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TO IMMEDIATE F C O

TELEGRAM NUMBER 1976 OF 1 JUNE

VERSAILLES SUMMIT: LATEST U.S. POSITIONS.

1. THE FOLLOWING IS A SYNTHESIS OF OFFICIAL VIEWS ON THE EVE OF PRESIDENT REAGAN'S DEPARTURE TO EUROPE. DISCUSSION IN THE WHITE HOUSE IS CONTINUING UP TO THE LAST MINUTE. WE WILL REPORT ANY FURTHER MODIFICATIONS IF NECESSARY.

CREDITS FOR THE SOVIET UNION AND EXISTING CONTRACTS
2. THIS STILL SEEMS LIKELY TO BE THE MOST DIFFICULT ISSUE. THE AMERICANS FEEL THAT THE TONE OF THE LAST ROUND OF OFFICIAL DISCUSSIONS IN PARIS ON 27 MAY WAS AN IMPROVEMENT ON ITS PREDECESSORS. BUT THEY ARE DISAPPOINTED AT THE LACK OF AGREEMENT ON A MECHANISM FOR CONTROLLING CREDITS TO THE SOVIET UNION. MR HAIG HAS NOW SENT A FURTHER LETTER TO HIS COLLEAGUES (WHICH WE HAVE NOT SEEN HERE). THE PRESIDENT WILL RAISE THE MATTER HIMSELF AND MAY WELL TABLE THE DRAFT PROTOCOL WHICH HIS OFFICIALS PUT FORWARD ON 27 MAY. THE MINIMUM THE AMERICANS COULD ACCEPT WOULD BE A VERY FIRM AGREEMENT IN PRINCIPLE, AND FURTHER WORK BY MINISTERS OF FINANCE (PARAGRAPH 5 (A) OF PARIS TELNO 551 TO F C O)). INDIVIDUAL ACTION BY GOVERNMENTS WOULD BE INADEQUATE. WITHOUT AGREEMENT, THE AMERICANS WOULD - OUR CONTACTS SAY - BE BOUND TO ACT IN WAYS THEIR PARTNERS FOUND UNPLEASANT.

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FOUND UNPLEASANT.

3. ON EXISTING CONTRACTS THE ISSUE REMAINS OPEN. HAIG AND REGAN
(WHO WILL BE AT VERSAILLES) AND BALDRIGE ARE IN FAVOUR OF
FLEXIBILITY. WEINBERGER IS AGAINST AND MRS KIRKPATRICK ARGUED IN THE
N S C ON 24 MAY THAT FLEXIBILITY WOULD BE QUOTE IMMORAL UNQUOTE. ONE
STATE DEPARTMENT OFFICIAL HAS COMMENTED THAT THIS ISSUE CANNOT NOW
BE RESOLVED WITHIN THE WASHINGTON BUREAUCRACY. HE BELIEVES THAT
ONLY A DIRECT APPEAL BY THE PRIME MINISTER WHEN SHE MEETS THE
PRESIDENT WILL DO THE TRICK.

O E C D EXPORT CREDIT CONSENSUS

4. THE AMERICANS WILL PROBABLY RAISE THE CONTINUING ABSENCE OF
AGREEMENT, BUT WOULD OBJECT TO LINKING THIS WITH THE ISSUE OF
CREDITS FOR THE SOVIET UNION.

