



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

26 March 1987

File LB

LOBAGL

cc fro

Sir PC

Many thanks for the thoughts in your letter of 18 March on likely Soviet tactics on arms control during the Prime Minister's discussions in Moscow, and for the enclosed paper on Soviet perspectives on British Security Policy. These are both welcome. I share your interpretation, on three points in particular.

First, I agree that in discussions of conventional arms control Soviet claims that "rough balance", or "sufficiency" exists in Europe must be firmly rejected. The disparity in major weapon systems is even greater than that in manpower. And the greater the reductions in nuclear weapons the more important it will be to redress conventional imbalances. Soviet calls for agreed numerical or percentage reductions which will not correct existing imbalances must be resisted. As to negotiating tactics, we should not let MBFR wither on the vine, as the Russians would undoubtedly like, without a satisfactory quid pro quo. Like you we have heard the Russians may be preparing to launch a new proposal on conventional arms. We must not be wrong-footed in our public response. But a UK pre-emptive bid is not on the cards, given the stage we have so far reached in discussion within the Alliance.

Second, I agree that a main Soviet concern is the US SDI programme. The problem here is, of course, the difficulty imposed by the widespread public knowledge of the US programme and the largely unacknowledged nature of the Soviet programme. The Russians seem to bid for an end to the US programme as a condition of reductions in strategic weapons while remaining free to pursue their own BMD activities. That is obviously an unrealistic posture and a way through the problems will have to be found. One way to achieve this would be for both sides to talk seriously about the range and scope of their activities and thus reduce the risk of unexpected and unwelcome surprises.

Third, I agree that the Russians have by no means given up their attempts to constrain our own strategic deterrent, notwithstanding their recent acceptance that the latter need not be included as part of NATO'S LRINF. Our well known conditions for considering a British contribution to arms control remain unchanged. Finally, on INF linkages I agree

BT

that the Russians may be prepared to accept that some way of dealing with the present imbalances must be found. But their way of doing so is rather blurry at present, and may well turn out to be rather different to our own. As for their ultimate aim of a completely denuclearised Europe, that of course is something the Alliance cannot accept; our defence will depend on nuclear deterrence for the foreseeable future.

I am less certain than you that they will want to link INF to the conventional imbalance; indeed, I would be surprised if they were exactly eager to set such an obstacle in the way of their "denuclear ambitions".

The Prime Minister is very grateful for all your help.

CHARLES POWELL

C. N. Donnelly, Esq.



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

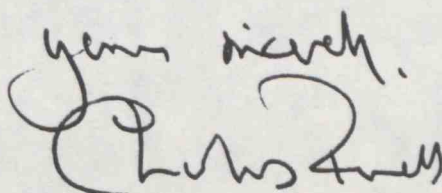
20 March 1987

Dear Lynn,

I enclose a copy of a letter I have received from Chris Donnelly at Sandhurst on a number of arms control issues which are likely to come up during the Prime Minister's visit to Moscow. The letter is written in response to a direct request from the Prime Minister for any advice which he wished to offer.

BF || I do not myself find that the letter offers us much that we do not already know. But I should be grateful for a kindly response with some brief comments on his proposals.

I also enclose a paper which he has sent me from the Institute for Defense Analyses in Washington on Soviet Perspectives on British Security Policy. This appears to be largely a compilation of Soviet views and statements, and does not add much to the general sum of our knowledge.

Yours sincerely,

C D POWELL

Lyn Parker, Esq.
Foreign and Commonwealth Office

DAS

file DASAFE
cc PC



CHARLES POWELL ESQ MP
10 DOWNING STREET
LONDON SW1

C N DONNELLY ESQ

SOVIET STUDIES RESEARCH CENTRE
THE ROYAL MILITARY ACADEMY SANDHURST
CAMBERLEY SURREY GU15 4PQ
{Camberley 63344
Telephone Ext 346
{Camberley Military

18 March 1987

Dear Charles

Thank you for your letter. By all means hang on to PHV's book till after Moscow. A lot of material is coming out now, stressing some significant themes, viz (a) conventional force reductions and (b) Trident. Our interpretation is as follows:

