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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

8 June 1990

Dear Stephen,

PRIME MINISTER'S VISIT TO MOSCOW

I enclose records of the Prime Minister's talk with the Chairman of the Moscow City Soviet, Professor Popov, and with the Soviet Prime Minister, Mr Ryzhkov.

I am copying this letter and enclosures to John Gieve (Treasury), Simon Webb (Ministry of Defence), Martin Stanley (Department of Trade and Industry) and Sonia Phippard (Cabinet Office).

Yours sincerely,

CHARLES POWELL

Stephen Wall Esq
Foreign and Commonwealth Office

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PRIME MINISTER'S MEETING WITH THE SOVIET PRIME MINISTER IN THE
KREMLIN: 8 JUNE

The following took part:

Mr Ryzhkov, USSR Prime Minister	The Prime Minister
Mr Sitaryan, Chairman of the State Committee for Foreign Relations	Sir Rodric Braithwaite Mr Powell
Mr Laverov, Head of State Committee for Science and Technology	Mr Turnbull
Mr Kvitinsky, Deputy Minister of Foreign Affairs	Mr Ingham
Mr Zamyatin, Soviet Ambassador in London	Mr Longrigg
Mr Uspensky, Head of Second European Department, MFA	

After welcoming the Prime Minister, Mr Ryzhkov opened the discussion by commenting that the Soviet Union was living through a complicated, but also an interesting period. Everything was changing, he hoped for the better. The Soviet Union was now in a critical decade which would determine the country's future in the 21st century. He hoped that they would enter this century fully prepared for what would lie ahead.

The Prime Minister said that if the Soviet Union could get their reforms to work it would be a marvellous end to a very turbulent century. All governments know that most battles were won on the home front: their people judged them by reference to their own standard of living. She commented that no country had ever achieved such a large-scale transformation from a centralised to a market economy as the Soviet Union was attempting. History showed that most people achieved freedom by pressure from below. The Soviet Union was attempting to introduce freedom from the top down. This was bound to be a very difficult task: people always wanted to know exactly where they stood. It would take time to change the legal system and, for example, to agree on which powers should belong to the Central Government and which to the Republics and regions. Enterprises would also have to learn how

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to develop initiative so that they could make the most of their new opportunities. It was easy to explain the theory: but practice was much more difficult.

The Prime Minister then said she would like to hear from Mr Ryzhkov how he thought the reforms were going and how they planned to move forward.

Mr Ryzhkov thanked the Prime Minister for the support she had always offered President Gorbachev and himself. He recalled that he had met the Secretary of State for Defence during his recent visit and had told him that, of all the foreign leaders he met, he had always felt he received the greatest support from the Prime Minister. He had read with interest the press interviews she had given before this visit and before the visit of President Gorbachev to Washington. He thought they contained a useful note of sobriety. In the Soviet Union, as in any other country, there was a wide range of political opinions. Mr Ryzhkov said that those he called 'left radicals' were always arguing that everything should have been done yesterday. Conservatives, on the other hand, argued that the Government should have done nothing at all.

When the Prime Minister interjected that British Conservatives were very progressive, Mr Ryzhkov replied that in a recent press article he had been called a 'progressive Conservative'. He was very happy with the term. He believed that Governments should always be a little bit conservative. But, as he told the Left Radicals, he himself was a radical and supported radical solutions. But there had to be an element of caution. Perhaps if they did not believe him they would believe the Prime Minister. She was right to say that the transition from one system to another would take ten years.

Mr Ryzhkov then turned to explain the country's economic reform plans in more detail. The first years of perestroika had been a period of preparation for change. Now the first real changes were beginning to take place. Not all, of course, were positive. For example, there was the problem with nationalities. There were at least 140 nationalities in the USSR. The exact figure was not even known. Mr Ryzhkov recalled that three months ago there had been a meeting in Moscow of the small peoples from

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the north and west of the country. Twenty six nationalities had been represented at this conference. The total population of these twenty six nationalities was only 180,000. Some nationalities numbered no more than 500 people. This was a serious problem. On the one hand, one understood their desire to retain their culture, language and traditions. But, on the other, even they knew that, biologically, they could not survive.

Mr Ryzhkov said that the recent violence in Kirghizia was an example of the problems they faced. He had been told that morning that the death toll had now reached 78 with hundreds injured. The situation was now a little calmer, but the atmosphere was still very tense.

Mr Ryzhkov said that the process of change was now taking place over a very wide front. Tactically, it would be easier if this front could be narrowed down. But in practice this was impossible. All the problems were inter-related. The Soviet economy had operated under a rigid centralised system of planning and distribution for more than 60 years. At some stages, Mr Ryzhkov believed, this had been the right system - for example before the war when it had been necessary to build up industry to resist Hitler, and immediately after the war when it had been necessary to concentrate efforts in certain directions in order to rebuild the economy. Two previous attempts to introduce a more flexible system - in 1965 and 1979 - had failed because the Government had realised that the process of change could not be restricted to the economy and had therefore brought it to a halt.

