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Ref. A09483

PRIME MINISTER

*MS*

*To be discussed fully at  
visit of Chancellor  
Schmidt's Visit*

*Prime Minister*

*You will wish  
to consider this  
minute in conjunction  
with the brief  
by Sir*

There are three points which may come up that the briefs do not cover or do not cover adequately.

British Nuclear Deterrent

2. The German Embassy have told us that Herr Schmidt may want to ask you about the future of the British deterrent. German officials may well be briefing him to raise this question but I find it a little hard to believe that he will in fact do so at your first meeting. I have, of course, given you a separate brief on the future of our deterrent (my minute A09454 of 4th May), but I see no need for you to have studied the matter in any depth before Chancellor Schmidt's visit on Thursday. All you need to know is that Chancellor Schmidt made it clear to the previous Administration that, while this was of course a decision for the United Kingdom Government alone, he hoped very much that we would go for a successor system to Polaris if only because he did not relish the thought of France being the only European nuclear power.

*We shall*

3. If Chancellor Schmidt should raise the matter with you, I think all you need say is

- (i) The Conservative Manifesto said that "the SALT discussions increase the importance of ensuring the continuing effectiveness of Britain's nuclear deterrent".
- (ii) Operationally there is no need for an immediate decision, but this is an important matter to which you and your colleagues will give early attention.
- (iii) What does he think about it?

Secretary-General of NATO

4. For some time there has been increasing dissatisfaction with the performance of Dr. Luns as Secretary-General of NATO, but no-one has been willing to take the initiative in pulling the rug from under him.



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Chancellor Schmidt feels strongly about the matter and took the initiative in raising it with President Carter, President Giscard and Mr. Callaghan at Guadeloupe. Various names were discussed including Count Davignon (the Belgian who is currently an EEC Commissioner), M. Thorn (Prime Minister of Luxembourg) and Mr. Mulley. No conclusions were reached though there was a good deal of support for Davignon. It was left that further thought would have to be given to the matter.

5. Since then a clear consensus seems to have emerged that Dr. Luns ought to go, and the United States Ambassador, speaking on instructions, asked us on 20th April for our views on the succession and in particular on Davignon. Mr. Brewster was told that we could not comment until after the Election.

6. The reason for consulting you in advance of Chancellor Schmidt's visit is that immediately following the United States Ambassador's approach there was a rather surprising development at the Nuclear Planning Group meeting in Florida attended by eight NATO Defence Ministers. <sup>It is claimed that here</sup> This was a general consensus among the other Defence Ministers that they would be ready to support Mr. Mulley! !!! Chancellor Schmidt, who is particularly anxious that Luns should go and who is also a personal friend of Mr. Mulley's, may well ask you what you feel about this.

7. Given the criticism which your Party made in Opposition of Labour's handling of our defences I do not imagine that you would wish to see Mr. Mulley appointed: and there are other reasons for doubting his suitability for this particular job. But, if this is the case, do you wish to seize this opportunity to run an alternative British candidate? Davignon is able and ambitious but has no relevant experience and in any case may well see his future in Belgian politics. M. Thorn is generally thought to be a lightweight and there seem to be no other strong runners. It is quite possible therefore that we could get this post if we could come up with a good candidate. This is something you might want to have a word about with Lord Carrington and Mr. Pym before Chancellor Schmidt's visit.

#### Turkey

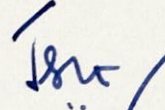
8. Because of your other preoccupations between now and the Schmidt visit we have kept the briefs down to a minimum. I think however that brevity has been overdone in the case of Turkey (paragraph 21 of the Steering Brief and

*A need -  
see note -  
above.*



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paragraphs 23-27 of brief No. 4) since this is a subject on which Chancellor Schmidt has strong views. Furthermore the brief takes no account of the defence angle. I think therefore that you ought to see the attached paper which has been prepared by an interdepartmental group under the chairmanship of Sir Kenneth Berrill.



JOHN HUNT

5th May, 1979



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### Introduction

1. This paper is the work of an inter-departmental group of officials. It considers the present crisis in the Turkish economy; the international effort to "rescue" Turkey (once again); the United Kingdom's interests and role in that rescue operation; the pressures on us to increase our contribution; and the tactics we might best pursue.
2. The present centre-left Government of Mr Bulent Ecevit (Republican People's Party) was formed on 5 January 1978 and is, like most recent Turkish Governments, a coalition. Since the end of last year, the Government has come under increasing pressure with several resignations from the Government and from the RPP. The internal security situation has remained critical with a high level of politically inspired violence. Martial law was recently extended to cover the greater part of Eastern Turkey where the risk of Turkish/Kurdish clashes and Kurdish separatism has again surfaced. The long standing divisions between the Moslem sects, left and right, rich and poor remain unhealed. On the economic front, the country's situation is also very difficult. Her Foreign Exchange reserves are low (\$850 million), her debts very large (\$13.5 billion, of which about 60 per cent is short term), her inflation rate very high (about 50 per cent) and her unemployed numerous (about 20 per cent of the working population).

