC staff, who are going up and down the aisles now, as fast as possible. I have one in-hand already.

In this climate of budget austerity, foreign aid is an unpopular program even in the best of times, and you've described it as being brutalized. What, sir, is this Administration doing to neutralize or reverse this alarming trend? What will you and the President be doing to get out the vote for foreign aid this year?

SECRETARY SHULTZ: First of all, I have been doing what I've done here. I regard it as our number one foreign policy problem, and I've been trying to tell the American people about it so that they know what's happening. When you cut to the degree that this budget has been cut, it is all out of proportion to what's happened to any other parts of the budget. The amounts, of course, are large by any standard other than the Federal Government's, but we're talking about a budget of a trillion dollars or more. So it isn't large -- you're not going to solve the deficit problem by these cuts. So we're explaining it. We're working with Members of the Congress on it.

I am somewhat encouraged that, nowadays anyway, I find people say, yes, we think you're right on the merits but somehow we're going to have to punish you by cutting it. I think we have to get out of the habit of calling this "foreign aid," Tom, because that implies that what we're talking about is a bunch of money that we're handing over to some other countries, sort of left over for them to do whatever they want with it. I think this money goes for our security, first of all. It helps us that Israel is strong. It helps us that we have countries around the world that are friends and allies and are willing to have us have bases in those countries. It helps our forward security in defense. So these are payments that go with that. It helps us if the world economy is prosperous. It helps us, and it helps our friends, when we see democracy expand, as it has in our hemisphere, as it has in the Philippines, and as we see people experimenting with more forms of freedom around the world. That helps us. That's good for the United States.

It's important for the United States that we fight terrorism. It's important for the United States that we fight drug-trafficking. And, remember, the terrorists and the drug-traffickers are aligned. The drug-traffickers provide the money -- and they have lots of it -- and the terrorists provide the muscle. It's an unholy alliance, and we have to fight it. We can't do it without resources. (Applause)

So I'm a preacher for the importance, particularly in the kind of world that we can see out ahead of us, with the opportunities that it has and the problems, and how small a world it is, that the United States has to be there. It has to be engaged; it has to take its responsibilities seriously.

So, help, Tom.

(Applause)

QUESTION: Well, as you know, this organization is totally dedicated to passing a full foreign aid budget that includes full funding for Israel and Egypt.

Several questions have come up, Mr. Secretary, about a proposed arms sale to Saudi Arabia that AP ran across the country on Saturday, and it appeared in the Saturday newspapers, and probably today as well. Since an arms sale of F-15 fighters may serve Saudi Arabia's short-term interests with respect to the Gulf war, isn't it, though, a potential long-term threat to Israel? And are there any alternative policies that the United States could pursue that serves Saudi interests in the Gulf but does not threaten Israel in the long run? (Applause)

SECRETARY SHULTZ: I think that it is in our interest to make these sales to Saudi Arabia. Otherwise, I wouldn't be supporting them. And they're structured in a way that we believe protects the Israeli interests. Now, what is involved here is a level of F-15s, basically, of, I think, 60 airplanes.

and a commitment basically to see to it that Saudi Arabia is able to maintain that level of inventory. That's what they need. They aren't adding to it. But planes are damaged, or they crash, or your inventory goes down and you have to replace it. And so there is a proposal to sell airplanes to provide that replacement.

The Saudis will buy them, and what will actually go over to Saudi Arabia is what is necessary to keep up the inventory that they already have, and which I think they need. It's not adding. It's a matter of maintenance of what's there. And what they don't need will stay here. If they go below the level, then more planes go over there. So it isn't as though it's some big, new thing that's being done; and we think that we should do it. And, certainly, the tension in the Gulf, and the stability that Saudi Arabia is able to provide -- because it does have some advanced aircraft -- is helpful to us. There's no question about that. So that's why I favor it.

QUESTION: Several questions about peace, and the peace conference -- international conference. What circumstances would you need to become personally involved in direct shuttle diplomacy between Israel and Jordan?

SECRETARY SHULTZ: I think that insofar as the President is concerned, he is ready to dispatch me whenever we think there is a reasonable prospect of doing something constructive. In order for that to happen, both governments need to think that it would be helpful and to ask. We can't want peace more than they do, or it's not so much wanting peace -- they all want peace -- but to want to exploit an opportunity more than they do. They have to want to have that happen, and then we can help to bring it about. So what we need is an invitation. But the invitation has to come from, obviously, King Hussein, speaking for Jordan, and for the Government of Israel, broadly conceived, and then we naturally will respond.

QUESTION: Shimon Peres said here this afternoon that Jerusalem is not negotiable. When will the United States recognize this and move its Embassy there? (Applause)

SECRETARY SHULTZ: The U.S. view is, and probably -- you're U.S. citizens, you may not necessarily share the view of the U.S. Government here -- but our view is that all of the territories that were taken and occupied by Israel are subject to negotiation. As far as Jerusalem is concerned, we also have the view that there needs to be -- our sense going in -- a unified Jerusalem, not cut up so we're not going back into two Jerusalems. But insofar as the nature and status and arrangements in that city is concerned, we think that in the end it has to be a matter of negotiation. It's one of the many items. Now, not everybody agrees on that, but that is our position.

The same with the Golan Heights, and the same with the West Bank. That's what you have to sit down and talk about when you get to direct negotiations. I'm sure you realize that if we ever get to that point, there are Arabs who feel that they have a legitimate right to access to holy places and to being part of a process of what goes on, at least, in some parts of Jerusalem. So, at any rate, our position is that this is a subject for negotiation.

QUESTION: I'll make this the last question. But before I do so, please stay put until the Secretary leaves. Then, leave through the back doors. Otherwise, we're going to have to go through a whole different security complex. Bob Asher will make some announcements before you leave.

Mr. Secretary, the pile on my table where I was sitting is basically about the international conference. It's about foreign aid, questions about the frigate that was hit. But there are a series of question about you. And, obviously, there is a certain magic going on between the AIPAC membership. I hope others of our brethren across the country, with you. Have you ever thought -- would you consider -- running for President of the United States? (Applause)

SECRETARY SHULTZ: Well, I appreciate very much --

(Sustained applause)

SECRETARY SHULTZ: I appreciate very much the question and its obviously supportive tone, (Laughter) and I know that you all recognize that in my dealings with AIPAC and my dealings with the many other groups from the Jewish community that come and call on me and that I have the privilege of consulting, that I always speak as candidly and directly as I know how. If that means that I have an answer to a group that they don't necessarily agree with, I feel I have to say what is my honest answer. Then, if they have something that they agree with, I don't mind saying either. So, in that spirit, I have to give you a one word answer: No.

(Standing Applause)

I appreciate the questions. I'm sorry I can't stay here for an hour or two and answer them, but I can't. Questions are very informative for me because they give me an idea of what's on your mind and how you see things. So I'd ask Tom if he would just give me that big stack, and I'll look through them. And who knows, I might even learn something.

Thank you.

* * * * *

U.S. Moves On Israelis In Spy Case

3 in Pollard Inquiry May Lose Immunity, 4th May Be Indicted

By Howard Kurtz
Washington Post Staff Writer

The Justice Department has notified three Israelis that it is moving to revoke the immunity from prosecution they had been granted in the Jonathan Jay Pollard spy case, and has told a fourth Israeli that an investigation against him could lead to his indictment, according to knowledgeable sources.

The Israeli who was told in recent weeks he might be indicted, the sources said, is a senior Israeli Air Force commander, Aviem (Avi) Sella, who was Pollard's first "handler" in the United States.

The three other Israelis received letters from the Justice Department in the last two weeks, the sources said, informing them the department was moving to revoke their immunity. Truthful testimony is a condition of a grant of immunity and federal investigators believe that the three Israelis lied or withheld crucial information in the Pollard probe, sources said.

The prospect of criminal charges being filed against Israeli officials could add a further irritant to U.S.-Israeli relations, which have already been strained by disclosures of Israel's role in arranging U.S. arms sales to Iran in an attempt to free American hostages.

The Israeli government has repeatedly described the Pollard spy ring as a "renegade" operation run by lower-level officials, but a U.S. indictment could contradict that

account by charging that the espionage was officially sanctioned by Jerusalem.

The four Israelis, who have been named as unindicted coconspirators in the case, are not expected to be tried in the United States, since the U.S. extradition treaty with Israel does not cover espionage offenses. But an indictment of Sella or the others would effectively bar them from entering the United States, where they would risk arrest, and could tarnish their reputations at home.

Sella, identified by federal prosecutors as Pollard's first "handler" in the United States, is a celebrated brigadier general who commands a major Air Force base and is viewed as a possible future leader of the Israeli military. Sella was a graduate student at New York University in 1984 when he first made contact with Pollard, according to federal prosecutors.

The three Israelis whose immunity is being revoked are Rafael (Rafi) Eitan, a former terrorism adviser to two Israeli prime minis-

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ters; Joseph (Yossi) Yagur, a former science consul at Israel's New York consulate, and Irit Erb, a former secretary at the Israeli Embassy here.

Pollard, a former U.S. Navy intelligence analyst, pleaded guilty last June to selling U.S. military secrets to Israel. U.S. Attorney Joseph E. diGenova said in court papers that Pollard provided "thousands of pages" of classified U.S. documents to the Israelis, who allegedly paid him \$2,500 a month, financed lavish European vacations for him and his wife and promised him \$300,000 more in a Swiss bank account over 10 years.

Pollard's sentencing has been delayed until March 4 at his attorney's request. He faces a maximum penalty of life in prison and a \$250,000 fine. His wife, Anne Henderson-Pollard, is awaiting sentencing on lesser charges.

When contacted yesterday, DiGenova said, "This case is being handled as any other criminal case. We've been in regular contact with the four unindicted coconspirators for some time, and have been in direct contact through their attor-

neys. Those communications are continuing." He declined to comment further. Spokesmen for the Justice and State departments had no comment.

U.S. investigators were rebuffed in several attempts to question Sella about the Pollard case, on a 1985 fact-finding trip to Israel and last year in Washington. Sella's attorneys insisted that he first be given a sweeping grant of immunity from prosecution, which Justice Department officials refused to provide.

Instead, the department told Sella in a recent letter that it is no longer interested in talking to him and will proceed with the investigation, which could result in his indictment.

The department indicated some time ago that it might seek to revoke the immunity of Eitan, Yagur and Erb, who were interviewed early in the investigation. None of the Israelis told U.S. investigators about Sella's role in the espionage ring or of the arrangement to pay Pollard \$300,000 through a Swiss account, sources said. These details were learned only after Pollard began cooperating in the probe, the sources said.

The Justice Department, which

has previously questioned the extent of Israeli cooperation in the case, has formally notified the Israeli ambassador here of the latest developments.

In his initial contacts with Pollard, Sella described "particular technical information which would be of primary interest to Israel and stressed that [Pollard] should obtain 'top secret' documents," according to diGenova's sentencing memo.