In the three years since the country's reform programme had begun, the Soviet Union had come a long way. Consequences had been both positive and negative. But even negative consequences were useful: one could learn from them. There was no such thing as an overnight change: this was for writers of fiction. One had to take into account the Soviet Union's particular difficulties - its size, the underdeveloped communications system, and three generations of people brought up under a system with very different ideas. The reform had now reached the stage where the old system had been dismantled. But the new system, based on a market, or partial market, had not yet been established.

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Earlier this year, the Government had reviewed the reform strategy. There had been two options: either to go back or to take a giant step forward towards a market. The Government had talked to hundreds of people - managers, financiers, bankers, etc. There were, of course, differences of view about strategy and timing of the reforms. But all had been unanimous that one could not go back. The Government's new plan, as the Prime Minister would know, had encountered sharp criticism from the people. This was because everyone turned straight to the section on price reform. But it was an integrated programme and needed to be looked at as a whole.

Mr Ryzhkov cited the example of the Government's proposals for the reform of enterprise taxation. From 1 January 1991, there would be a single rate of tax (on profits) for all firms. This would replace the old system whereby the Government had taken money from profitable firms to subsidise the unprofitable. He thought the reform would be adopted within the next week. It would force firms to be more efficient. Those that were not would go bankrupt. The Government estimated that some 20 per cent of firms would go bankrupt if they did not improve their performance. Finance policy would also be changed. At present the average interest rate in the economy was 2.4 per cent. One of the fundamental problems of the economy was that money played only a secondary role.

The Prime Minister asked how firms could know whether they were making a profit when there was no proper system for calculating costs. It might be possible for a farmer to do this reasonably easily. But for a factory, one needed a whole new cost and accounting system. Would a small businessman who faced, for example, a 30 per cent tax on profit know how to calculate his profit? It would also be very difficult for people who had been brought up in the old system to adapt to their new circumstances. They had always been told what to make, and it had always been someone else's job to sell what they made. People sometimes got irritated in Britain when they produced high quality products but could find no new market for them. But the point was that if no one wanted to buy the product it should never have been made in the first place.

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The Prime Minister said she knew about the problems the Soviet Government was having with food prices. Sometimes one had to sell food at below production cost. But, more generally, there was a choice. One could have low cost food - but only little of it as prices would not provide farmers with the incentive to produce. Or one could have sufficient food at reasonable but higher cost.

Mr Ryzhkov said that the whole Soviet price structure was distorted. Everyone talked about retail prices. But the real problem for the Government was wholesale prices. The Government had once boasted that a litre of petrol cost the same as a bottle of mineral water. But this had to be changed. The coal industry was operating on average at a 15 per cent loss.

The Prime Minister interjected that we too had problems with the British coal industry. It was still nationalised and therefore expected to have all its costs met. Governments should not become involved with fixing prices. When she had come to power there had been some fixed prices - for example milk. But this was something that should be left to farmers.

The Prime Minister asked whether there was anything more the United Kingdom could do to help, for instance with training people, particularly in distribution. She referred to the agreement on management training that she and Mr Ryzhkov were about to sign.

Mr Ryzhkov recalled that two groups of managers who had already been to the United Kingdom. They had been very pleased with the programme. The Soviet Union was also training its own managers, but the scale of this still needed to be increased. He then turned to the issue of bread prices. They would be increased - probably now on 1 August rather than 1 July. There would be 100 per cent compensation for the population. With the subsequent retail price increases of 1 January there would only be 70 per cent compensation. The Prime Minister asked what the purpose was of increasing bread prices if all the money was to be given back. Mr Ryzhkov said that the price increase would encourage people to economise. At present there was huge wastage. The price rise would also begin the process of readjustment. The extra money that people received would not all

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be spent on bread. He said the Government had received thousands of letters on this subject. Most had supported the price increase. People knew that bread was too cheap.

Noting that time was running out, Mr Ryzhkov said he wanted to raise one last issue - the fact that the Soviet Union was not an organic part of the world economic community. The rouble was not convertible. If it had been, the reform process would have been much simpler. They were, however, doing all that they could to speed up convertibility. They had told their CMEA partners that, from 1 January 1991, trade between them would be in world prices and in convertible currency. This had not been received with applause.

The Prime Minister said that this was natural. People did not like discipline. But some people understood it was necessary. The Soviet Union was rich in so many ways, for instance in natural resources, that she was sure that once they had got their priorities right, the country's prospects would be very good indeed. She said she had confidence the Soviet Union could succeed. One had to be an optimist.