### Political Considerations

3. Turkey has been a rough and ready democracy since the mid 1940s and a genuine if unstable one since 1950. It is one of the very few democracies in the Middle East region and the developing world. It is regarded by many as a test case of whether democracy and economic development from a low starting point are compatible. The West's interest in the preservation of democracy in Turkey is impossible to quantify, although it can be argued to be substantial.
4. The political and social instability occasioned by economic, internal security and foreign affairs difficulties (Cyprus, the Aegean, US arms embargo) has led to doubts about Turkey's western orientation. The upheavals in Pakistan, Afghanistan and Iran have intensified the West's worries. A full-blooded realignment to bring Turkey into closer association with the Soviet Union or with some new group of Islamic states is highly unlikely. More

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likely, if political instability continues, is a surly and unco-operative Turkey, wooed by the Soviet Union, linked more closely with the Islamic movement, especially on the Palestine issue, but still reluctantly dependent on the West for markets and supplies.

5. Britain has a particular interest in Cyprus which stems not only from traditional ties with that country but also from the presence of the Sovereign Base Areas and their associated facilities; these could be threatened by any renewal of intercommunal conflict. Any solution to the Cyprus problem requires Turkish co-operation. And a deterioration in the current situation of uneasy stability with de facto partition would be much more likely if Turkey were to be alienated or realigned.

#### Military and Strategic Considerations

6. If Turkey abandoned her Western orientation, a number of strongly adverse military consequences would follow for the West, even if she did not align with the Soviet Union. NATO would lose the control exercised by Turkey over the Bosphorous and Dardanelles choke points which give the Soviet Black Sea fleet its only point of exit to the Mediterranean. The balance of forces between NATO and the Warsaw Pact would also be significantly altered by the loss of Turkey's armed forces, which, although subject to serious training and equipment deficiencies, are large, tough and resolute (her army is the largest in European NATO). The change would be accentuated if the Soviet Union chose to redeploy against other parts of NATO some of the force of 30 Warsaw Pact divisions and 1000 strike aircraft which at present pose a threat to Turkey from Bulgaria and the Caucasus, though her readiness to take this step would be likely to depend upon how closely Turkey aligned herself with the Warsaw Pact. The USA would be denied Turkish sites for important intelligence and air defence surveillance facilities and the use of Turkish military airfields. And this would follow the loss of similar facilities in Iran. The military position would be the more serious if the Soviet Union were herself able to exploit Turkish airspace or, worse, given use of Turkey's airfields. In that event, the Eastern Mediterranean might become untenable by NATO in time of tension or war.

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7. A change in Turkey's alignment would also have implications for Greece and the Middle East. Greek reintegration into NATO's military structure might be eased, but the military threat facing Greece would be increased and Turkey, unconstrained by NATO and possibly supported by the Soviet Union, might be prepared to advance her interests more aggressively in the Aegean and Cyprus. NATO (and the EEC of which Greece but not Turkey will soon be a member) would be likely to support Greece, thus providing a motive for Turkey to try to form alliances with other countries, possibly including the Warsaw Pact. With a change in Turkey's stance, the "Northern Tier" against the expansion of Soviet influence in the Middle East would disappear, probably permanently. If Turkey were to become a bridge rather than a buffer, the consequences for the whole area would be far-reaching.

Economic Considerations

8. Turkey has faced successive economic crises over the past quarter of a century. The immediate crisis is the most acute yet. The balance of payments aspect is particularly difficult. According to latest OECD forecasts, the current account deficit in 1979 is likely to reach about \$2 billion, despite a major reduction in imports. Moreover, on Turkey's present policies, the current account deficit is set to double in four or five years.

9. Even if, as a result of current international action, the very difficult short-term problems of the Turkish economy are eased, Turkey will require an extended period to restructure its economy (and its debt profile) in order to become independent of continuing large scale external assistance. This will require a complete change in the economic policies which have guided Turkish Governments, of whatever political complexion, for decades. They have all been strongly committed to the concept of rapid growth, with primary attention focussed on development of the industrial sector through heavily protected import-substitution industries in the public sector. Much of the industrial investment has been in inefficient projects not well suited to Turkey's comparative advantages in terms of location, natural resources and labour availability. Little attention has been paid to the need to generate foreign exchange flows through exports. As a result most of Turkey's industry is characterised by high cost public sector production and dependence on both Government subsidy and a highly protected domestic market. Investment in agriculture has been neglected, foreign inward investment discouraged and Turkey's considerable tourist potential largely unexploited.