Sella told Pollard he would receive a "salary" from the Israelis and coached him on a "cover" story to explain his newfound wealth, prosecutors said. They said Sella taught Pollard other intelligence techniques, including a code system based on the Hebrew alphabet that Sella used to contact Pollard at pay telephones.

Eitan, now president of a state-run chemical company in Israel, assured Pollard that he would be "taken care of" if arrested and that any U.S. investigation of him could be "contained," according to Pollard's account to prosecutors.

Pollard told an Israeli reporter that he is a "loyal son" of Israel and described himself as "heartbroken" at his abandonment by the Israeli government.

Philippine constitution viewed as only small threat to US bases

By Tom Ashbrook
Globe Staff

MANILA - The constitution approved last week in the Philippines opens legal avenues for rejection of two giant US military bases in the country.

But loopholes in the new charter, general public acceptance of the bases and the large financial stake that the Philippines has in the US military presence are expected to work in favor of keeping the bases intact.

Sections of the constitution limiting the presence of nuclear weapons in the country and requiring the approval of a new US-Philippine treaty on the facilities are aimed at the American military's key Pacific outposts.

The charter states that "consistent with the national interest," the Philippines will adopt a policy of freedom from nuclear weapons in its territory.

It also requires that after the 1991 expiration of the US-Philippine agreement on the bases, the future of the installations will be subject to treaty approval by the national legislature and, if the legislature so requires, to a national referendum.

Concession to nationalists

Both provisions were included in the charter as concessions to nationalists, who have long argued that the bases impinge on the country's independence and are a remnant of the 48 years of US colonial rule, which ended in 1946.

US officials, however, believe that barring dramatic political changes in the Philippines the bases will remain open, mainly as a result of the charter's language and the national interests that are associated with the installations.

In keeping with its policy, Washington will neither confirm nor deny the presence of nuclear weapons at Clark Air Base or at Subic Naval Station, where more than 14,000 US troops are stationed.

In the transcript of a taped telephone conversation last September, however, Joker Arroyo, a top Aquino adviser, said, "Americans will not care to... maintain those bases if there are no nuclear weapons."

Opponents of Aquino obtained and released the illicitly recorded tape in an attempt to embarrass the government. Arroyo later said that portions of the transcript were inaccurate.

But most analysts in the Philippines assume that the US warships and planes that visit the country often carry nuclear weapons.

Little alarm so far

The US refusal to acknowledge the nuclear question and the vague language about "national interest" contained in the Philippine charter have combined to prevent the nuclear provision from raising alarms.

"I don't think your bases are in imminent danger of being booted out," said Ben David, an Aquino spokesman, last week.

Over the longer term, US officials say they are counting on the country's financial stake in the bases and pro-American sentiment in the Philippines to lead to a renewal of the agreement on the disposition of the facilities.

The current five-year financial agreement earmarks \$900 million in grant aid and military assistance to the cash-strapped Philippines. Manila is expected to ask for much more compensation when negotiations begin next year.

American officials estimate that the bases, along with three small satellite installations, pump an additional \$300 million annually into the economy in wages, contracts and local procurement.

Aquino has said she will stick to the agreement on the bases until 1991, leaving her options open for negotiating or rejecting an agreement beyond then.

Referendum a possibility

Leftist political leaders in the country have vowed to try to have the question of the bases put to a national vote, and to mount a vigorous campaign for public rejection of the US facilities.

Diplomatic observers say they do not rule out the possibility that the question might end up on a national referendum and that opponents will use the new constitution to sharpen sentiment against the bases.

Local surveys, however, indicate a general acceptance of the

U.S. Military Personnel in the Philippines

Total number, as of March 31, 1985, was 14,534, with an estimated 5,000 at Subic Bay Naval Base and 6,700 at Clark Air Force Base.



UPI Graphic

US military presence.

One national survey made last October by Ateneo de Manila University and the Manila-based Social Weather Station found that 60 percent of respondents believed the US bases should be kept in the Philippines. Another 18 percent opposed the bases and 20 percent were undecided.

About half of those polled - 48 percent - said the US presence was important to the defense of the Philippines. Only 6 percent said the bases impinged on Philippine independence. Twelve percent agreed that the bases heightened the risk to the Philippines of involvement in a nuclear war.

The survey, funded in part by the Ford Foundation, asked whether "most of what the United States government wants to happen in the Philippines is good for the Filipino?"

Of those surveyed, 55 percent agreed, 18 percent disagreed and 27 percent were undecided.

Zorrell

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Pollard: Not A Bumbler, But Israel's Master Spy

By Wolf Blitzer

FROM THE FIRST revelation that U.S. Navy intelligence analyst Jonathan Jay Pollard was spying for Israel, one question has puzzled almost everyone knowledgeable about Israeli-American relations: Considering how close the two countries are and how much is already shared, what could Pollard have provided that would be worth the risk?

After investigating the Pollard case for more than a year, and interviewing dozens of U.S. and Israeli officials, I have learned some of what Pollard provided to Israel. My information suggests that far from the small-time bungler portrayed in some news accounts, Pollard was a master spy, who provided very important information to the Israelis.

Leon H. Charney, a New York lawyer who briefly represented Pollard and is close to senior Israeli officials, says: "His help was clearly invaluable to the security of the State of Israel."

The motivation of my sources in telling me about the case was complex. Some Israeli and American sources wanted to show that Pollard was an Israeli hero. Other sources in Israel and America provided details because they believed the public deserved a fuller accounting of the Pollard case.

The intelligence provided by Pollard to Israel included specific material dealing with the following general areas:

- Reconnaissance of PLO headquarters in Tunisia, including a description of all the buildings there, according to one American with first-hand knowledge of the Pollard case and confirmed by an Israeli who is familiar with what Pollard provided. This and other related data obtained by Pollard—especially the specific capabilities of the Libyan air defense system and the movement of U.S., Soviet and French ships in the Mediterranean—enabled the Israeli air force to evade detection and to bomb those headquarters on Oct. 1, 1985. Pollard's information "made our life much easier" in the Tunis raid, one Israeli official said.

- Iraqi and Syrian chemical-warfare production capabilities, including detailed satellite pictures and maps showing the location of factories and storage facilities, according to Israeli officials who were told by colleagues what Pollard had provided. An American official

subsequently confirmed that Pollard had provided information about Iraqi chemical warfare.

America's refusal to provide this chemical-warfare material directly to Israel had angered Pollard, according to one knowledgeable source. Israeli officials said that the first documents Pollard gave Israel, which greatly impressed his handlers, included the layout of eight Iraqi chemical warfare factories.

- Regular U.S. intelligence assessments of operations planned by a PLO unit, according to an American account that was confirmed in Israel.

- Soviet arms shipments to Syria and other Arab states, including the specifics on the SS-21 ground-to-ground and the SA-5 anti-aircraft missiles, according to knowledgeable American and Israeli sources. Whenever the U.S. discovered that a Soviet ship was passing through the Bosphorus into the Mediterranean, Pollard passed that information to Israel, the sources said.

- The U.S. intelligence community's assessment of a particular Soviet-made fighter.

- Pakistan's program to build an atomic bomb, including large satellite photographs of its nuclear facility outside Islamabad, according to an American source with detailed knowledge of the Pollard case.

Despite the official Israeli claim that Pollard was part of a rogue operation, Israeli officials speak of him in terms that suggest he may prove to be one of the most important spies in Israel's history.

Indeed, Pollard's Israeli handlers even compared him to the legendary Israeli spy in Damascus, Eli Cohen, who rose to the top echelon of the Syrian government in the mid-1960s but eventually was exposed and executed. When Pollard was given an Israeli passport containing his picture as a token of Israel's appreciation, the name on the passport was "Danny Cohen"—the implication being that Israel once had an Eli Cohen in Damascus and now had a Danny Cohen in Washington.

In general, Pollard gave Israel the pick of U.S. intelligence about Arab and Islamic conventional and unconventional military activity, from Morocco to Pakistan and every country in between. This included both "friendly" and "unfriendly" Arab countries.

Pollard, 32, was arrested outside the Israeli embassy in Washington on Nov. 21, 1985 after attempting to obtain political asylum there. He pleaded guilty to espionage charges and his wife, Anne Henderson-Pollard, 26, pleaded guilty to lesser charges involving unauthorized possession of classified documents. Both of them are scheduled to be sentenced on March 4.

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POLLARD...CONTINUED

Why did Israel recruit and run Pollard? Some U.S. officials argue that the operation wasn't necessary, since Israel gets virtually everything it needs from American intelligence agencies. But Israeli officials, living on a thin margin of security, apparently were not convinced of this logic. They feared that the United States wasn't supplying everything. And what the United States wasn't supplying could be essential for Israel, especially in the area of sophisticated reconnaissance photography and electronic intercepts, where Israel's capabilities are limited.

Pollard had all the proper credentials, as far as Israel was concerned. He was intelligent. And he was a dedicated Zionist. Indeed, Pollard told me in the only interviews he has granted since his arrest that he was obsessed by the need to help Israel "personally."

Pollard held "Top Secret" security clearances. According to the pre-sentencing memo submitted last month by U.S. Attorney Joseph E. diGenova, Pollard had access to "Sensitive Compartmented Information," principally data about technical systems for collecting intelligence "as well as the intelligence product collected by the systems." A relatively small percentage of individuals who have "Top Secret" clearances are also approved for SCI access, the court document said.

Throughout the Washington area there are secure libraries containing this kind of extremely sensitive intelligence information which is accessible only through computer terminals requiring codewords, diGenova's memo explained. He said Pollard could "readily access these libraries, repositories and computer terminals to obtain data in order to perform specific duties."

The court documents suggest lax security and sloppy procedures in the military intelligence facilities where Pollard worked. Like other intelligence analysts, he was supposed to operate on the honor system, meaning that he would limit his access to that information for which he had an official "need to know," according to diGenova's memo. But since he had the appropriate access codes, he could easily obtain information unrelated to his duties.

In addition, according to diGenova, Pollard had a "courier card," permitting him to leave

these libraries without having his belongings checked by security personnel. In short, he had all the credentials to become an extremely valuable spy.

In fact, diGenova says that Pollard provided Israel with more than 1,000 classified documents, some of which were several hundred pages in length. Stacked up, the tens of thousands of pieces of paper could have filled a small hall. Most of the documents, according to the pre-sentencing memo, "were detailed analytical studies containing technical calculations, graphs and satellite photographs." Other information included "highly classified message traffic and intelligence summaries" as well as data on "specific weapon systems." He apparently was able to take copies of this material—including satellite photos—with him out the door.