1. We should expect Soviets to link INF not only to short range nuclear forces but also to the conventional force balance.
2. There are far more real savings for both sides in conventional force reductions than in nuclear reductions. It is in Gorbachev's interest to cut defence resource allocation to enable him to improve his economy.
3. The Soviets have been keen to stress that in their opinion there is really a conventional military balance in Europe, although they admit that there is some assymetry as to who has which weapons. It is important to establish that we do not accept their figures and to explain why.
4. Any new proposal might be expected to be for a percentage reduction on both sides, rather than the previous unattractive Soviet proposals of reductions in equal numbers.
5. Given the current NATO-WP force structures, % reduction of overall troops and equipment from teeth arm units (tanks, infantry, artillery, etc.) will

benefit the Warsaw Pact, i.e. if both sides have one million men, the WP has a much larger % of its men in teeth arms and NATO has more in rear services. An overall reduction of 10% teeth arm manpower on both sides will leave NATO relatively weaker in combat power (and therefore more vulnerable to surprise attack).

6. Any % reduction on both sides reduces NATO's force:space ratio which makes cohesive defence more difficult. The Russians already have a saturation of force:space ratio (i.e. they have more troops than they can fit onto offensive axes, given the nature of the terrain) and can well afford to reduce this. There are many other complicating factors.

7. Several small indications point to an early Soviet proposal on this issue. Gorbachev has already prepared the military to expect this and it would be in line with keeping pressure on the West and hindering too careful a consideration of INF offer before decisions are made and announced.

8. Place and timing of proposal could be (a) at Vienna just before the PM goes to Moscow, with the expectation of discussions on the subject in Moscow, (b) in Moscow or (c) in Prague in early April.

9. Attack being the best means of defence, and the Russians being vulnerable to surprise, the PM might like to get in first with concrete and specific proposals on conventional force reductions and seize the initiative. It will annoy Gorbachev to be pre-empted. However, no offer should be made for which we would not welcome acceptance. The most likely response to an unwelcome offer is a Soviet counter-offer, proposing something different.

10. Whatever future offer is made on INF, SRF or conventional forces, we remain convinced that the Russian's main target will be to undermine support for the continuation of SDI research.

11. Accompanying Soviet official statements that they do not expect unilateral disarmament moves, the UK Trident system is now coming under more flak as being 'pointless' or 'so called independent'. We expect this to come under pressure down the lines.

12. If you have a surfeit of advice of this kind do please let us know. It is not our wish to waste your time and ours sending you unnecessary letters.

13. I am sending under separate cover ^ya paper for your interest. As far as the interpretation of Soviet attitudes goes, we are in general agreement with it. Please note the caveat on the covering letter.

very best
wishes

Chris

↓ enclosed

RESTRICTED



Foreign and Commonwealth Office

London SW1A 2AH

26 March 1987

Dear Charles,

Letter to the Prime Minister from Chris Donnelly
at Sandhurst: Arms Control

Thank you for your letter of 20 March enclosing a copy of a letter from Chris Donnelly at Sandhurst and a paper on Soviet perspectives on British security policy. As you say, there is little in Mr Donnelly's letter that is new. I attach a draft reply along the lines you requested. Mr Donnelly suggests that the Russians might launch a new initiative on conventional arms control on the eve of the Prime Minister's visit to the Soviet Union. There have been numerous rumours to this effect and we are preparing a response on a contingency basis. Mr Donnelly's suggestion that the Prime Minister should preempt this with a proposal of her own is, I fear, somewhat over-ambitious. NATO is still far from agreeing on concrete and specific proposals to redress the conventional imbalance.

Mr Donnelly's point that the British deterrent will again come under pressure is well taken. We have ample evidence that, having first raised the issue in 1969, the Russians are not going to drop it once and for all in 1987, with or without an INF agreement. As you already know, the brief for Moscow contains suitable material to rebut Soviet demands and claims.

Yours ever,

L Parker

(L Parker)
Private Secretary

C D Powell Esq
PS/10 Downing Street

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DSR 11 (Revised Sept 85)

DRAFT: minute/letter/teleletter/despatch/note

TYPE: Draft/Final 1 +

FROM:

Reference

No 10

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DEPARTMENT:

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Your Reference

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ROOM NO:

SECURITY CLASSIFICATION

Top Secret

Secret

Confidential

Restricted

Unclassified

TO:

Copies to:

C N Donnelly Esq
Soviet Studies Research Centre
The Royal Military Research
Sandhurst, Camberley
Surrey GU15 4PQ

To [unclear]

SUBJECT:

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..... In Confidence

CAVEAT

Many thanks for the thoughts in your letter of 18 March on likely Soviet tactics on arms control during the Prime Minister's discussions in Moscow, and for the enclosed paper on Soviet perspectives on British Security Policy. These are both welcome, I share your interpretation, on three points in particular.

