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From the Private Secretary

11 February 1987

Dear dyn,

ANGLO-ITALIAN SUMMIT: PRIME MINISTER'S MEETING  
WITH THE ITALIAN PRIME MINISTER

The Prime Minister had a long tête à tête discussion with the Italian Prime Minister at the beginning of the Anglo-Italian Summit today. Signor Craxi was accompanied by Signor Badini. Foreign Ministers and Ambassadors joined the discussion towards the end.

Economic and Political Prospects in Italy

The Prime Minister complimented Signor Craxi on the performance of the Italian economy under his stewardship and invited him to give an account of the prospects.

Signor Craxi said that, when he took over as Prime Minister, the Italian economy had been a classical case of stagflation, with zero growth and 16% inflation. Italy now had higher growth than almost any other industrialised country, while inflation was stable at 4%. The unemployment figures remained high. But the real level of unemployment was much lower, possibly only half or less the official figures. For the first time (presumably since the Romans), Italy was beginning to import labour from the Third World. There was likely to be a labour shortage in Northern Italy in the 1990s. Acute problems of poverty and unemployment remained in the South, although it was not a consistent pattern. There were pockets of prosperity there as well. The most acute social problem was that of inner cities, with Naples the worst case.

Signor Craxi avoided any direct comment about the current political situation in Italy, beyond observing that the last four elections in Italy had been held a year early. In reply to the Prime Minister's question, he said that the Italian Communist Party were in crisis. Losing the referendum on indexation had taken the stuffing out of them. They were likely to lose votes in the elections, at least he hoped that they were. Their great dream remained an alliance with the Christian Democrats. But he was not disposed to worry about them. They were toothless.

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### Strategic Defence Initiative

Signor Craxi was concerned about recent statements from Washington on the Strategic Defence Initiative. The SDI had so far been on a carefully charted course, limited to research, with constraints on eventual deployment, and borne by the crucial proviso that the ABM Treaty should be respected. It was on this basis that Italy had supported the SDI. There now seemed to be a change of gear, although it was hard to understand exactly where matters stood.

The Prime Minister said that there had been a lot of careless talk. There was no question of deployment of an SDI system for many years. She believed that the undertaking given by President Reagan at Camp David in December 1984, that there would be no deployment without negotiation, still held good. What was at issue was how far research could be taken under the terms of the ABM Treaty. There was specific provision in Agreed Statement D to that Treaty for systems based on different physical principles to be the subject of discussion between the parties. The precise interpretation of the ABM Treaty was a matter for the United States and Soviet Union. Only they had access to the negotiating record. But in her view, it was a matter of commonsense that research should be taken to the point of establishing feasibility. If we tried to constrain United States research and testing unreasonably, we should only drive them towards abrogating the ABM Treaty.

The Prime Minister continued that the immediate issue was the need for the United States to consult its NATO allies before taking any new steps. We needed to re-establish the pattern of transatlantic consultation on these issues which had been broken by Reykjavik. Common European positions should be worked out wherever possible. More widely, it was important to recognise the consistent Soviet aim of achieving superiority in every category of weapons: ICBMs, INF, shorter range systems, conventional weapons and chemical weapons. The SDI would upset that superiority, which was why the Soviet Union was so determined to suppress it. No doubt when she went to Moscow Mr Gorbachev would try to get her to persuade the Americans to give up the SDI. He would fail. She did not share the worries of some people about the SDI. It was vital that the West should always be in the forefront on new defence technology.

Signor Craxi accepted that the United States would not give up the SDI and acknowledged the importance of the project. His problem was that the United States had mapped out a clear course which the Italian Government had explained to its public opinion. But that now seemed to be changing, and the whole programme accelerated. The Prime Minister said that she did not think there had been any basic change. At Reykjavik, the United States had offered a commitment not to deploy SDI for up to 10 years. That remained the official position. The Soviet Union should not be given a veto over deployment. The main point, which she wanted to stress, was



that there should be proper consultation within the Alliance on all aspects of arms control.

### East/West Relations

The Prime Minister said that she had found Mr Gorbachev's recent speech to the Central Committee Plenum very interesting. She wondered what Signor Craxi had made of it. Signor Craxi said that Gorbachev's aim seemed to be to make the Soviet system more efficient without changing its fundamentals. Although the new leaders were superficially different, they knew nothing but communism and had no real concept of alternatives to it. He therefore expected change in the Soviet Union to be minimal, with full control remaining in the hands of the party. The problem confronting the Soviet leaders was that they could not start down the road of liberalisation and stop after the first step. Liberty was explosive when you tasted it for the first time, as experience in Hungary and Poland had shown.

The Prime Minister did not dissent from Signor Craxi's analysis. Gorbachev clearly knew that the Communist system was not now delivering prosperity. It was less certain that he recognised that the system could never deliver prosperity. He would do nothing to put the system itself in jeopardy. China's experience was revealing. They had not got very far towards liberalisation before finding that they had to call a halt. What concerned her most was the impact of Gorbachev on public opinion in the West, and particularly in Europe. There was a risk that people would say he was a nice chap who was doing his best to change things, and that therefore he should be given what he wanted on arms control.

The Prime Minister continued that recent Soviet moves over Afghanistan demonstrated a more skilful style of diplomacy. There were worrying signs that Pakistan were bringing pressure to bear on the mujaheddin to give up the fight and on the refugees to return. Signor Craxi was sceptical whether the mujaheddin would give up and equally whether the Soviet Union would ever succeed in defeating them. They would have to sustain far greater losses than hitherto to do so.

The Prime Minister asked whether it was the case that Mr Gorbachev would be visiting Italy. Signor Craxi said that nothing had been decided about such a visit.