Citing security concerns, the U.S. government has refused to release the exact nature of these documents. Secretary of Defense Caspar Weinberger, in a classified affidavit presented *in camera* to U.S. District Court Judge Aubrey Robinson, said that Pollard had indeed provided Israel with extensive information, according to two U.S. sources who are familiar with the memo. Weinberger reportedly complained in his memorandum to the court that because Pollard had already given away so much information, the U.S. intelligence community's bargaining power in official exchanges with Israel was severely reduced.

An Israeli intelligence official told me that some of the information was "so breathtaking" that it justified the risk Israel was taking in running an agent in Washington. Pollard's handlers—including Air Force Brig. Gen. Aviem Sella, veteran intelligence agent Rafael Eitan and former science counselor at the Israeli Consulate in New York Yosef Yagur—told him that he was "a one-man intelligence agency" for Israel, one source said.

What Pollard did was to make virtually the entire U.S. intelligence-gathering apparatus available to Israel, completing the picture in those areas where Israel's knowledge was limited. His Israeli contacts, knowing where Israel was in need of specific information, "tasked" Pollard on a weekly basis to obtain it, according to the American prosecutors.

The Israeli government has maintained officially that the Pollard operation was "un-

authorized," part of a "rogue" unit that ran amok. Israel formally apologized to the United States and later cooperated in the investigation by making available for questioning to a visiting delegation of U.S. officials some of the Israeli operatives involved in the ring.

Some American intelligence sources remain very skeptical about Israel's denials. They argue that the unit that recruited Pollard, known as "Lekem," was created years ago to collect scientific intelligence. They also assert that Israeli intelligence experts had to know that only an inside American agent could supply the massive quantity and quality of satellite photography that they were getting. Israel lacks that capability and Israeli experts knew the U.S. was not supplying that information to Israel officially.

Israel had set up a special unit in New York and Washington to obtain Pollard's documents. Court papers showed that Irit Erb, a secretary at the Israeli embassy in Washington, was given a second apartment where she operated sophisticated photocopying equipment for the documents provided by Pollard. Typically, he would deliver a large suitcase full of papers on a Friday evening on his way home from work and retrieve them on Sunday evening in order to return them to the appropriate national defense repositories the next morning.

Pollard told me in interviews that he was motivated by his anger that the United States was withholding from Israel information that was vital to the security of the Jewish state. He had been a member of the American delegation on two official intelligence exchanges with Israel, so he had a good sense of what was being shared and what wasn't.

"I was very frustrated at the end of these two sessions. And the frustration builds," he told me during a lengthy interview at the federal prison outside Petersburg, Va. Eventually, he added, his frustration became "relentless" and led him to pass to the Israeli government the information they were being denied—information he described as "horrifying."

Wolf Blitzer, Washington correspondent for The Jerusalem Post, is the author of "Between Washington and Jerusalem: A Reporter's Notebook."

CHICAGO TRIBUNE

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Taking advantage of a friend

Israel's pursuit of military technology hampers U.S. ties

By Douglas Frantz
and James O'Shea
Chicago Tribune

WASHINGTON—The Israeli government is waging a deliberate campaign to obtain vast amounts of restricted U.S. military technology through legal channels and a clandestine network of agents.

Israel is using the technology to bolster its national defense and to turn itself into a major international weapons merchant that competes in the high-technology field with the U.S. arms industry.

The situation is creating increasing concern among mid-level U.S. officials responsible for safeguarding American military technology. These officials say the United States is losing control of its ad-

This is another in an occasional series of articles examining international weapons trafficking.

vanced weapons technology because it is being used in arms that Israel sells to third countries, including China.

They say several instances in recent years have strained U.S.-Israeli diplomatic relations, in part because the manipulation is coming from an ally that receives more U.S. aid than any other country, \$3 billion a year, and has received costly favored treatment by every U.S. administration since Israel was granted its independence in 1948.

High-ranking Israeli officials deny exploiting their nation's special relationship with the U.S. They said Israel has proved itself to be a stable democracy and a loyal American ally in the Mideast.

The Israelis maintain they violate no laws in pursuit of technology and that special treatment is a two-way street often benefiting the U.S.

Israel traditionally has provided the U.S. with military assistance,

such as intelligence on the Mideast and the Soviet Union. It has provided data on how U.S. weapons perform in battle, and it has passed along the most recent Soviet weapons systems captured from Arab states.

The closeness of the two nations was illustrated by the recent disclosures that Israel served as middleman in the secret arms deals with Iran that were arranged by the White House in the hopes of freeing American hostages held in Lebanon. This is only the latest incident where a U.S. president has asked Israel to help the U.S. carry out a dual policy in the Middle East.

Indeed, America's relationship with Israel has fostered two sets of policy guidelines governing aid and access to military technology—one set for Israel and another for the rest of the world.

The Reagan administration, citing Israel's strategic value, has granted Israel enormous flexibility in its use of U.S. aid and unprecedented access to American technology.

But a three-month investigation, based on scores of interviews and examination of hundreds of pages of government documents, found evidence that Israel has taken advantage of its unusual ties to the U.S.

With little monitoring from federal agencies and active assistance from some U.S. officials, Israeli defense companies have obtained access to some of the most sophisticated American weapons technologies.

Israeli companies have purchased small U.S. firms involved in classified work for the military, established joint ventures with major U.S. defense contractors and set up American subsidiaries. Spokesmen for the Israeli government and the companies said the effort was motivated only by eco-

nomics considerations and is not government directed.

Yet the Israeli companies, most of which have close ties to their government, are being exposed to more and more U.S. defense technology through the economic program.

As a result, Israel not only is being given \$1.8 billion a year by the U.S. to buy weapons, but it is snapping up the technology to build the weapons itself for sale around the world—at a profit and with little effective U.S. control over its customers.

Furthermore, the Israeli actions have prompted a string of federal investigations into whether the Israelis have crossed the legal boundaries into the areas of espionage and theft.

Federal law-enforcement authorities are known to be investigating six cases where Israeli agents and government employees have been accused of trying to obtain an array of military secrets, from the know-how to build deadly cluster bombs to a process for making the world's most accurate and durable tank barrels.

Most of the investigations deal with possible violations of U.S. export laws, which are designed to protect American military technology and control the spread of weapons.

A high-ranking Justice Department official said the cases "represent problems," and added: "We're going to try to continue to tackle each one of them and do something about it."

Barukh Binah, an Israeli government spokesman in New York, said when some of the cases under investigation were outlined for him by a reporter: "Any case you have described has no criminal meaning. It might have been a misunderstanding, but there is no

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SYRIA...Continued

arms and weapons sales and that they most recently involved the imminent purchase by the Syrian government of a special aircraft tracking system used by NATO countries.

Through Jamali, prosecutors say, Gilday was able to use Syrian diplomatic pouches to ship documents and other materials in and out of this country.

Gilday and a business associate, Rosemary Loughery, 45, of Mount Holly, N.J., were arrested two days before Thanksgiving and charged with conspiracy to defraud the government by violating arms export regulations stemming from the Syrian deal and the planned sale of as many as five C130H transport planes to Libyan leader Moammar Gadhafi.

The export regulations prohibit the sale to various unfriendly countries of certain arms, defensive weapons and high-technology equipment that could be used in weapons systems or by the military. State Department officials have said that no export license would be granted for the sale of C130H planes to Libyan or for the sale of the aircraft tracking system to Syria.

No such sales were completed, and no shipments were made.

Gilday was attempting to broker the sale of a sophisticated IBM computer to East Germany and to help Iran and the Irish Republican Army acquire a laundry list of arms and weapons, according to Customs Service investigators. Those weapons and materials included .357 magnum revolvers, M14 automatic rifles, spare parts for F4, F5 and F14 fighter planes, TOW and Dragon antitank missiles and Stinger antiaircraft missiles, the investigators said.

James Lyons, Gilday's lawyer, has said that his client's talk of ties to the Syrians, terrorist Abu Nidal and the Irish Republican Army was a bluff to try to persuade customs agents, posing as arms dealers who would provide the weapons, that his company was able to make big deals.

Lyons declined to discuss the charges against Gilday.

Sources said Customs Service of-

ficials were aware of Gilday's involvement in Mideastern and Eastern bloc weapons and computer deals before undercover agents contacted him early this year.

Telephone toll records obtained by the government and a device on Gilday's telephone that noted each number called showed numerous calls to London, Northern Ireland and Syria, customs agent Donald Bludworth testified at a detention hearing for Gilday.

Gilday was released on \$500,000 bond and is confined to his parents' home in Wilmington, Del. Loughery is free on \$130,000 bond.

"This is completely groundless," Syrian Embassy chief Kanafani said in an interview last week on Gilday's alleged links to the embassy. "This is a case of somebody trying to pin something on our embassy Some people want to involve our embassy . . . just want to use this for stories against our embassy."

She denied that Jamali, who worked for Syria's defense ministry before joining the foreign ministry, was Gilday's official Syrian "contact" in this country and said Jamali was not being transferred to Moscow, as prosecutors claimed.

Kanafani said Jamali, who has been in the United States since January 1982, was being recalled to Damascus because of embassy cutbacks required by U.S. sanctions against Syria. On Nov. 14 President Reagan announced the sanctions, which also banned the sale of sophisticated computers, aircraft and spare parts, to show U.S. "outrage" at Syria's involvement in international terrorism.

But sources said Jamali's departure was planned before Reagan's announcement and that she is scheduled to be posted to Moscow after attending language school in Damascus. Jamali, who has full diplomatic immunity, was to leave the country this weekend, sources said.

Government investigators and prosecutors paint a much broader picture of Jamali's involvement in the planned arms shipment, and say she also worked with Thomas Henry O'Brien, an Irishman who they

say has ties to the Irish Republican Army and the Irish government.

O'Brien has also been charged with conspiracy to violate arms export control regulations, but he has not been arrested and his whereabouts are unknown.

Sources said that customs agents had more than 100 contacts with Gilday during the 10-month investigation and that agent Bludworth earlier met O'Brien at Gilday's Philadelphia apartment.

O'Brien was to come to Washington on Nov. 22 to complete final details of the sale to Syria of the aircraft tracking system, according to court documents and testimony. Gilday came to Washington to meet with Bludworth and Robert Fischer, whom he believed were arms traders, but O'Brien never showed up.

Bludworth testified that Gilday called Loughery in New Jersey in an effort to locate O'Brien and that he also telephoned Ireland and England looking for him. Gilday used a pay telephone on Third Street SE to telephone Jamali to find out if she knew O'Brien's whereabouts, according to court testimony.

Gilday and Jamali apparently met Nov. 22, investigators said.

Investigators said the two customs agents met with Gilday on Nov. 23, 24 and 25, but Gilday was still unable to locate O'Brien. O'Brien was to bring with him certificates saying that the tracking system, which actually was going to Syria, was to be shipped to Cyprus, they said. The certificates would have made the deal appear legal and were crucial to its completion.

