

Subject

RECORD OF A CONVERSATION AT A WORKING LUNCH GIVEN BY THE PRESIDENT OF THE UNITED STATES FOR THE PRIME MINISTER AT THE WHITE HOUSE AT 1240 HOURS ON THURSDAY, 29 SEPTEMBER 1983

Present:	Prime Minister	President Reagan
	Foreign and Commonwealth Secretary	Mr. Shultz
	Sir Robert Armstrong	Judge Clark
	Sir Antony Acland	Mr. Regan
	Sir Oliver Wright	Mr. Louis
	Mr. Butler	Mr. Burt
	Mr. Coles	Mr. Thayer
	Mr. Fall	Mr. Sommer

Following introductory remarks by President Reagan, the Prime Minister suggested that the two Foreign Ministers should indicate the ground which they had covered in their own discussions. The Prime Minister then summarised the tête-à-tête conversation which she had just had with the President. Most of the time had been devoted to East/West relations. It had been agreed that there was a need to resume the dialogue with the Soviet Union though not necessarily at the highest level. On arms control, she had explained to the President our concern about the rather facile arguments that the British and French deterrents should be included in the arms negotiations. If they were ever included in the START negotiations, the implication was that the United States would have less than parity with the Soviet Union. Mr. Shultz agreed. The Prime Minister said that the Russians were putting forward this proposal to confuse the issue and to avoid a serious negotiation on reducing their own vast strategic arsenal. START should concentrate on deep reductions; if the negotiations were successful then there would be a different world.

She had also discussed with the President the question of Belize. She had told him of British support for American policy in

Central America. She had also emphasised that if the Americans resumed arms supplies to Argentina, this would not be understood in Britain.

Earlier she had spoken to Mr. Regan about the unitary taxation issue with regard to which we had serious objections. Some of the heads of US multi-nationals with whom she had dined on the previous evening seemed to agree with our views. (At this point the President left to take a telephone call). Mr. Regan said that he understood the Prime Minister's views about unitary taxation.

The Foreign and Commonwealth Secretary said that he had been in close touch with Mr. Shultz about the situation in the Lebanon. The immediate task was to arrange for the supervision of the truce by observers. Yesterday he had seen the Syrian Foreign Minister. Syria was clearly riding high. It recognised the need for supervision of the truce but was not prepared to agree to UN observers. It was not yet clear whether the Soviet Union would obstruct UN action.

The Prime Minister said that she wished to look a bit further ahead in the Middle East. When Britain had departed from Palestine the idea had been that Palestine should be partitioned. The fact was that the area now occupied by Israel constituted the whole area of the former Palestine. Jordan feared that as more and more Israelis settled on the West Bank, the Arabs would be pushed back into Jordan and Palestinians would enter Jordan from other countries. If this happened, Jordan would have no future. The Hashemite monarchy would fall. We should have lost a great friend of the West and one of the few moderates. Following the fall of the Shah, the reputation of America would be very considerably affected. She therefore hoped that the United States would consider the Jordan factor most carefully.

Mr. Shultz said that when President Reagan had devised his initiative on the Middle East it had been recognised that the problem was partly Israeli policy but that the major problem was to get the Arabs to the negotiating table, accompanied by Palestinian representatives who were ready to talk to Israel. Until this could be done, it would be difficult to persuade Israel to modify its policy.

/ Hussein

Hussein had been in principle ready to sit down with the Israelis but naturally had to be careful about the circumstances. Hussein and Arafat had almost reached agreement in April but this had been torpedoed by Syria which was determined that there should be no peace process that was not controlled by Damascus. Syria had then caused chaos in the Lebanon and thereby might have made Israeli withdrawal more difficult. It was therefore clear that Syria was a large part of the problem. Somehow it must be cut down to size.

The Prime Minister agreed that Syria had blocked many peace efforts. (At this point the President returned and the Prime Minister reiterated her concern about Jordan). Israel was now establishing more and more settlements as a matter of policy. One day there would be an Israeli majority on the West Bank and it would be incorporated into Israel. This would destabilise Jordan - and it was perhaps Israeli policy to achieve this. The Israelis argued that Jordan was Palestine. This was not true. Attention was inevitably focussed on Lebanon at the moment but we should not lose sight of the threat to Jordan. We must not let down Hussein who was shrewd and courageous. The integrity of Jordan must be maintained.

Mr. Shultz said that the President had earlier agreed with King Hussein that if he showed a readiness to negotiate with Israel, then the Americans would strenuously urge Israel to announce a modification of its settlement policy. But the factors he had already described had prevented this. The Prime Minister said that if things were simply left as they were, Jordan would disappear. Mr. Shultz said that it was not the intention to acquiesce in the present situation. America wanted to start a peace process but the situation in Lebanon prevented this for the present.