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10. Advisers and aid donors have long recommended a more open economy and a more appropriate allocation of resources, but without success. The external assistance that is eventually required to take Turkey through the short-term will be wasted unless the Turks can be persuaded to change radically their economic priorities and pre-occupation with the public sector. Only such a change can bring any hope of economic recovery and sustainable growth in the medium and longer term. This means that any assistance should include comprehensive conditionality to ensure that it is not used simply to fund a continuation of past policies. The first step must be a new agreement between the Turks and the IMF to replace the standby agreement that was negotiated in April 1978 but which lapsed after the second tranche when Turkey failed to meet a number of performance criteria. It has to be said, however, that experience of past crises is not encouraging. The Turks will undertake short-term adjustment in order to get foreign assistance. But each time a new 5-year plan appears, it is a continuation of its predecessors.

11. As for the EEC, Turkey has an Association Agreement with the Community which brings her only limited benefits although the terms are currently being improved in her favour. In some respects however the Community is taking a harder line; the Germans want to restrict Turkey's future rights to the mobility of labour, Italy and France are extremely reluctant to agree to any improved access for Turkish agricultural products and we have insisted on restricting Turkey's textile exports to the United Kingdom. Moreover financial aid in real terms has become less over the years. All in all, the Community is unlikely to appear in Turkish eyes as adopting a very helpful or generous attitude to their problems, and in truth Turkish membership of the EEC would be a major source of political embarrassment to the present members. The Turks for their part are jealous of what they see as preferential treatment of their permanent enemy, Greece; and they seem incapable of realising that joining the Common Market means what its name implies; joining a free trade area, a concept incompatible with a policy of industrialising behind a protective wall. On the other hand, if Turkey can be persuaded to make the essential changes to her economy, she could in the much longer run develop a relationship with the Community of a kind which is out of the question at present. This in turn could open up welcome new trading opportunities for the United Kingdom.



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International Response to the Economic Crisis

12. Western financial institutions continued to finance Turkey's balance of payments deficit through 1977, especially through short-term loans from German, United States and Swiss banks. These largely ceased in late 1977 and dried up almost completely when the Turks defaulted on loan repayments and were unable to draw the third tranche of their IMF standby in late 1978.

13. Anxiety among western governments about the financial implications of a threat of default by Turkey and its virtual economic collapse were compounded by fears that the combinations of economic crisis and a worsening internal security situation could undermine Turkey's democracy and western commitment. Events in Iran emphasised the risks involved in allowing the situation to deteriorate further in a country as strategically important as Turkey. At the Guadeloupe Summit in January, it was agreed that Germany would take the lead over measures to help Turkey. Provided that Turkey reached agreement with the IMF, these measures would comprise immediate aid and a medium-term programme for the Turkish economy, both co-ordinated through the OECD.

14. It is not clear how much immediate assistance the Turks will need. Estimates of their net balance of payments deficit for 1979 (after crediting commercial bank lending, debt rescheduling, possible IMF support, and continuing project aid under existing programmes) are in the region of \$1 $\frac{1}{4}$  billion. The following offers of assistance have so far been made, but it is not yet clear how far they represent new money or what they mean in practice. The United States subject to congressional approval intends to contribute some \$200 million towards the immediate aid package for Turkey, (\$100 million in economic assistance, \$50 million in military equipment and \$50 million in export credits); Germany intends to contribute a commodity credit of \$100 million, which may be increased; France envisaged providing FF300 million (some \$68 million), two-thirds of it in export credits. Britain has committed £7.5 million (some \$15 million) in programme aid and has received top level approaches from both the United States and the FRG to do more. Other OECD countries have been canvassed for contributions. Some have responded positively; some have declined to participate and others have said that they will not do more than the smallest contributor from the Guadeloupe countries.

15. The Turks themselves have sought to drum up financial assistance from Arab sources, in particular Libya and Saudi Arabia. The Saudis have agreed to put up a loan of \$250 million for project aid, which however does not help with Turkey's immediate financial crisis. The Libyans have promised help with both oil supplies and credits but no firm figures are available. Turkey is the largest non-communist recipient of Soviet aid but this too is long-term project aid. The



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Russians have shown no inclination to provide financial aid. The Turks are also seeking substantial military assistance from NATO (some \$3 billion over the 5 years 1979-83). The United Kingdom is considering the offer of a small quantity of surplus military equipment. Offers of equipment and financial aid have so far been made by the USA, Germany and Norway.

