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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

28 July 1987

MEETING WITH THE SOVIET AMBASSADOR

I wrote to you on 21 July about my meeting with the Soviet Ambassador. I should record that the Prime Minister has subsequently commented that she would very much like to see Mr. Aganbegyan in the autumn.

(Charles Powell)

Lyn Parker, Esq.,
Foreign and Commonwealth Office.

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~~Please put in~~
~~box 4~~

PRIME MINISTER

MEETING WITH THE SOVIET AMBASSADOR

~~Link~~

You will, I think, want to see my note of the meeting with the Soviet Ambassador, together with the information brief on the Soviet economy which has been prepared for you on Gorbachev's instructions. You will note that Gorbachev is offering to send his chief economic adviser to brief you more fully in the autumn.

—

e.d.p

mt

C.D. POWELL
21 July 1987

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10 DOWNING STREET
LONDON SW1A 2AA

Prime Minister
For well-lead
box
over.

From the Private Secretary

21 July 1987

Dear Lynn,

Would very much like to see
The Aganbegyan.

MEETING WITH THE SOVIET AMBASSADOR

The Soviet Ambassador came to see me today at his own request. He was accompanied by his Private Secretary (the egregious Kosov being on holiday).

The Ambassador said that he had been in Moscow for the recent Central Committee plenum. He had subsequently had a very brief meeting with Mr. Gorbachev. The latter had charged him to convey his sincere congratulations to the Prime Minister on her election victory, and to say that he was glad but not surprised that she had won.

Soviet Economy

Mr. Gorbachev had also asked him to convey to the Prime Minister a note (copy enclosed) summarising the economic reforms on which the Central Committee plenum had agreed. This did not attempt to conceal the very real difficulties and problems. The reforms were far-reaching. From now on, the control of the central planning machinery would be drastically weakened. Decisions would be taken at plant level. Individual factories would have to pay for their inputs and calculate their prices on the basis of their costs. There would be scope for paying incentives. Some enterprises might go bankrupt with consequent loss of jobs. The Ambassador continued that Mr. Gorbachev would be willing to send over his chief economic adviser on these reforms, Mr. Aganbegyan, to brief the Prime Minister more fully in the autumn. Equally he (the Ambassador) would find it very helpful to have a briefing on how the Prime Minister had restructured the British economy.

I said that the Prime Minister would be grateful for the briefing paper. During her first meeting with Mr. Gorbachev in December 1984 they had discussed the difficulties of running a highly centralised economy. The recent reforms were clearly a major step towards decentralisation and greater autonomy at the level of the individual enterprise. I would only note, as a historical fact, that this was the direction which the Prime Minister had then urged upon Mr. Gorbachev. I added that one implication of the reforms seemed to me that unemployment would inevitably become a feature of the Soviet economy. The Ambassador said that it was certainly the case

that jobs would be lost in the drive for greater productivity or if individual enterprises went bankrupt. But since there was a shortage of labour in the Soviet Union, there would be no continuing unemployment.

Yes I continued that I would ask the Prime Minister whether she would like to see Mr. Aganbegyan. I was sure that we could arrange for the Ambassador to be briefed on our own economic restructuring. Indeed it was gratifying that Thatcherite economics were in such demand. I should be grateful if you could consider who might best do this. Perhaps Terry Burns would take it on.

Arms control

The Ambassador said that he had noted claims being made during the Prime Minister's visit to Washington that the Soviet Union was dragging its feet in the INF negotiations in Geneva. He wanted to refute this strongly. He handed over a short speaking note, saying that it was his own work and had no official status. (I enclose a copy: you may wish to pick up some of the points in the Prime Minister's message to Gorbachev.) He wished to stress that the Soviet Union remained seriously interested in the conclusion of an INF agreement with President Reagan. Whatever the effect of the current Congressional hearings on his standing, they recognised that unless an agreement was concluded relatively soon it might be two years or more before there was another opportunity, and it would probably mean starting again from scratch. Mr. Gorbachev was ready for a Summit at the end of this year or early next, although for obvious reasons he could not manage November. There had been speculation as to why a meeting had not yet been arranged between Shevardnadze and Shultz. The Soviet side saw no point in such a meeting until the negotiations in Geneva had reached the point where political decisions were required. The Pershing IAs were a particular problem. If they were retained, then the GDR and Czechoslovakia would insist upon retaining an equivalent number of Soviet missiles on their territory.

I recalled that the Prime Minister had said publicly in Washington that it was not a question of anyone dragging his feet. There were very difficult and detailed issues to be resolved, and it was important to get them right. That said, I did not accept that the Ambassador's notes gave a fair picture of the negotiations in Geneva. Indeed in several respects they seemed to lag well behind other indications of Soviet policy such as General Chervov's reported comments. There was no question of including the Pershing IAs in an agreement. They were a bilateral arrangement between the United States and Germany, and had never been raised throughout six years of discussions until relatively recently. Many of the alleged problems in the Ambassador's note would disappear if the Soviet Union accepted NATO's proposal for global elimination of INF systems.