### Terrorism

Signor Craxi said that the Italian Government had largely succeeded in eliminating indigenous terrorism in Italy. The existence of some 2/3,000 former terrorists in prison remained a major problem. Efforts were being made to separate those who were prepared to disassociate themselves from their former activities from the hard-liners. But the real problem remained Arab terrorism. This showed no sign of diminishing. He was concerned by reports that the Israelis and Americans might be prepared to exchange 400 Palestinians held in Israel



for a single Israeli officer and the four American hostages. This would cut the ground from under the feet of countries who refused to engage in deals. Signor Craxi added that a magistrate had recently discovered fresh evidence of links between the Syrian Embassy and Arab terrorists operating in Italy. If confirmed, this would suggest that the Syrian regime had not changed its ways. The Prime Minister said that the United Kingdom was not prepared to bargain for the release of hostages. She was disturbed by what Signor Craxi had said about Syria. She had hoped that their experience with the United Kingdom and the FRG had taught them a lesson.

The Prime Minister welcomed the improved co-operation between the police and security services of the United Kingdom and Italy. We were concerned, however, that the Italians had not yet procured the equipment for a secure telecommunications link which had been agreed upon in the Trevi group. Signor Craxi appeared surprised and discomfited by this and said he would look into the matter.

### Libya

Signor Craxi reported some recent developments in Libya. Colonel Younis, Head of the Armed Forces, had apparently resigned. Major Jalloud was in Cairo. This suggested that something was afoot. The Prime Minister said that hopes of getting rid of Gaddafi had been raised too often in the past. She was sceptical. In any case, several of the potential successors seemed no better than Gaddafi himself.

### Lebanon

The Prime Minister said that President Gemayel would be visiting Britain shortly. There was little we could say to encourage him. Lebanon was a problem that could not be solved. The only reason for trying was to prevent the Lebanese people from losing all hope. Signor Craxi found it a scandal that the international community tolerated the situation in Lebanon. The only real solution would be for the major powers to mount an expeditionary force to restore order to Lebanon. The various armed bands who held sway there were not really significant in military terms. But he did not for a moment expect this to happen. The Prime Minister commented that the only prospect for peace in Lebanon lay in solving wider regional problems, such as the Iran/Iraq conflict and the future of the Palestinians.

### Ferruzzi Bid For The British Sugar Corporation

Signor Craxi asked about the outcome of the Monopolies and Mergers Commission inquiry into Ferruzzi's bid for the British Sugar Corporation. The Prime Minister explained that this was a matter exclusively within the statutory responsibilities of the Trade and Industry Secretary. She could not give any view on what conclusions he might reach.

At this point, Foreign Ministers and Ambassadors joined the meeting.



European Community

The Prime Minister said that she had told Monsieur Delors during his recent visit that the Community's priority must be to establish a system of financial discipline which actually worked. It was simply not acceptable to have a situation where member states individually exercised tight control over their public expenditure but there were no similar constraints on Community spending. Until such a system was in place, she was not prepared even to consider any new resources for the Community. An organisation which could not live within one income would not live within another. It was also essential to reform the CAP, both to get rid of existing surpluses and to prevent new ones being created. The British Government had played its part in this to such effect that the National Farmers Union had just passed a vote of no confidence in the Minister of Agriculture. That would not change the Government's policies one bit. Supply and demand must be brought into balance. The Foreign Secretary added that the problems of agricultural subsidies and surpluses were not limited to the Community. The United States and Japan were just as bad. This should be a major theme of the Economic Summit.

Signor Andreotti said that one had to distinguish between what was given as direct aid to producers and support delivered by maintaining high prices. At present, the CAP was tilted too far towards the latter. The balance needed to be corrected. Intervention mechanisms worked automatically and the costs of the CAP continued to rise without restraint. This could be laid at the door of continental rather than Mediterranean products. The immediate problem was that, as a result of the spiralling cost of the CAP, the Community had run out of funds. Desirable objectives agreed by the European Council such as a more extensive research programme could not be financed. The 1987 Budget must be settled quickly or the whole Community would come to a halt.

The Prime Minister said that everyone had to live within a budget. The Community could not be an exception. It was irresponsible of individual Ministers to agree policies and commitments for the Community which took spending beyond the ceiling. The only way to stop this was to make clear that there would be no more money. Without this discipline, they would go on breaking through whatever ceiling was established. It made no sense to give bankrupts more money to spend. Other industries were subject to market forces. Agriculture must be too. The agri-monetary system must also be reformed. The linkage to the strongest currency simply dragged all other prices up. Ministers should take the necessary decisions on the CAP at the price-fixing in March.

Signor Craxi agreed that if the Community was given new resources, it would simply go on as before. Some pain therapy was needed. Signor Andreotti brushed this aside and said that there must be new resources to finance the objectives which Heads of Government had adopted. He agreed about the urgency



of modifying the CAP. But individual countries must be forbidden to obtain competitive advantage by national financing. The Prime Minister said that social measures to help small farmers would have to be financed from national budgets although this must be done without creating further surpluses and without distorting competition. But she must repeat: the essential step was to establish effective budgetary discipline, and there would be no more money for the Community until that was done.

I am copying this letter to the Private Secretaries to the Chancellor of the Exchequer, the Home Secretary, the Minister of Agriculture, the Secretary of State for Trade and Industry, the Secretary of State for Defence and Sir Robert Armstrong.

*yours sincerely,*  
*C D Powell*

C D POWELL

Lyn Parker, Esq.  
Foreign and Commonwealth Office.

ITALY: Sunday p<sup>r</sup> 4