About 11:30 a.m. on Nov. 25, Gilday called Jamali again to find out if she knew why O'Brien was missing, the probers said. Jamali said she had no indication that O'Brien had encountered any problem. Gilday was arrested by Bludworth and Fischer a short time later.

Sources said that they knew O'Brien's movements until a short time before he was to board a plane to come here but they did not know if he was on the plane.

ADVANTAGE...CONTINUED

pattern. The attempt to put them all together is artificial and arbitrary."

Binah agreed to respond to part of a list of written questions, but declined to answer others on what he said were security grounds.

Several of the federal investigations involve employees of Israel's Defense Procurement Mission in New York, a delegation of an estimated 200 military and technical experts who act as a liaison to defense companies and military installations.

Binah said no official from the mission would respond to questions, and he refused to confirm the number of employees in the New York office.

A secret report prepared by the Central Intelligence Agency in 1979 described the procurement mission as a key element of Israel's intelligence-gathering operations.

Collecting scientific information in the U.S. to accelerate Israel's technological and military development was one of the three top goals of the Mossad, the Israeli intelligence service, according to the CIA assessment of Israel's espionage activities.

The CIA report said Mossad agents used jobs in the Israeli purchasing mission as a cover for spying and to establish commercial companies for long-range penetration of specific fields of military technology and science.

The report was found in the U.S. Embassy in Tehran by Iranians during the 1980 hostage crisis. It later was made public by Iran, and the CIA never has denied the authenticity of the report.

A similar description of Israeli methods was presented more recently by R.D. McLaurin, a former expert on international security at the Pentagon. McLaurin's findings were based on a classified report he prepared as a consultant for the Defense Department.

The report was not available, but McLaurin, now senior consultant at a research firm specializing in the Middle East, delivered an unclassified version at a symposium on international relations last year.

"One of the most interesting aspects of the Israel-U.S. case is the conscious, assiduous and broad-based effort Israel has made to acquire advanced military technology," McLaurin said in his symposium paper.

McLaurin said that largely through the efforts of Foreign Minister Shimon Peres when he was defense minister, Israel developed what McLaurin called a "technology penetration and acquisition network" to obtain the technology.

He said the network involves the New York purchasing mission, science attaches at the Israeli Embassy in Washington and at consulates around the country, and Israeli military and scientific officials who visit U.S. military bases and research centers. When Jonathan Pollard, a U.S. Navy intelligence analyst, was exposed last year as a spy for Israel, Joseph Yagur, an Israeli science attache in New York, fled to Israel. Yagur later was described by prosecutors as the chief handler of the spy.

The Israelis have been accused in the past of stealing technology from other countries. For instance, the Israeli jet fighter, the Kfir, was developed from 200,000 blueprints for the French Mirage that were stolen by a Mossad agent and shipped to Israel in 1968 and 1969, according to published accounts.

Since 1948, Israel has been surrounded by Arab enemies, and its survival has depended on military supremacy. Often, however, other nations have imperiled Israel by embargoing weapons shipments there. So Israel's initial goal in seeking U.S. technology was to improve its defense and attain military self-sufficiency.

But in recent years, Israel has reached the stage where its weapons industry has developed into a major component of its foreign trade and domestic employment. Today, one out of every five industrial workers in Israel is connected to the expanding defense industry.

The reasons for this development appear to be related more to economics than to self-defense, according to Meir Tamari, director of the Jerusalem Institute of Ethics and Economics, who said in a recent article that Israel's weapons industry "has become an economic enterprise justified by its profitability."

The need for this profitability lies in Israel's economic troubles. Since 1982, Israel has been forced to reduce domestic defense spending by \$2 billion, a decline of more than 25 percent. Some of

the slack has been picked up by increased aid from the Reagan administration.

But to continue expanding its defense industry, the Israeli government has encouraged defense companies to expand sales abroad.

Israeli arms exports reached \$1.2 billion in 1982, a staggering increase from \$50 million in 1974, according to figures from the Stockholm International Peace Research Institute and the U.S. government. Weapons sales account for about one-fourth of Israel's annual industrial exports.

A nation of 4 million people, Israel has emerged as a major international weapons supplier. It has an export list that includes missiles, tanks, advanced electronics and jet fighters, and a customer list that includes such repressive regimes as South Africa, Chile and much of Central America as well as China.

Executives at American firms privately expressed anger that they have to compete for international sales against Israeli weapons that are based on U.S. technology and indirectly subsidized by U.S. tax dollars.

For instance, at a recent arms show in Washington, the state-owned Israel Military Industries displayed its new antitank missile, called MAPATS, a few hundred yards from a booth where Hughes Aircraft Co. exhibited the latest version of its TOW antitank missile.

From outward appearances, the two missiles are almost identical, and some Hughes executives said they think the similarities are more than skin deep.

Hughes, a giant in the American defense industry, pioneered the TOW for use in Vietnam, and U.S. export law still imposes tight restrictions on its export. Among the countries permitted to buy the TOW is Israel, which has purchased thousands of them.

"We are very perturbed that the Israelis took our TOW design and modified it, and [have] begun selling it," said a Hughes executive, who refused to be identified.

Eitan Dromy, an Israel Military Industries official, denied that Israel stole TOW technology. He said MAPATS is a "new generation of missile" with a laser guidance sys-

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ADVANTAGE...CONTINUED

tem that is better than TOW's wire system, as well as other differences.

He acknowledged, however, that MAPATS is so similar that it can be fired from a TOW launcher.

Another Israel Military Industries official, Yitzhak Gilat, said the Israelis are trying to sell MAPATS to the U.S. Marine Corps, and the missile is being produced for a South American country that he refused to identify.

The sale of MAPATS to a South American nation disturbs some U.S. officials, who view it as an example of the difficulty of controlling U.S. technology once it leaves the country, even when the technology goes to a friendly nation such as Israel.

But that is only one of the concerns expressed privately by U.S. officials.

Behind the scenes at the Justice Department, Customs Service and Pentagon, officials said they think Israel has grown too aggressive in its quest for American technology.

"The prevalent view here is that the Israelis are trying to get whatever they can, however they can," one law-enforcement official said. "People stop short of saying it is a 'well-orchestrated effort,' but I don't know what else you can honestly call it. They're trying to get everything they can."

Israel's espionage in the U.S. made the headlines last year with the arrest of Navy intelligence analyst Pollard, who admitted spying on the U.S. as part of an Israeli ring. He is now cooperating with the government.

Pollard was nabbed outside the Israeli Embassy in Washington as he sought asylum. He since has identified several Israelis involved in the operation, including science attache Yagur, a secretary at the Israeli Embassy and an intelligence officer in Israel.

Israel apologized publicly for the affair, saying it was "an unauthorized deviation from the clear-cut Israeli policy of not conducting any espionage activities whatsoever in the United States." The Justice Department and FBI are continuing to investigate the extent of the ring.

The Pollard affair was followed by a series of disclosures of other federal investigations. Top-ranking Israeli government officials have

taken a hard line in response to the other disclosures, repeatedly denying any wrongdoing and protesting publicly and privately to U.S. officials about what they consider an unfair campaign against Israel.

After raids by Customs agents last December in connection with an attempt by Israel to obtain technology for chrome-plating tank cannon barrels, Israeli officials contended the raids were "anti-Israel" and part of a "vendetta."

Yet information obtained from court documents, military records and interviews show the tank-barrel episode illustrates many of the concerns expressed by law-enforcement officials.

In late 1984, the Israeli procurement mission requested bids from U.S. companies to build a chrome-plating facility in Israel for Israel Military Industries. The contract was to be financed by \$1.8 million in U.S. military aid.

The successful bidder was NAPCO Inc., a small electroplating company in Terryville, Conn.

In winning the contract, a company lawyer said NAPCO stressed to the Israelis that it had a crew, under an Army subcontract, working on a new chrome-plating process for 120 mm. tank barrels inside the Army arsenal at Watervliet, N.Y.

But the proposed contract submitted by Israel to the Pentagon for routine approval contained no reference to tank barrels. The document said the technology was to chrome plate "hydraulic tubing and cylinders."

Defense Secretary Caspar Weinberger said in a letter to a congressman this year, "There was no mention or implication in the contract provided by the government of Israel for financing approval that the technology involved was for large caliber cannons."

Chrome-plating the lining of cannon barrels extends their life and enhances accuracy. A cathode conducts electricity through an anode, which causes the chrome to adhere to the inside of the barrel.

The U.S. was five to seven years ahead of the rest of the world in chroming 26-foot cannon barrels for tanks because of a unique configuration of anodes and cathodes

developed at the arsenal. The transfer of the technology to any other country is specifically prohibited by federal law.

Soon after signing its contract with Israel, members of the NAPCO crew at Watervliet sketched the anodes and cathodes at the arsenal and delivered the drawings to company officials, said William Flannery, a lawyer for NAPCO.

Flannery and Ray Banoun, a defense lawyer hired by NAPCO, said the company had not violated the law in sketching the devices, because the technology was not restricted. They said the devices were in an open area at the arsenal, and arsenal personnel were aware that sketches had been made.

But federal agents said authorities at the arsenal did not discover what was going on until months later.

On Oct. 16, 1985, Thomas Mahar, a metals expert for the Army at Watervliet, made a routine visit to an arsenal subcontractor in Pennsylvania and was stunned to find the company manufacturing anodes based on the arsenal's design.

A company executive told Mahar the anodes were for Israel under a subcontract with NAPCO and showed Mahar photocopies of hand-drawn sketches of the anode provided by NAPCO.

The executive later told a Customs agent that representatives of NAPCO and Israel Military Industries had visited the plant in the spring of 1985 and authorized production of the anodes.

Mahar's discovery touched off a federal investigation that led to raids of three U.S. companies last December. A government affidavit said the raids were part of an investigation of a possible conspiracy to steal the arsenal's technology and transfer it illegally to Israel.

The federal investigation is continuing, said David Homer, the assistant U.S. attorney in Albany, N.Y., who is handling the case.

Federal grand juries in Iowa and Pennsylvania are conducting inquiries into a similar attempt by the Israelis to obtain technology to make cluster bombs.

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ADVANTAGE...CONTINUED

Cluster bombs are metal pods containing hundreds of smaller bombs that explode individually, spewing shrapnel over a wide area. The U.S. halted shipment of cluster bombs to Israel in 1982 after the Israelis used them against civilians in the invasion of Lebanon.

Israel responded by stepping up production of its own cluster bombs for its use and for export. But U.S. defense experts said the Israeli technology was far behind that of American manufacturers.

In 1985, Israel Military Industries signed contracts with companies in Iowa and Pennsylvania to produce machinery that would vastly improve its ability to produce the bombs.

As in the case of the chrome-plating technology, the machinery was to be paid for with U.S. military aid and the contracts were arranged by the Israel Defense Procurement Mission in New York.