The Ambassador asked whether the Prime Minister assessed that President Reagan was serious in wanting an agreement and a Summit later this year. I said that there was no doubt of that, but equally no question of the United States being ready to pay a price for a Summit. Our impression was that they were looking to Mr. Gorbachev to propose a date.

Prime Minister's Visit to Washington

The Ambassador asked whether I could tell him anything about the Prime Minister's visit to Washington. I said that, as he would have read, the Prime Minister would be sending a message to Mr. Gorbachev in the next few days setting out her reflections on the way ahead. I thought that this would cover arms control, Iran/Iraq and an international peace conference on the Arab/Israel problem. I drew the Ambassador's attention to the Prime Minister's comments in Washington about the historic and courageous changes being made in the Soviet Union by Mr. Gorbachev and our support for them.

We had brief exchanges about all three issues, which revealed nothing of any moment.

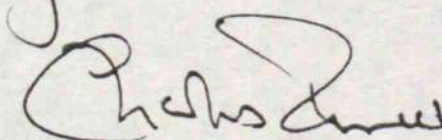
Possible Visit by Gorbachev

The Ambassador said that he had read some comments by the Prime Minister about a possible visit by Mr. Gorbachev. I said that the Prime Minister had made clear that we would be happy to have Mr. Gorbachev pay a visit. We would no doubt be following this up more formally soon. The Prime Minister had also indicated that if Mr. Gorbachev wished to stop briefly in London for a talk on his way elsewhere, he would be equally welcome.

Afghanistan

As he was leaving, the Ambassador said that he would welcome an opportunity to discuss with me soon Soviet views on Afghanistan and their contacts with the former King in Italy. I said that I was ready to listen.

I am copying this letter to Trevor Woolley (Cabinet Office).

Yours sincerely,


CHARLES POWELL

Lyn Parker, Esq.,
Foreign and Commonwealth Office.

Information brief for the Rt.Hon.
Margaret Thatcher,
the Prime Minister

Importance of the June 1987 plenary meeting of the Central Committee of the Communist Party of the Soviet Union lies with the fact that it marked a crucial shift to large-scale practical measures in reforming the economy and society. The perestroika has been raised to a new level.

I think the Prime-Minister remembers from her recent visit to Moscow the animated discussion of the ways and means of reorganisation, on how it affects the lives of people, many changes being already visible.

Yet, at the plenary meeting both Mr.M.Gorbachev and other members of the Central Committee frankly admitted that reorganisation was advancing slowly, with numerous difficulties. Of course, we have some hopeful signs - higher industrial and agricultural output, more high-quality goods. Glasnost and democratisation make people more aware of what is happening around them, more active in pursuit of common goals. There is, as Mr.Gorbachev put it, "an explosion of spiritual activity".

At the same time, in the last 6 months the party realised fully the complexity of the problems and contradictions we face. They surfaced in the difficulties of the state quality control, anti-drinking campaign, drive for efficiency and discipline. We still cannot overcome wide-spread shortages both of industrial and consumer goods, management is by fiat. In short, the plenary meeting concluded that piece-meal changes in the economy cannot take it away from the "pre-crisis" situation.

We are now convinced that the reform in our country can only advance through a major overhaul of the national economy - from the factory level to management, planning, pricing, trade, finance. The Plenum approved the main guidelines for their reform with the aim of implementing most of it by the year 1990.

As you know we started with an individual enterprise - factory, considering it to be the basic unit of the economy at large. The Supreme Soviet has already adopted ~~The~~ Law on State Enterprise. Under the new economic mechanism, factories' accountability and dependence

on the end result will increase dramatically through introduction of the criteria like cost-effectiveness, self-financing, profit-and-loss accounting. Here are just a few of the new features:

- factories are free to draw up their own production and sales plans guided by the public demand expressed through direct competitive orders of the state, other factories, trading firms;
- economic competition is encouraged;
- after covering to the state the costs of basic assets, land, water, etc., factories retain their profits and can invest them at their discretion into modernisation, capacity build-up or into social amenities;
- funding from the state budget is only preserved for major national orders, while bank credits should be widely available;
- factories can determine the number of employees they need;
- factories, unable to show a profit sufficient to cover the losses and sustain a normal level of income for the workforce, can be closed, in which case the state still guarantees the constitutional right of citizens for work.

In exercising all these new freedoms and responsibilities we see as a major factor the right of self-management, election of executives, collective decision-making. Factories' economic well-being will now be directly dependent on meeting the present customer demand, making good use of resources, raising quality level.

Instead of day-to-day running of subordinate factories, ministries, state committees, other national economic bodies will now focus on overall economic strategy, keeping the proportions in balance, organising research and development, introduction of new technologies. What control over factories is left in their hands will be executed through a system of economic norms and target figures (level of demand for goods of social priority, minimum efficiency rate, etc.).

State planning organisations should now concentrate on spelling out basic priorities and long-term macroeconomic and social targets, structural policy and investment criteria, guidelines for research and development, enhancing scientific, cultural, educational potential and maintaining defence.

Quite obviously, more low-key role for central planning and management bodies will involve streamlining of cumbersome bureaucracies, cutting down on the staff. This creates, as you would know very well, another set of social problems.