MACRO-ECONOMIC POLICY AND EXCHANGE RATE MANAGEMENT

5. THE AMERICANS SEE VERSAILLES AS AN IMPORTANT OPPORTUNITY TO
RE-STATE OF THE COMMON THEMES SET OUT AT THE ORIGINAL RAMBOUILLET
SUMMIT. OFFICIALS ARE ENCOURAGED BY GREATER FLEXIBILITY IN AMERICAN
ATTITUDES, AND BY A CORRESPONDING FRENCH REALISM. THEY ARE HAPPY
WITH THE DRAFT LANGUAGE FOR THE SUMMIT TO ADOPT AS IT NOW STANDS.
THEY EXPECT SOME CRITICISM OF THEIR DOMESTIC ECONOMIC POLICIES, BUT
ARE LIKELY TO OPPOSE SUGGESTIONS THAT SCHEDULED TAX CUTS BE CANCELLED
THAT PLANNED INCREASES IN DEFENCE EXPENDITURE BE CUT TO THE POINT
OF DIMINISHING U.S. SECURITY, OR THAT THE U.S. MONEY SUPPLY SHOULD
BE EXPANDED RAPIDLY TO BRING DOWN INTEREST RATES. THEY ARE LIKELY
TO CONTINUE WARNING OTHER COUNTRIES AGAINST THINKING THAT A
REDUCTION IN U.S. INTEREST RATES WILL BRING DOWN INTEREST RATES
ELSEWHERE, UNLESS OTHER COUNTRIES ADOPT SUITABLE COUNTER-
INFLATIONARY POLICIES THEMSELVES. THEY ARE UNEASILY AWARE THAT THE
PRESIDENT'S FAILURE TO GET A BUDGET AGREEMENT WILL WEAKEN HIS HAND,
THOUGH THE PRESIDENT WILL DOUBTLESS BLAME THIS ON CONGRESSIONAL
POLITICS.

6. ON INTERNATIONAL MONETARY CO-OPERATION, THE AMERICANS ARE CONTENT
WITH THE LANGUAGE THAT HAS ALREADY BEEN AGREED.

TRADE

7. THOUGH THE AMERICANS WANT THE SUMMIT TO SPEAK UP FOR FREE TRADE
AND TO SUPPORT INITIATIVES AT THE NOVEMBER G A T T MINISTERIAL
MEETING ON SERVICES AND INVESTMENT, THE PRESIDENT IS UNLIKELY TO
MENTION THAT THE JAPANESE

TRADE

7. THOUGH THE AMERICANS WANT THE SUMMIT TO SPEAK UP FOR FREE TRADE AND TO SUPPORT INITIATIVES AT THE NOVEMBER G A T T MINISTERIAL MEETING ON SERVICES AND INVESTMENT, THE PRESIDENT IS UNLIKELY TO MAKE DETAILED PROPOSALS. THE AMERICANS THINK THAT THE JAPANESE TRADE MEASURES OF 27 MAY REPRESENT A SUBSTANTIAL STEP ESPECIALLY ON INDUSTRIAL GOODS THOUGH LESS SO ON AGRICULTURE. THEY BELIEVE THAT THE JAPANESE ANNOUNCEMENT WILL DEFUSE WHAT COULD HAVE BEEN A DIFFICULT SITUATION. INSTEAD, THEIR ATTENTION MAY FOCUS ON EUROPE, ESPECIALLY AGRICULTURE AND STEEL (NO SETTLEMENT ON THE LATTER IS LIKELY BEFORE THE SUMMIT). BUT ON THE WHOLE THEY FEEL TRADE WILL NOT BE A DIFFICULT ISSUE.

GLOBAL NEGOTIATIONS

8. THE CONFUSION DESCRIBED IN WASHINGTON TELNO 1927 CONTINUES. BASIC AMERICAN ATTITUDES ARE UNCHANGED. BUT THE STATE DEPARTMENT THINK THAT HORMATS (AND PERHAPS HAIG) BUT NOT THE PRESIDENT MAY PROPOSE LANGUAGE IN VERSAILLES SHOWING GREATER FLEXIBILITY ON PROCEDURE, WHILE REMAINING FIRM ABOUT THE INDEPENDENT ROLE OF THE SPECIALIZED AGENCIES. OTHERWISE, THE AMERICANS FEAR, THE EUROPEANS WILL MOVE AWAY FROM THEM TOWARDS ACCEPTANCE OF THE G.77'S BEDJAQUI TEXT. BUT THE TACTICS STILL REMAIN TO BE DECIDED BY THE PRESIDENT.

YOUTH EXCHANGES

9. THOUGH IT HAS ACHIEVED LITTLE PUBLIC PROMINENCE HERE, THE WHITE HOUSE TELL US THE PRESIDENT (AND MR WICK) STILL WANT THE SUMMIT TO ENDORSE THE PROPOSED INITIATIVE.

F C O PLEASE ADVANCE TO PS, PS/PUS, BRIDGER, EVANS, BAYNE AND GOWLLAND (T R E D)

HENDERSON

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