U.S. Customs agents raided both plants last July and halted the shipment of machinery to Israel. Several employees of the New York purchasing mission were subpoenaed by the grand juries, but the subpoenas were dropped after Israel pledged to cooperate in the probe.

Israeli officials have denied trying to skirt export laws and have maintained they had proper licenses for the cluster bomb machinery. American officials said at least one employee of the Israeli purchasing mission had suggested the export licenses be written in a way that disguised the military use of the machinery.

In a slightly different twist, the Customs Service is investigating allegations by Recon/Optical Inc., of Barrington, Ill., that Israel tried to steal the technology for a super-sophisticated aerial reconnaissance system that Recon was developing for the Israelis under a \$40 million contract paid for with U.S. military aid.

Three Israeli air force officers who had been monitoring the project at Recon for two years were stopped when they tried to leave the plant last May with 50,000 pages of documents in Hebrew. Recon contends the documents contained technical information that could not be provided to Israel under U.S. export law.

The Israeli Defense Ministry said

it was entitled to the technology under the contract negotiated by the procurement mission with Recon and approved by the U.S. government.

Israel was more successful in obtaining krytrons, which are 2-inch electronic tubes used to trigger nuclear bombs and as timing devices in many conventional weapons.

A California aerospace engineer and computer expert, Richard K. Smyth, was indicted last year on charges that he illegally exported 800 krytrons to Israel between 1980 and 1982.

Smyth was a consultant to NATO and the U.S. Air Force, with a top-secret U.S. clearance. He ran a small firm outside Los Angeles that developed computer software for the military. Prosecutors also say Smyth used the company to make at least 10 illegal shipments of krytrons to Heli Trading Ltd. in Tel Aviv.

The krytron order came from one of Heli's owners, Arnon Milchan, who was acting on behalf of the Israeli Defense Ministry.

Milchan is an Israeli millionaire with close ties to the government. He was identified widely as a participant in a money-laundering scandal in the mid-1970s involving Israel's role in South Africa's attempts to buy newspapers and TV stations around the world to improve Pretoria's image. Milchan also has produced Hollywood films, such as "Once Upon a Time in America," which is about Jewish gangsters.

Smyth first tried to obtain the krytrons for Milchan in 1975, but the State Department refused to grant an export license because the devices were on a list of restricted technology.

When he got another order from Milchan in late 1979, the government said Smyth mislabeled the krytrons and shipped them without a license.

The Israeli government claimed to be unaware that the krytrons had been exported illegally, and it eventually returned 460 unused devices. Israel said the rest were used in research and development.

U.S. intelligence agencies have thought for more than a decade that Israel makes nuclear weapons, but the Israeli government has said only that it will not be the first country to use nuclear weapons in the Mideast.

Last month, an Israeli told the London Sunday Times that he worked for 10 years in a top-secret, underground bunker in the Negev desert where Israel manufactured components for its nuclear weapons. The Israeli, Mordechai Vanunu, disappeared last month.

Last week, Israeli officials admitted they are holding Vanunu "under lawful detention," but refused to give further details.

Smyth's attorney, Alan Croll, has indicated in court papers that the California case involves issues more extensive than krytrons.

He said U.S. authorities uncovered the shipments after Smyth reported a suspicious burglary at his offices in January, 1983. Computer software was taken, but the burglars left other valuable property.

The CIA was the first agency to investigate the break-in, Croll said, and he said Smyth had provided information to the CIA in the past.

Croll, who no longer represents Smyth, refused to expand on his court filings in an interview. William Fahey, the assistant U.S. attorney handling the case, said he did not know what Croll meant by more significant issues. Fahey said the investigation remains open.

Smyth's company records indicate that he did a large amount of business with Israel. Federal law-enforcement sources said investigators suspect Smyth obtained other restricted military technology for Israel over a long period.

A new mystery developed Aug. 14, 1985, when Smyth didn't show up for a court appearance. Authorities later said he and his wife vanished from their sailboat. A few months later, relatives said an anonymous caller told Smyth's mother-in-law that the missing engineer and his wife were safe.

U.S. intelligence reports indicate Smyth and his wife were seen in at least three European countries in late 1985 and earlier this year, according to law-enforcement sources.

"The latest intelligence is that Smyth is in Israel," one of the sources said.

FEDERAL CONTRACTS REPORT
1 DECEMBER 1986 Pg. 951

CHINESE INTEREST IN ECONOMIC TIES WITH U.S. CITED BY CONGRESSIONAL DELEGATION

Peking's interest in greater economic ties with the United States was the "clearest" message received by a Senate delegation to China earlier this year, according to a report on the trip just released.

The report, issued by Senate Banking Subcommittee on International Finance and Monetary Policy Chairman John Heinz (R-Pa.), said that during the May 23-June 1 trip, the "clearest message received by the delegation was that the Chinese welcome the expanding economic ties between the United States and China."

The Chinese welcome sectoral cooperation agreements in telecommunications, science and technology, and machine building, according to the report.

Burden On U.S. Side

China, the report said, is anxious for closer economic ties, but tries to put the burden for more effort on U.S. government and business, claiming the United States has disproportionate advantages in the countries' relations, "supported by misleading and incomplete bilateral trade statistics that ... turn a slight surplus for China into an annual deficit of roughly \$1 billion."

Heinz said in the report that Peking claims the West is missing a great opportunity by not investing in China and argued that the only problems are in China's exports, mainly textiles, which are controlled by the United States.

The key U.S. strength in China, he said, is U.S. firms' willingness to set up joint ventures despite "considerable difficulties in establishing themselves and high start-up costs."

The Chinese attitude toward the United States is in contrast to their view of Japan, Heinz observed, saying the Chinese see Japan as interested only in making sales, not sharing production capabilities or transferring technology and skills.

"China is hungry for technology, and American firms have been scoring points with the Chinese by putting their money and know-how into the country. It may well be that the willingness of American firms to stay the course of building a joint venture will give the U.S. a firmer footing in China than all of Japan's massive sales effort," the report suggested.

Following that course has its costs, however, and business officials in China meeting the delegation "reported that their operations were marginal in terms of profitability."

Although there are pledges of commitment to reform and interest in Western economic models, "we generally concluded that the capacity of the system for profound change and the likelihood of change along Western lines remain question marks," the report said, citing evidence of an entrenched central planning orientation.

The delegations reported that Chinese officials are not receptive to negotiating "meaningful investor protections" in a bilateral investment treaty and warned that relatively minor requests can run into problems, noting failure by U.S. business to have the U.S. Cham-

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NEW YORK CITY TRIBUNE
2 DECEMBER 1986

Pg. 1

U.S. Has 'Little to Gain, a Lot to Lose' By Selling China Arms, Says Scholar

BY PETER SAMUEL
Special to the New York City Tribune

WASHINGTON, Dec. 1 — American arms sales to communist China are unwise, according to a new book. They will not be sufficient to make China a serious counterweight to the Soviets but might give it the power to threaten Taiwan or South Korea, it says.

It concludes that America has "little to gain and a lot to lose" from closer strategic ties with the People's Republic of China (PRC).

The book, *The China Connection* by James Gregor, just published by Hoover Institution Press at Stanford University, takes a position that is decreasingly heard within conservative circles, where the trend has been to ease hostility toward the largest nation on Earth.

However, Gregor's thesis is forcefully argued and his scholarly credentials are impeccable.

He is principal investigator in the Pacific Basin Project of the Institute of International Studies at the University of California at Berkeley. A leading authority on East Asia, he previously published *Arming the Dragon: The U.S. Security Relationship with the People's Republic of China*.

The new book represents a serious critique of the Reagan Administration policy of shipping increasingly advanced weaponry to communist China and giving Peking access to U.S. nuclear technology.

China's support for North Korea and its continued claims to Taiwan could, if backed by advanced U.S. weaponry, tip the balance of regional power, tempt aggression and bring war to the area, reasons the Hoover scholar.

Support of China's nuclear technology "could considerably complicate American efforts to restrict nuclear proliferation," Gregor says. He points to China's close relations with Pakistan and its sales of other weaponry to states in the Middle East and Africa regardless of their political color.

The United States has been concerned over the acquisition of nuclear weapons by countries like Pakistan, Iraq and Libya, and China has been will-

ing to collaborate with all in varying degrees.

The author touches on the possibility that U.S. technical assistance to China in the nuclear field could allow it to refine its technology in the area of battlefield tactical weapons. This represents a danger of increased nuclear weapons proliferation.

Sales to China will not be sufficient to make it a major military challenge to the Soviets but can "disturb the tenuous balance in the Taiwan Strait and enable Beijing [Peking] to supply advanced weaponry to the communist regime in North Korea," the book says.

"Many of the PRC's non-communist neighbors have good reason to fear a better-armed and more mobile communist Chinese military.

"Beijing has made it eminently clear that it does not seek closer strategic ties with the anti-Soviet coalition. The PRC is content to allow the United States to continue to provide an effective counterweight to Soviet conventional and nuclear firepower. This has enabled Beijing to reduce its military expenditures."

The supply of U.S. Blackhawk UH-60 and SH-60 helicopters to China will not be sufficient, the author argues, to achieve the desired U.S. purpose of making Chinese forces in the north a real match for Soviet forces along the border, but it could produce the undesired result of altering the balance of power *vis-à-vis* Taiwan — making a future communist Chinese government confident about bringing the Republic of China government on Taiwan to heel by naval blockade.

(SH-60 helicopters carry advanced anti-submarine and anti-shipping weapons technology. UH-60 army utility helicopters could greatly assist an invasion force).

Gregor says the trade potential of China is exaggerated by many in the United States and that Taiwan is likely to continue to be more important as an American trading partner for "the foreseeable future." If trade with China tripled by the turn of the century, it would still only represent 2 percent of total U.S. trade.

Closer U.S. economic relations with the PRC have put American oil companies in the middle of a squabble over who owns the Spratly Islands in the South China Sea. The islands are claimed by the PRC, Vietnam, Taiwan and the Philippines. Already there have been

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Draft Congressional Presentation

REPORT ON THE ECONOMY OF ISRAEL

January 1986

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Bureau for Asia and the Near East
Agency for International Development
Washington, D.C. 20523

EXECUTIVE SUMMARY

Following two decades of rapid growth, Israel's economic performance began to deteriorate in the early 1970's. Since that time, growth has averaged less than 3 percent per annum (vs. 9 percent in the years between 1950 and 1972), inflation has accelerated to triple digit levels, and Israel has experienced growing balance of payments difficulties.

When the National Unity Government came into office in September 1984, it confronted rampant inflation -- consumer prices had already tripled since the beginning of the year and the rate of increase was accelerating -- and a potential balance of payments crisis. It initially responded by devaluing the Israeli shekel, attempting to cut government expenditures, and freezing prices, profits and tax rates. However, the expenditure cuts did not materialize, and by early 1985, the effect of the devaluation had been eroded by rising domestic costs. Thus, the only operative elements of the program remaining were the price controls, and these proved to be totally inadequate to stem continuing strong inflationary pressures and loss of international reserves.