The United Kingdom Position

16. In addition to the £7.5 million for immediate aid, the United Kingdom share of the EEC's various commitments to Turkey under the Third and Supplementary Financial Protocols to the EEC/Turkey Association Agreement amounts to \$100 million. To this must be added a further \$20 million as the United Kingdom share of the Community's package of emergency assistance which is being mounted alongside the Guadeloupe exercise. The EEC commitments are due to be disbursed over the next two years; and are all chargeable against the aid programme. In addition we are refinancing aid debts of £3.7 million in 1978-79 and are likely to have to provide similar amounts in the next 2 years.

ECGD Cover

17. On the export credits side, ECGD has already paid claims totalling some \$120 million and has outstanding liabilities of \$330 million. This includes some \$245 million in respect of industrial projects which have not been completed and which ECGD would not normally have continued to support, but have agreed to do so in the light of the Guadeloupe decision. All told something like \$600 million of Government money is therefore tied up in Turkey. We cannot yet say how much, if any, of this will count as aid for the purposes of the assistance package. We hope to agree on a definition at an OECD meeting on 4 May.

18. Exports credits are bound to be an important issue in any discussions on aid to Turkey. The Americans and the French are including export credits in their contributions, and are sure to raise the issue of resumption of export credit insurance cover by ECGD. ECGD's losses on Turkey are the heaviest so far encountered in its history. Turkey is not meeting all of the payments falling due under the Rescheduling Agreement and a further rescheduling of debt guaranteed by the Department - the fourth in 15 years - seems inevitable. The ECGD's basic remit is to exercise a reasonable judgment of risks and on this basis there is no prospect of an early resumption of export credit cover.



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19. Even under its Section 2 (national interest authority) ECGD is required to avoid unduly hazardous risks. Before the Export Guarantees Committee could recommend further cover, it would therefore need to be satisfied with Turkey's performance in honouring the existing debt agreement and its ability to meet further commercial payments promptly. It seems likely to be some time before these conditions could be satisfied. In the meantime the provision of export credit cover could only be regarded as a disguised (and less helpful) form of development aid. If this option were to be pursued, earlier assurances to Parliament would make it necessary to reveal publicly that ECGD was being used for aid-giving purposes.

Conclusions and Policy Options

20. British policy towards Turkey has been based on a number of British and Western interests. The crucial one is that Turkey should remain Western orientated and a member of NATO. Others are that the Turkish economy should be healthy and viable, that democracy should be preserved and that Turkey should be co-operative over a settlement of the Cyprus problem. All these interests may be at risk if the Turkish economy deteriorates further and, in particular, if balance of payments difficulties lead to further restriction of imports and to still higher unemployment. Yet, as the analysis in paragraphs 7-9 shows, the cost of underpinning the Turkish economy in the medium term would be very high. A measure of the problem is that Turkey's balance of payments deficit is currently about the same as her earnings from exports (interest payments alone amount to about a third of export earnings), and the position is expected to get worse.

21. The chances of Turkey reforming the economic policies followed for decades and in effect changing her whole economic ethos, so that balance is restored and foreign subsidies dispensed with, are poor. A full British share in the sort of medium-term aid effort likely to be required would necessitate a significant reorientation of our general aid policies and affect public expenditure priorities.



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22. The United States and Germany have both evidently concluded that Turkey's strategic importance dictates a further major attempt to bolster the Turkish economy. It is not clear that they have quantified all the implications and are prepared to provide massive aid on a continuing basis. But, in the short term at least, they have decided to take the lead over international help: they look to the United Kingdom and France, as fellow members of NATO and fellow participants at Guadeloupe, to help

23. On the face of it, the United Kingdom offer of £7.5 million will be regarded by others as derisory. We could of course argue that, taken with our other commitments to Turkey, it is not a negligible sum. But we are bound to come under further pressure from the Americans and Germans, as well as from the Turks themselves, to increase it, particularly since other potential donors, for example the Japanese and the Dutch, have said that they will not put up more than the lowest Guadeloupe contributor, and the Canadians, though willing in principle to help, are holding back until they know exactly how much the Guadeloupe Four are contributing.

24. The strategic implications of the West's willingness to aid Turkey are very important. A failure to provide aid would, following Iran, underline the West's unwillingness (or inability) to help its friends. But the bill could be very high and Western interests could remain at risk even if it is met. We could have doubts whether further United Kingdom contributions to the Save Turkey Fund would be money well spent but are unlikely to be able to avoid looking again at our offer. Tactically our best course for the moment is probably to stick to £7.5 million for the emergency aid package and take credit for our continued support of the Turkish industrial projects financed by ECGD, and for our commitments to helping other countries such as Jamaica. Before any further commitment is made to Turkey - and any larger commitment would be difficult to fit into the aid programme for 1979-80 and 1980-81 - which is already very heavily committed we should seek to establish more clearly the prospects for eventual viability in Turkey, the willingness of other Western allies to underwrite the Turks on the scale likely to be necessary and the adequacy of the overall United Kingdom effort in comparison with that of our allies.

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