President Reagan said that he shared the Prime Minister's feelings about King Hussein. If it were possible to re-start the peace process, he felt that Israel must exchange territory for secure borders. He was sure that King Hussein did not wish to have the West Bank back and its Palestinians incorporated in Jordan. Therefore the aim should be a federation with the West Bank which

/ was autonomous

was autonomous but not a separate State. It would be for Jordan to guarantee that that autonomous unit did not become a threat to Israel. America could not impose such a settlement but the whole peace process depended on Israel being willing to give up territory for security.

The Prime Minister commented that Israel's willingness to do so was in doubt under the present Government. The Foreign and Commonwealth Secretary said that the continuing process of Israeli settlement made the prospects for peace more remote. Mr. Shultz commented that Arabs still outnumbered Israelis by ten to one on the West Bank. The Foreign and Commonwealth Secretary said that every time we in the West appeared to condone the settlement policy Israel was encouraged to proceed. Mr. Shultz said it was not yet properly realised that the President's proposals had stated that if Israeli settlements fell within the jurisdiction of the autonomous unit on the West Bank, the settlers would, if they chose to remain there, have to accept that jurisdiction.

The Prime Minister said that the President's initiative had been excellent but it had been announced and then nothing much had happened. The fact was that Israel was defying the President's wishes. Mr. Shultz said that the problem was how to tackle Israel. Railing at Israel was no better than railing at Syria. The analysis of American experts was that the right announcement by King Hussein that he was ready to negotiate would have an electric effect in Israel. The Prime Minister said that there were Palestinians who could be viable negotiating partners. She had refused to allow a PLO representative in the Arab League Delegation which had visited London but a Palestinian called Walid Khalidi had been most impressive.

President Reagan said that earlier every Arab State except Egypt had denied Israel's right to exist as a nation. But American efforts had moved the Arabs a long way towards recognising Israel's right to exist. He did not believe that Israel could continue with the present combination of enormous military expenditure and fund-raising drives. The exchange of territory for security would mean that they would not live for ever in an armed camp. He agreed that Jordan held the key. The problem with Palestinian representatives

/ was that

was that those who were prepared to stand up without the PLO did not live very long. There had to be security for right-thinking Palestinians.

The Prime Minister asked whether Mr. Regan would say a few words about the US economy.

Mr. Regan said that the question which preoccupied the Administration was when a sizeable deficit began to affect investment and slow down recovery. He judged that this would not occur in the next twelve months. Businessmen were awash with cash as a result of the tax policies and the economic recovery. They could finance themselves over the next year. He did not share the prediction of many people that the American deficit would reach \$200 billion. If real growth of $4\frac{1}{2}$ - 5% could be maintained over the next twelve months, then 10% nominal growth in GNP should be achievable. A deficit next year of \$165 - \$170 billion dollars could be reasonably prophesied. If money supply were kept within the intended bracket of 5 - 9%, then it should be possible to sustain real growth of $4\frac{1}{2}$ - 5% without inflation. However, the deficit was huge and it would be necessary to come to grips with it eventually. If growth did not deal with the deficit then it would be necessary to cut spending or raise revenue. He preferred the former.

The Prime Minister commented that if Mr. Regan was right in his analysis, then interest rates should soon fall. Mr. Regan said that we should not look at prime rates. Large corporations were borrowing at 10 - $10\frac{1}{2}$ %. Brokers' loans were paying only 10 - $10\frac{1}{8}$ %. The Prime Minister said that this was a very high rate for small businessmen. High interest rates were our worst problem and were reining back recovery.

Mr. Regan said that he believed that the increase in the American trade deficit was due to global factors. A fear of an escalation in the Iraq/Iran conflict, and a consequent interruption of the oil supply, had driven oil companies to acquire much larger reserves than usual. Over 60% of the US trade deficit last month had been due to a sharp increase in oil imports.

/ The Prime Minister

The Prime Minister said that she thought that the aim should be to get interest rates down to 3 - 4% in real terms.

The President said that certain banks were now making available large sums for home mortgages at 9.9%. He had recently seen a TV advert offering car loans for 8.8%. Another factor keeping interest rates high was the fear that artificial stimulation might be used, as in the past, to bring the economy out of recession. People were not yet quite sure that it was possible to obtain growth without inflation. But inflation had been 2.6% in the last twelve months and this was the lowest for twenty three years. The need was to convince people that the recovery was real.

The Foreign and Commonwealth Secretary said that the very size of the deficit posed the risk of inflation taking off again.

The discussion ended at 1335 hours.

A.J.C.

29 September 1983