In July 1985, the government adopted a new, more

comprehensive program which featured cuts in the budget deficit, reductions in real wages, high interest rates, and another devaluation, followed by stabilization of the dollar/shekel exchange rate. Prices remained subject to administrative controls, but these were no longer the centerpiece of the program.

While it is still too early to pronounce the program a success, there are encouraging signs. The inflation rate has dropped sharply, and there is reason to believe that this reflects reduced pressures, not simply the short term effects of price controls. Equally important, international reserves have stabilized, and recently have risen as a result of disbursements of U.S. economic assistance.

To consolidate the achievements of the past several months, Israel needs to find formulae which assure that future increases in remuneration to labor and capital are consistent with rising productivity. Additionally, further budget expenditure cuts are necessary (and at this writing are under consideration) to offset anticipated domestic demand pressures arising from wage hikes scheduled for the next few months and to leave some room for needed tax cuts and reform.

To facilitate a resumption of sustainable, non-inflationary economic growth, Israel would also do well to consider policy changes designed to encourage domestic and foreign

investment and labor mobility, and institutional changes -- particularly delinking of liquid financial assets and incomes from the domestic price index -- to strengthen the government's hand in dealing with inflation.

Assuming that the stabilization program initiated last July is continued and strengthened in areas already mentioned, there is good reason to be optimistic that Israel has at last turned the corner and will be able to achieve a growth rate which it considers acceptable within a few years without reigniting inflationary pressures or again subjecting itself to intense balance of payments difficulties. Under these circumstances, and assuming that U.S. assistance continues to be forthcoming, Israel should experience no difficulty in servicing its external debt.

BACKGROUND

Israel's economic achievements in the first 25 years of its existence were remarkable, particularly in view of its limited natural resources. Fueled by very high levels of investment (frequently reaching 30 percent of Gross Domestic Product), real Gross Domestic Product (GDP) rose at an average annual rate of 9 percent between 1950 and 1972. At the same time, prices were relatively stable; until 1970 consumer prices increased at an average annual rate of 7 percent.

Since the early 1970s, Israeli economic performance has deteriorated. By the early 1980s, GDP growth rates were much reduced, averaging only about 1.4 percent per annum, and annual inflation had reached triple digit levels. Increasingly, private savings were used to finance current government expenditures, while productive investment dropped because of the uncertainty of real returns under conditions of high inflation as against the certainty of positive real returns on securities issued by the government to help finance its own consumption expenditures and transfers. The level of gross domestic investment declined from 31 percent of GDP in 1972 to 22 percent in 1984. The incomes of Israeli consumers, on the other hand, were largely protected against the erosive forces of inflation by an increasingly widespread system of indexing wages, welfare payments, interest

income, and income tax brackets to rises in consumer prices or related exchange rate movements. Relatively high levels of consumption were stimulated by deficit spending and marked increases in real wages. Over the 1971-1983 period, labor market conditions were tight as reflected in an unemployment rate of 2.5-5 percent and Israeli real wages increased at an average annual rate of 3 percent, which exceeded growth in labor productivity. The high levels of private and government civilian consumption coupled with growing defense requirements and a lessened ability of the Israeli economy to supply goods and services because of inadequate investment led to growing current account deficits, which were financed both by increased U.S. assistance flows and rising foreign borrowing. The deficit on civilian goods and services account increased from \$600 million in 1972 to \$4.2 billion in 1983. External foreign debt (net of foreign assets of Israeli commercial banks) rose from \$4 billion in 1972 to \$22.8 billion at the end of 1983.

RECENT ECONOMIC DEVELOPMENTS

1) GNP and its components

Real gross national product (GNP) in 1984 was virtually unchanged from the previous year at a level of approximately \$22.5 billion. Per capita GNP was approximately \$5,400.

While the economy as a whole neither grew nor contracted, there were significant changes in its component parts. In particular, domestic uses of resources (GDP plus the import surplus) declined by 6.6 percent. This was roughly offset by a 14.5 percent real increase in exports of goods and services. The relative importance to exports in the economy thus increased, accounting for 30 percent of total resource use in 1984 as opposed to 26 percent in 1983.

Domestic demand fell across a broad front. Private consumption declined 6.3 percent; investment was down almost 14 percent. Domestic public consumption was virtually unchanged. Major explanatory factors were a small drop in real wages, a substantial decline in the value of the public's liquid asset holdings as a consequence of the stock market crash which took place at the end of 1983, high real interest rates, a reduction in public sector investment, and changes in foreign exchange rate policy and an increase in import duties (which reduced speculative purchases of imported goods).

For the first 6 months of 1985 GNP grew at a 4.7 percent per annum rate. Private consumption rebounded during the first quarter and then leveled off during the second. The growth rate for the 6 month period was 2.4 percent. Government consumption expenditures rose sharply (by 15.4 percent vis a vis the 1984

level), but it is likely that much of the increase relates to defense imports which do not contribute directly to domestic demand. Exports continued to grow during the first half of 1985, but at a slower rate (4.4 percent) than in 1984. On the other hand, the sharp decline in investment of 1984 (14 percent) continued into 1985. For the first 6 months of the year, seasonally adjusted expenditures were off a further 3.5 percent. The decline in gross fixed investment was even steeper (8.5 percent). Overall resource availability (GDP plus imports) increased by 4.7 percent. As in 1984, domestic uses accounted for 70 percent of the total and exports 30 percent. Within the domestic use category, consumption increased from 57 to 59 percent of the total, while investment declined from 13 to 12 percent. The decline in the relative weight of investment in total uses continues a trend which dates back for more than a decade. The decline parallels the reduction in the rate of economic growth. Nevertheless, while it is clear that acceleration in the growth rate for the long term will require higher levels of investment, there is no evidence that capital stock limitations are currently constraining the level of economic activity.

While no data on GNP and its components are available for the second half of 1985, it is likely that growth rates and usage patterns have changed. The economic stabilization program adopted by the Israeli Government in July (described in section below) is designed inter alia to reduce domestic consumption to free

resources for investment and exports. This is being accomplished by cutting government expenditures and real wages, raising taxes, and maintaining high real interest rates. For the year as a whole, it is expected that GDP will increase by approximately 2 percent. Given the rate of growth which occurred during the first half of the year, this implies that the level of economic activity during the second half will decline by some 3.5 percent. Domestic uses will be particularly hard hit.

2) Inflation

The consumer price index rose by 445 percent in 1984, compared to 191 percent in 1983. Acceleration of inflation actually began during the fourth quarter of 1983 when monthly increases in the consumer price index reached 14 percent, as against 3 percent during the two preceding quarters. In October 1983, the shekel was steeply devalued and prices of subsidized goods were increased. Subsequently, the government depreciated the shekel more rapidly than was necessary to offset domestic inflation, thus intensifying inflationary pressures. Efforts to further reduce subsidy outlays by increasing prices of government controlled goods had a similar effect.

Once a new, higher level of inflation had been reached, institutional arrangements tended to firmly establish it.

Indexation of liquid financial assets to the domestic price level or to a hard currency is particularly important in this context. For many purposes these assets serve as money. Thus, while indexation protects the real value of the public's liquid holdings, it also deprives the authorities of any effective means of controlling growth of the monetary aggregates.

In the first half of 1984, inflation stabilized at an average monthly rate of 13 percent. 1/ However, a new, still higher plateau was reached during the summer months. The seeds for this further intensification of inflationary pressures were sown in the spring when the pace of increases in prices of government controlled commodities was slowed. The cost of subsidies thus increased. This, in combination with lagging tax collection and adjustments designed to offset the sharp (15 percent) drop in real wages which had occurred late in 1983, bolstered private consumption and contributed to a deterioration in the budget picture. Seasonally adjusted private consumption increased slightly in the second quarter, reversing a steady decline over the preceding 12 months. In the third quarter, the rate of increase accelerated to 4 percent, as Israelis purchased large volumes of durable goods anticipating a devaluation of the shekel after the formation of a new government following the July elections. The consumer price index rose at an annual rate of over 600 percent during the third quarter (about 17 percent a month), and over 1,000 percent in September and October, before

declining sharply at the end of the year following the imposition of price controls.

The end of year respite in inflation was short-lived, however. Administrative controls on prices alone could not contain underlying domestic demand pressures and increasing costs for very long. 2/ In particular, rising nominal wages, a burgeoning budget deficit and continued shekel depreciation forced the government to relax price controls in January 1985. For the first six months of 1985, the consumer

price index rose by some 13 percent a month, or 350 percent on an annual basis.

3) Balance of Payments

The goods and services deficit fell from \$5.2 billion in 1983 to \$4.9 billion in 1984, despite an increase in defense imports of some \$440 million. The balance of payments deficit on current account declined still more steeply -- from \$2.3 billion (9.5 percent of GNP) to \$1.5 billion (7 percent of GNP). A \$600 million increase in goods and services exports (6 percent in terms of current dollars; 14.5 percent in real terms), a large increase in U.S. Government grant financing (economic and military), and a

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\$400 million decline in non-defense imports were the major factors. Both export growth and the drop in imports were facilitated by the decline in local demand (which released resources for export production) and strengthening of demand for Israeli products, particularly on the part of the United States. Industrial exports other than diamonds accounted for virtually the entirety of the export surge. Metals, electronics and chemicals were the fastest growing sectors.

The decline in consumer goods imports was especially sharp (31 percent). Investment goods imports also declined (by 12 percent), while, on the other hand, imports of production inputs rose, presumably to accommodate the needs of export oriented industries.

Net medium and long term capital inflows fell by almost \$1.2 billion in 1984, more than offsetting the decline in the current deficit, thus resulting in a substantial increase in the basic deficit. 3/ The major factors were a large decline in private investment 4/, a smaller drop in medium and long —

term commercial borrowing, and sales of foreign currency to an Israeli public which had "...doubts regarding the government's willingness to deal with the (balance of payments) problem by making budget cuts, and ...(consequently a) concern about possible government measures to reduce the real value of financial assets." 5

5/ The deficit was financed by short term

borrowing by the government and a \$600 million decline in international reserves. The latter stood at \$3.06 billion as of December 31, 1984, approximately 2.6 months of non-Foreign Military Sales (FMS) financed imports of goods and services at the 1984 level.

Total outstanding external debt increased by \$560 million (2.5 percent) during 1984 to a year-end level of \$23.4 billion. 6/

This is a much smaller increase than in recent years. All of it is accounted for by Israeli Government obligations; private sector and (net) banking system debt actually declined slightly, reversing the trend of recent years. Government debt now accounts for approximately two-thirds of the total.

The structure of the debt is favorable; only 15 percent is short-term, while well over one-half represents very long term and/or concessional loans provided by the U.S. Government and holders of Israeli bonds.