Mr Ryzhkov confirmed that he was. Things were very difficult now, but he looked ahead with confidence. The most difficult thing was to change the mental attitudes of the population. The Prime Minister assured him that he had numerous well-wishers in the UK and full support from her Government. She understood that the Soviet Union could not do everything at once. But one always needed to go a little faster than people wanted. It was like training a skier: you had to persuade him to go faster than he thought he could. One also had to understand, as she knew from her own experience, that no one thanked you for introducing reforms. People took the benefits for granted and complained about the problems. But she had great faith in the Soviet leadership. She understood that Mr Ryzhkov was very preoccupied at present. But she hoped that we would be able to see him in London soon.

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fileNOTE FOR THE RECORD

cc: HM Ambassador
Mr Powell
Mr Ingham

**PRIME MINISTER'S VISIT TO MOSCOW CITY SOVIET
0930 HOURS, FRIDAY 8 JUNE**

On arriving at the Moscow City Soviet, the Prime Minister was given a brief presentation by the Carroll Group of the proposed British/Soviet Trade Centre project. The Prime Minister was shown a model of the twin-tower hotel and business complex.

The Prime Minister, accompanied by HM Ambassador, then had a discussion with the Chairman of the Moscow City Soviet, Professor Gavriil Popov. He was accompanied by Mr Luzkov, Chairman of the Executive Committee.

Mr Popov said the Soviet Union had 70 years of experience of moving from a market to a state-controlled economy: no one ever imagined it would be necessary to make the transition back. He identified two specific Moscow problems. First, there was now a position in which the Government was of one political persuasion and the City of another. There was no experience of this, nor did the legislation provide for it. He was, therefore, thinking about a special law for Moscow which could provide a precedent for the rest of the country. Secondly, Moscow was a non-market City. In his view, the central problem was to give property to the people. Without this they could not be expected to partake fully in a democratic society. The Soviet Union had started to build democracy without the necessary economic basis to accompany it. The fact that the process of distributing property was lagging behind explained why there was such political turmoil. He warned that radical populism, if not backed by economic changes, could turn into conservative populism, with the danger that there could be a return to bureaucratic socialism.

Mr Popov continued that decisive action was required at all levels in society, but no single person or political party was capable of resolving the problem. Perestroika had been started by the Government and they had to be given credit for that. But

over time the area over which they could exert leadership was dwindling. The centre was diminishing while the radical and conservative wings were gaining strength. The centrist forces, including the President, were not capable of leading the country alone; it was essential, therefore, to think in terms of a coalition. The President should lead the country but should form a union around him for left-wing and conservative forces, both shorn of their extremists. After Mr Popov's political grouping had won the election they had formed just such a coalition. It was essential to see the same thing repeated at the level of the Russian Federation and the Soviet Union. He described the President as a great diplomat who, through negotiation, had achieved important international agreements. He should now turn those talents to domestic issues.

The Prime Minister said the role of Government was to create new opportunities, and it was for the people to take them up. But, if this was to work, new firms or businesses should be sufficiently free and not tied up in bureaucracy. There had to be a degree of regulation to set general standards, but this should not be too detailed. She asked whether the lines of responsibility between central government and local government were drawn clearly enough.

On the latter, Mr Popov replied that Moscow itself was drafting the law. On regulation, he said the laws passed by the leadership were still too detailed and were passed on the premise that people at the top could tell others how to live. All the laws adopted in recent years would have to be changed. It was essential to allow the man in the street to be master of his own life, though he recognised that many were not yet ready to take on that responsibility. They had lived for too many years like clients of an hotel.

The Prime Minister said that all revolutions were led by the few. For the revolution to a market economy to succeed, some people would prosper and others would have to be prepared to see that happen. She asked whether feelings of envy were still present. Mr Popov replied that there was some progress but this was far

from complete. He went on to give some examples of the kind of issue the City had to tackle. The kindergarten system, which he described as a shambles, was heavily subsidised by the State, which paid five roubles for each one paid by the parents. The system had to change to give parents more responsibility, together with a withdrawal of State subsidy. In housing, people should be encouraged to own apartments and shops, and service industries should be transferred to private ownership. He felt that the Supreme Soviet laws gave sufficient scope to start this process. As the number of people who became owners grew, the pressure for change would grow also.

The Prime Minister asked whether the City Soviet had started to reduce the number of people employed. Mr Popov said a decision had been taken to eliminate one entire level of administration; this was the highest level, the most remote from administrative problems. Staff numbers were being cut by 200-300, around 20 per cent. It would be possible to go further once responsibility for retail trade had been transferred to the private sector.

The Prime Minister raised with Mr Popov the British Embassy's accommodation problems. Applications for visas were increasing rapidly and cultural exchanges were being developed. The existing offices were having difficulty coping and queues were forming. This created entirely the wrong image for Britain. She therefore urged the City Soviet to approve the proposals for new offices that had been put to them. Mr Popov said that Embassy officials had met Mr Luzkov, Chairman of the Executive Committee to discuss these problems. The Moscow City Soviet were ready to resolve these problems.

The discussions, which lasted about twenty minutes, were extremely amicable and open throughout.

AT

ANDREW TURNBULL

8 June 1990