Now modus operandi for factories and ministries can only function under a new system of procurement and supply. Wholesale trade and plant-to-plant co-operation replaces the supply quotas of materials, determined by the centre. Yet, it can only become possible if we overcome the wide-spread shortages in the economy both in industrial and consumer markets. That is another complex task of high priority.

As part of the drive to overhaul economic management, pricing is to be revamped. Currently, economically unjustified price fixing leads to ever increasing government subsidies which, I can tell you, have reached the annual level of 76 billion roubles. The Plenum has ruled that the government bodies will only fix the price for the priority products. Otherwise, the emphasis should be on wholesale and contract prices, determined by the supply and demand situation. More details of the pricing reform are yet to be worked out.

Finance and banking should be re-organised in such a way that monetary figures strictly corresponded to the volume and quality of goods and services produced. Banks cease to be a channel of government subsidies and return to their original role of creditors.

To implement all these reforms, we also need managerial personnel of a new mould - young, efficient, innovative. New measures to raise the level of professional training are to be adopted, new incentives introduced.

It is very important to satisfy the demand for high-quality consumer goods and foodstuffs now in short supply. Otherwise, there is no sense in raising wages and salaries, introducing new higher bonuses. The principle "to everyone according to his work" must be backed up economically.

This might be especially interesting for you. We feel that our standing on international markets should change. Many ministries and individual enterprises have now obtained the right of access to the foreign markets. They also retain larger part of their hard-currency proceeds. Steps are planned to strengthen the

rouble, make it a convertible currency. The structure of our foreign trade should be changed in a way that ensures us fuller participation in the international division of labour.

It was stressed at the Plenum that the ultimate success of this enormously complex and complicated economic reform depends on the continuation of the political process of glasnost and democratisation. New style of thinking, new style of management must lead to more active mass participation in governing the country - both economically and politically. A series of concrete measures to this effect were adopted.

We realise we face a difficult situation. It is aggravated by the fact that we undertake our reforms simultaneously on all directions. There will be a certain transitional period, when both old and new elements are going to co-exist within the economy, adding to the confusion.

That gives additional significance to the conclusion drawn by the Central Committee, that in political terms there is no opposition to the course of reform we have taken. There are people reluctant to face new challenges, vested interests who do not want to part with their fringe benefits, bureaucrats opposing a change as such. But the vast majority of people fully supports the party's call to make socialism more socialist, to make our system more efficient. We are sure of that, and on that certainty rests our conviction in the ultimate success of perestroika.

Although the Soviet Union and the United States have come close to reaching an agreement to eliminate intermediate- and shorter-range missiles in Europe, there are still obstacles to signing such an accord soon.

One serious stumbling block is the U.S. insistence on the right to convert Pershing-2 missiles into shorter-range Pershing-1Bs rather than eliminate them.

But the reverse process would be just as simple. Pershing-1Bs can be easily turned back into Pershing-2s within two days.

Nor does the United States want to destroy its medium-range cruise missiles in Europe. The Americans suggest now that the problem can be solved by removing their warheads or by transferring those missiles to battle-ships near Europe.

Another important issue is the standing U.S. proposal that the Soviet Union should reduce and dismantle its missiles unilaterally while the United States monitors us. At the same time, the U.S. arsenal would remain intact, and our inspectors would not be allowed on American bases.

If any U.S. warheads are left in Europe under any pretext, it could hardly be called a "true zero" level. I am sure Washington would make the same argument if Moscow decided to store some warheads in an East European country for its own or another country's missiles. Thus, the American insistence on keeping 72 U.S. warheads for use on West German missiles poses a serious problem.

The Americans want to deploy their remaining Pershing-2 missiles in Alaska, thus increasing the nuclear threat to Soviet territory without allowing a reciprocal threat.

We have agreed to U.S. request that our remaining SS-20 missiles not be deployed west of the 80th meridian in the Eastern Hemisphere, thereby preventing the missiles from reaching Western Europe. Our medium-range missiles would also not be able to reach U.S. territory. So why does the United States insist on deploying Pershing-2s in Alaska?

The United States is planning to increase the number of submarine-launched cruise missiles, to deploy more bombers and atomic artillery and to enhance the range of Lance missiles.

All existing asymmetries should be dealt with decisively through reductions by the side that is ahead to establish equal, low levels of troops and arms. Those levels should be sufficient for defense but should exclude any possibility to conduct offensive operations.

We are ready for a "global zero" option - the elimination of all U.S. and Soviet intermediate-range weapons - provided that American nuclear weapons in the Far East are taken into account, including those in Japan, the Philippines, and South Korea, and that the U.S. carrier-based force in the Pacific be removed beyond certain agreed on boundaries.

The possibility for elimination of intermediate-range weapons is ripe, and we do not want to miss this chance.

We are convinced that the agreement on elimination of intermediate-range nuclear forces in Europe, together with an agreement on key elements of a 50 percent reduction of strategic nuclear weapons and a ban on space weapons, could provide a solid basis for a future U.S.- Soviet summit meeting.

Our impression is that our negotiating partner cannot decide what is the proper course. The remaining obstacles can be easily overcome once America finds the will to do so.