Debt service payment on gross debt rose by \$450 million in 1984 to a total of \$3.9 billion -- \$2.8 billion in interest payments (\$2.5 billion in 1983) and \$1.1 billion in amortization of medium and long term loans (\$1 billion in 1983). Net debt

service, i.e. total principal and interest obligations less interest receipts, totaled \$2.85 billion, up \$640 million from 1983. On a net basis, debt service obligations required expenditure of approximately 23 percent of the foreign exchange Israel received from exports of goods and services plus unilateral transfers (vs. 19 percent in 1983 and 20 percent in 1982). As a percentage of GNP, net debt servicing also rose substantially -- from 9 percent in 1983 to 13 percent in 1984.

*1984
1983*

Clearly, Israel's debt servicing burden increased appreciably in 1984. This is accounted for by the continued increase in outstanding debt, albeit at a slower rate than in the past, a decline in foreign currency assets, and rising interest rates. The rise in the debt servicing/GNP ratio also reflects the fact that, unlike in most previous years, the Israeli economy did not grow in 1984.

On the basis of data for the first 6 months of 1985, it does not appear that balance of payments financing presented any serious problems. The goods and services deficit increased by approximately \$250 million vis a vis the first half of 1984 due entirely to a doubling of defense imports (almost all of which are financed under the FMS program). By contrast, the non-defense deficit dropped by some \$350 million (21 percent) to \$1.3 billion. Non-defense imports of goods and services were off by 5 percent (\$340 million) in current dollars. All major categories

of merchandise imports -- consumer goods, investment goods, and production inputs (other than diamonds) 7/ -- dropped. So too did service

imports -- by \$190 million. Exports for the first 6 months of the year were virtually unchanged from the corresponding period in 1984. Merchandise exports continued to grow, although more slowly than they had the previous year (9.3 percent in terms of current dollars vs. 14.4 percent in 1984). As in 1984, industrial exports led the way. However, service exports dropped due in the main to declining interest receipts.

In real terms, merchandise exports increased by a healthy 9.5 percent (7.7 percent if diamonds are excluded), continuing the trend which had begun in 1984. The corresponding figures for imports are 3.4 percent and 2 percent.

Almost 60 percent of the total goods and services deficit (\$2.6 billion) recorded during the first half of 1985 was covered by transfer payments from abroad, of which U.S. assistance accounted for two-thirds. This left a current account deficit of less than \$1.1 billion (vs. \$1.4 billion for the first half of 1984), which was financed in part by further drawing down foreign exchange reserves. 8/

Data for the second half of 1985 is very fragmentary.

Merchandise trade statistics indicate no dramatic shifts from earlier months. Apparently, the stabilization program promulgated in July (see section below) has not yet had a major impact in this area. Assuming -- as seems reasonable -- that the goods and services accounts continued to perform during the second half as they did during the first, the overall balance of payments outcome for ^{this} ~~the~~ period was probably much better than it has been for some time. Given a projected decline in defense imports from the unusually high level of January - June 1985, the goods and services deficit for the second half of the year will probably be in the neighborhood of \$2 billion. Disbursements of U.S. economic and military assistance grants alone should exceed that amount by a wide margin (Economic Support Fund disbursements alone -- including \$750 million from the supplementary assistance package appropriated in fiscal year 1985 -- totaled \$1.95 billion during the second half of 1985). U.S. assistance in combination with private transfers and personal restitution payments from the Government of the Federal Republic of Germany, will both cover the goods and services deficit and permit Israel to rebuild foreign exchange reserves and further reduce outstanding short term debt.

ECONOMIC STABILIZATION EFFORTS OF THE NATIONAL UNITY GOVERNMENT

To stem foreign exchange outflows and reduce inflation,

the coalition government formed in September 1984 decided to cut government expenditures by \$1 billion, devalue the shekel by 8 percent, raise prices of subsidized goods and services by 18-55 percent, impose a six month ban on imports of consumer appliances and luxuries, and restrict foreign exchange purchases for foreign travel and other personal purposes. In November, the government decided on a further \$550 million budget cut and reached agreement (the first so-called "package deal") with the Histadrut (the labor confederation) and the Manufacturers' Association (representing private employers) on a three month freeze of prices, profits, and tax rates. The agreement also stipulated that, for November and December 1984, wage earners would receive only two-thirds of the cost of living adjustment that would otherwise have been due them.

Initially, these initiatives appeared to be having a salutary impact. The rate of increase in the consumer price index slowed dramatically in December and January to a rate which, had it been sustained, would have resulted in annual inflation of about 70 percent, the lowest Israel has experienced since 1978. Moreover, the non-defense foreign trade (goods and services) deficit dropped by one-third during the fourth quarter as compared with the last three months of 1983. Reserves increased by \$500 million, owing to disbursement of the full \$1.2 billion fiscal year 1985 Economic Support Fund cash grant in October 1984. This was partially offset by continuing outflows of foreign exchange,

but at a rate which was slower than that of the previous quarter.

On the other hand, the government was not able to cut the budget as intended. The major difficulty was that the price freeze, which was a major feature of the first package deal, was applied to subsidized goods and services. As domestic costs continued to rise, owing particularly to increasing nominal wages and shekel depreciation, the budget for subsidies rose correspondingly, more than offsetting whatever savings were achieved in other budgetary expenditures.

By January 1985, it was clear that the government's economic program would need to be strengthened. While the price freeze was generally observed, domestic costs were rising, squeezing profits. Hard hit businesses were threatening to cut production if they were not granted some relief, and spot shortages were beginning to develop. Additionally, government expenditures at the end of 1984 were running at a pace which, had they been sustained over the full Israeli fiscal year (April 1 - March 31), would have exceeded the amount originally budgeted by \$1.8 billion or 12 percent. Moreover, tax receipts were falling short of the expected level. The upshot was a budget deficit for the last quarter of 1984 in excess of 25 percent of GNP. Although foreign grants -- largely U.S. economic and military assistance -- totaled over \$2.2 billion during the Israeli fiscal year which ended on March 31, 1985, a very sizable proportion of the budget

financing requirement was met by government borrowing from the Bank of Israel (the central bank). Thus, despite relatively low recorded inflation rates in December and January -- due to the price freeze -- it was clearly understood that underlying inflationary pressures had not abated.

The government responded at the end of January by raising the price of subsidized goods and services once again, and then negotiating "package deal II" with the Histadrut and the Manufacturers' Association. The new arrangement permitted periodic, administratively determined price increases, promised further subsidy cuts, and continued the process of partially delinking nominal wages from increases in the price index begun during the first package deal.

The agreement was to remain in effect for eight months, but could be renegotiated at the request of any of the involved parties at the end of the fifth month. In fact, it quickly ran into trouble. Determining prices for the myriad of goods and services produced by the economy in a way which would not give rise to distortions and inequities, and at the same time would contribute to achieving the objective of reducing inflation, proved to be a very difficult task. Efforts to amend the agreement in a way which satisfied all of the parties succeeded only in prolonging it for a time.

In July 1985, faced with growing dissatisfaction, resurgent

inflation, an unsustainable budget deficit, and continuing decline in foreign exchange reserves, the government put into effect ^{new,} more comprehensive economic stabilization program. The basic elements were

- 1) increases in prices of subsidized consumer goods and services ranging from 25 to 100 percent,
- 2) increases in the prices of most other goods and services of 17 percent,
- 3) a price freeze (subsequent to the above mentioned increases),
- 4) a complex series of wage adjustments designed to erode real wage rates during the last half of 1985, and then permit them to rise again during the first quarter of 1986,
- 5) reductions in the public service workforce,
- 6) increases in various taxes, the most important being an 8 1/3 percent supplemental tax on the incomes of companies and self-employed persons applicable to the 1985 tax year,
- 7) reductions in expenditures of government ministries

totaling approximately \$530 million on an annual basis,

- 8) an 18.8 percent devaluation of the shekel, after which the dollar/shekel exchange rate was to be stabilized for a time at IS 1500 = \$1,
- 9) abolition of foreign currency linked deposits (PATAM) which mature in less than one year, and
- 10) a restrictive monetary policy featuring high real interest rates.

The government hoped that the program would be instrumental in effecting a sizable reduction in private consumption and the budget deficit, thereby releasing resources for use in export oriented industry and containing inflationary pressures. At the same time, it was expected that export profitability would be maintained at reduced cost to the treasury. The reduction in private consumption was to be accomplished by keeping interest rates high -- thereby encouraging savings -- and reducing real private disposable income by means of cuts in subsidies on consumer goods and services, upward adjustments in various taxes and fees and, most importantly, reductions in real wages.

Reductions in subsidies and other government expenditures

in combination with increases in taxes and fees were also designed to reduce public deficit financing requirements, which according to budget projections were, for the most part, to have been met by inflationary advances from the Bank of Israel.

Lastly, the devaluation was clearly indicated in view of the need to narrow the current account deficit and restore confidence.

The Government of Israel is making a serious effort to implement the program. Thus

- 1) domestic budget expenditures (excluding interest payments on domestic debt) declined by approximately 12 percent in real terms during the July-September period vis a vis the preceding quarter. Reductions occurred over a broad range of expenditure categories including civilian wages, local defense expenditures, other domestic expenditures of civilian ministries and credit subsidies. At the same time, current domestic revenues were virtually unchanged. For the first seven months of the Israeli fiscal year beginning April 1, 1985, the budget deficit declined by about \$1.3 billion.

- 2) Interest rates have been kept high in relation to

domestic inflation--and presumably near term inflationary expectations--in order to encourage private savings (and, what is the same thing, discourage private consumption) and choke off private demand for credit. In November, for example, the weighted average cost of short term bank credit (which includes credit in foreign currency) was approximately 3.2 percent a month, or 46 percent a year) vis a vis an inflation rate of 0.5 percent for that month, and projections of 1-2 percent a month for December and January. At the same time, Bank of Israel discount window loans ranged from 3.5 to 5 percent. The Bank of Israel has also substantially increased commercial bank reserve requirements in order to prevent a rapid expansion of credit. This became an acute danger when the public shifted out of foreign currency linked assets (PATAM), for which the reserve requirement is 100 percent, in favor of shekel assets, which carry much lower requirements.

- 3) As of November 1985, real wage rates had declined by 6-12 percent from their June level.
- 4) Cuts have been made in the public sector workforce.

While the program is still too new to say anything

definitive about its adequacy, there are some very encouraging signs. First, the inflation rate has dropped sharply. Following a surge in July, which was due to the price increases and devaluation announced when the program was first put into effect, the inflation rate has averaged 3 percent a month (vs. 12 percent for the first six months of the year). It is, of course, possible that the decline is due to the price controls, and that underlying inflationary pressures have not abated. This is exactly what happened following implementation of the first package deal in November 1984. However, unlike the package deals, the essence of the new program is a serious attempt to deal with the problem of excess domestic demand by cutting government expenditures and private disposable income. Moreover, it seems unlikely that inflationary pressures could be successfully suppressed by administrative means for more than a short time. In that regard, it will be recalled that the private sector was exerting strong pressure to raise prices by January 1985, i.e. less than three months from the beginning of the package deal period. For these reasons, ~~plus recent, albeit fragmentary data on the government budget, real wages and interest rates (already cited)~~ ^{point to the same conclusion} it seems likely that current prices broadly reflect market conditions.

Second, foreign exchange reserves stabilized in July and August after falling almost continuously during the preceding year. (More recently, they have increased substantially due to large disbursements of U.S. economic assistance.) While hard

information is not yet available, it seems likely that this reflects inter alia growing confidence on the part of private Israelis and foreigners alike.

The successes of the past several months have not been achieved without cost or pain. As already noted, real wages have dropped. Additionally, unemployment, which had been climbing during the spring, reportedly reached a peak of about 8 percent during the summer before dropping a percentage point or so recently. While the recent decline in unemployment encourages one to be optimistic that Israel is beginning to shift productive resources away from public services and production for domestic consumption and toward export oriented industry and investment, it is very doubtful that stabilization and adjustment can be achieved without short term costs in terms of reduced economic growth. The GNP probably declined during the last six months of 1985. While a resumption of growth in 1986 is possible, and is not necessarily inconsistent with economic stabilization, it is unlikely that Israel will quickly achieve growth rates which it considers acceptable in a longer term context.

FUTURE PROSPECTS

In the near term, the success of the stabilization program depends on Israel's ability to maintain and make permanent the things it has achieved during the past six months. The budget and real wage

level are critical. By the terms of the agreements reached with the Histadrut last summer, wages are expected to rise significantly during the next few months. This in turn could give rise to a resurgence in private consumption and a deterioration in Israel's competitive position in international markets. If that happens, another currency devaluation would probably be necessary. That in turn could start a new inflationary spiral.

Clearly, the key is to find formulae which assure that increases in remuneration to labor and capital are consistent with rising productivity. Additionally, further budget expenditure cuts to offset domestic demand pressures arising from scheduled wage hikes are necessary (and at this writing are under consideration).

In the longer term, reforms in several areas would be useful in facilitating noninflationary economic growth.

- 1) Delinking of financial assets from domestic price indices and/or associated changes in the foreign exchange rate. Under current arrangements, the value of near money liquid assets adjusts automatically to changes in the inflation rate, thereby depriving the Bank of Israel of effective control over the monetary aggregates. Thus, once generated, inflationary pressures are very difficult to reduce. Steps taken by the Israeli government in 1985 to abolish liquid

assets tied to the dollar are in the right direction. More needs to be done, particularly measures to do away with or diminish the attractiveness of liquid shekel assets linked to the consumer price index.

- 2) Labor market reform. Wages are partially linked to the consumer price index. This too complicates the process of bringing inflation under control, although the problem is not as serious as is linkage of financial assets. More importantly, wage rates for different sectors of the economy are linked to each other. This tends to suppress wage differentials which might otherwise be useful in facilitating shifts of labor out of services and sectors which produce for the domestic market and into export oriented industries.

It might also be useful to take a good look at other labor market rigidities to see if they significantly reduce mobility. To the extent that legal and/or institutional impediments to the hiring/firing and shifting of workers between sectors can be eliminated, the process of economic adjustment will be less painful.

- 3) Investment Policy. Here too, a careful review would

be useful to determine whether current policy is consistent with the objective of facilitating self-sustaining growth while at the same time maintaining price stability and balance of payments equilibrium. While plant and equipment already in being is sufficient to permit growth in the short run, longer term development will require new investments. However, non-residential investment as a proportion of GNP has been falling for many years. And foreign equity investment has never been significant. The reasons are complex and not completely understood. Doubtless, inflation has had serious disincentive effects, since it is very difficult to gauge profitability when input and output prices are escalating rapidly. Thus, stabilizing the economy might be the most important thing Israel could do to encourage a resurgence of investment. But other things could also prove very significant, e.g. a review of investment incentives currently in place to determine their effectiveness and cost, efforts to strengthen Israeli capital markets to better channel traditionally high levels of private savings into productive investments, and a careful study of the potential role of deregulation of industry and divestiture of government owned enterprises in promoting domestic and foreign investment.

✓ 4) Tax Policy. Contrary to popular opinion, the tax burden on Israelis is not particularly heavy. In 1984, net taxes--that is taxes less subsidies and transfers to the public--^{was}~~was~~ approximately 20 percent of GNP (down from 25 percent in 1983). However, gross tax receipts have been running between 43 and 50 percent of GNP for several years, which is high. Moreover, in 1984 a 66 percent tax bracket was introduced on incomes in excess of \$52,000 a year. Thus, it seems likely that tax policy is a disincentive to work effort and may be an important factor in explaining emigration of skilled Israeli workers.

While reducing high marginal taxes has obvious attractions, it needs to be considered in the context of the budget deficit. If public expenditures can be reduced, tax reform becomes very attractive.

Assuming that the stabilization program is continued and strengthened, there is good reason to be optimistic that Israel has at last turned the corner and will be able to achieve a growth rate which it considers acceptable within a few years without ⁿreigniting inflationary pressures or again subjecting itself to intense balance of payments difficulties. Under these

circumstances, and assuming that U.S. assistance continues to be forthcoming, Israel should experience no difficulty in servicing its external debt.

1/ April was an exception due to seasonal factors.

2/ It can be cogently argued that had demand and cost pressures been successfully contained, price controls would have been unnecessary.

3/ The current account deficit less medium and long term capital movements.

4/ Historically, foreign investment has never been a major source of foreign exchange for Israel. However, in 1983 there was a surge of capital inflows to support the stock market shares of Israeli banks, which were recorded as foreign investment. The subsequent decline in 1984 represented a return to historical patterns.

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5/ Bank of Israel, Annual Report 1984, page 88.

6/ Includes the gross debt of the government and the nonbanking private sector, and the net obligations of the banking system. This is the most commonly used definition of the debt. However, for analytical purposes, net debt, i.e. total liabilities less all foreign currency assets, is more useful. Changes in net debt are equal to the current account deficit less net foreign investment (after taking into account changes in currency valuations). Thus, the net debt represents the cumulative import surpluses of past years which could not be financed by unilateral transfers (including U.S. grant assistance) or foreign investment.

7/ Due to favorable price movements. In real terms, imports of production inputs other than diamonds increased by 6 percent.

8/ The remainder was not financed by borrowing, and remains unexplained. In fact, Israel's gross foreign liabilities declined by almost \$700 million during the first half of 1985.



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JEWISH WAR VETERANS OF THE UNITED STATES OF AMERICA

CHARTERED BY AN ACT OF CONGRESS
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HARVEY S. FRIEDMAN
NATIONAL COMMANDER

0386130R
March 21, 1986

President Ronald Reagan
The White House
Washington, D.C. 20500

Dear Mr. President,

I am writing with reference to an incident concerning Radio Liberty and their present suit, in German courts, against Mr. Vadim Belotserkovsky. It would appear that Radio Liberty is suing for Mr. Belotserkovsky's dismissal because he dared to speak out against anti-semitism.

America's expressed policy has been to fight against the very injustices on which Mr. Belotserkovsky has spoken out.

I represent a national organization which has joined you in your efforts to help Soviet Jews who wish to emigrate. It is clear to me that in our attack on Mr. Belotserkovsky, we are simply fanning the flames of anti-semitism and making it that much more difficult for those Jews who are trapped behind the Iron Curtain.

I ask your attention to the matter and await your response.

Sincerely,

Harvey S. Friedman
National Commander

HSF:eo

cc: Radio Liberty

UNCLASSIFIED

ISRAEL/EGYPT

*Israeli
devis*

I. POLITICAL

- o The relationship remains cool, but bilateral communication has improved.

FYI: Mubarak has said Ambassador will not be returned until there is progress on Israeli withdrawal from Lebanon, an improvement in conditions in the occupied territories and steps toward resolution of the Taba dispute. END FYI.

-- Israel has ambassador resident in Cairo. Egypt is represented by Charge in Tel Aviv.

-- High level visits continue to take place.

- o Both sides are committed to peace treaty and to improving relationship despite problems.

- o Maintaining peaceful relations with Egypt is vital for Israel's long-term interests and security.

- o Egypt's improving relations with Arab countries have not been at expense of treaty with Israel.

- o No reason to doubt Egypt's continuing commitment (1) to the process of peace begun at Camp David and (2) to the Egypt-Israel peace treaty.

II. ECONOMIC

- o Israel is Egypt's principal trading partner in M.E.

-- 1983 imports from Israel approx 56.7 million dollars.

-- 391.5 million in exports (all but one million is oil) in 1983.

III. PERSON-TO-PERSON

- o Large numbers of Israeli tourists visit Egypt each year (over 100,000 since 1979). No incidents.

- o Few Egyptian tourists visit Israel, but financial factors are at least as important as the political.

- o Numerous cultural and scientific exchanges have taken place.

July 1

Israel Economic Measures

- \$750 million in new budget deficit reductions which include cuts in government expenditures for goods and services, more cuts in government subsidies (including reductions in export subsidies) beyond those already carried out or planned as part of the FY 85/86 budget, and selective tax increases.
- A reported 6% cut in public sector employment to be implemented through negotiations with various civil service unions and presumably phased in over time.
- Implementation of \$400 million in consumer subsidy cuts that were included in the FY 85/86 budget but postponed, and implementation of \$400 million in revenue measures (per Steinberg Committee recommendations) which were also included in the FY 85/86 budget but have remained bottlenecked in the Knesset.
- Increases in prices of consumer staples by 45% to 75% and a 25% rise in petroleum prices - as a result of the above subsidy cuts.
- An 18% immediate, one-time devaluation of the shekel (following a 6% accelerated depreciation of the shekel since June 25, which partly offset the appreciation in April).
- Alteration in the linkage of financial assets. The Patam account system will be changed while preserving existing saving schemes. No new short term Patam accounts will be opened. Existing Patam accounts can be withdrawn but not increased.
- Alterations in the tax regime. The self-employed and corporations will pay the equivalent of a 13th month in income taxes. Certain tax exemptions for wage earners will be withdrawn.
- A three month wage/price/exchange rate freeze. The price freeze will cover most goods (subsidized and nonsubsidized) and services. The private and public sector wage agreements include a 14% COL adjustment in the August 1 paychecks (covering May/June price increases), a one-time 12% compensation in September 1 paychecks (but not incorporated into the salary base), and a 12% cumulative compensation to be paid in the December, January, and February paychecks. The basic COLA agreement is to be modified covering the period October through March, with the threshold for COL adjustments reduced from 12% to 4%.