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Enclosures flag(s)

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Finally, on INF linkages I agree that the Russians may be prepared to accept that some way of dealing with the present imbalances must be found. But their way of doing so is rather blurry at present, and may well turn out to be rather different to our own. As for their ultimate

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grateful for all your help.

Oh.



SOVIET UNION

PM'S VISIT

1/47



file 26

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

16 March 1987

I should have written before to thank you for your notes about the Soviet proposals on INF and for the various articles. The Prime Minister found these very helpful, both in deciding our immediate position on the Soviet proposals (or acceptance of Western proposals, as it should more accurately be described) and for deciding how best to pursue these matters in her discussions with Mr. Gorbachev at the end of the month. She was particularly grateful to you for having come in to discuss the problem at such short notice.

I have held on to Mr. Vigor's book "The Soviet View of Disarmament". If you agree I would like to keep this by me until after the Moscow visit but will return it promptly thereafter.

Thank you again for all your help.

CHARLES POWELL

C. N. Donnelly, Esq.

slw



CHARLES POWELL
10 DOWNING STREET
LONDON SW1

C N DONNELLY ESQ

SOVIET STUDIES RESEARCH CENTRE
THE ROYAL MILITARY ACADEMY SANDHURST
CAMBERLEY SURREY GU15 4PQ
{Camberley 63344
Telephone Ext 346
{Camberley Military

3 March 1987

Dear Charles

I enclose herewith the notes and one or two articles of interest. Should you wish to contact me, Lt Col Stanford on the above number, or my wife on 0264 75 322 will be able to help. I shall be back in MOD (MO4, Major Boscawen 218-3939) on Friday morning for an afternoon lecture.

I also enclose Peter Vigor's book, which I can wholeheartedly recommend. Perhaps we could have it back in the long run as it is our only copy.

Yours age

Chris

TEXT COMMENTS

1. Text p.3 para 2. N.B. omission from Downing Street text.

2. Para 2 "should": link with SDI? Needs to be clarified. See 3(v) below.

3. Why has G done it now?

(i) because of need to get US action by the summer to be ratified by their Administration. Waiting even a month adds serious delay. US 'Positive' action in six months is to be expected.

(ii) to exploit President Reagan's vulnerability and need to find a political advantage post "IRANGATE".

(iii) to exploit the PM's desire to seize popularity before an election.

(iv) to put pressure on the PM now, especially by the opposition, etc. so that she arrives in Moscow with proposals to table instead of listening there and coming home to think about it.

(v) Ending the moratorium - typical Soviet heavy-handed pressure on European fears, especially Germany.

(vi) Soviet aim - to keep up pressure and "rapid fire" on West, so we must expect more of same. See FT 3/3/86 attached, statement by Bessmertnykh. This is the thin end of the wedge and it is going to be driven in hard.

4. Text includes e.g. page 1:-

para 2: "survival of humanity"

para 3: "logic of humanity's suicide".

G has been using this line a lot lately, and is playing this card for all it's worth, that "the world is moving towards disaster", etc. This is very

effective propaganda with the peace movement.

(a) The fact remains that it is nonsense. We are no nearer an East-West war today than we were, say, twenty years ago.

(b) G must know it is rubbish.

(c) Its inclusion here means that there is a considerable element of psychological warfare about the current proposal and this is an important indicator as to the aim of the current proposal and why it has been launched in this way.

5. The Russians cannot do away with all nuclear weapons while the Chinese have some, but they would do away with weapons in Europe and US which could hurt them, so to this extent, the offer is 'genuine'.

6. N.B. The concept of "Equal Security", in the Soviet sense of that phrase, means very little security for the West.

Policy Considerations: What to do.

1. G's offer is difficult to answer without going into a long lecture on military strategy to a UK public which doesn't want to hear and an opposition which refuses to listen.

2. Ideally G's proposal should be rejected - perhaps made palatable by referring to the "need to keep an effective deterrent".

3. The line to play if this point is pursued might be to come back to the

fundamentals of nuclear deterrence.

- "It is a fact that there have been lots of wars since 1945 but none where both sides had nuclear weapons. Therefore, the evidence is that nuclear deterrence works, and that non nuclear deterrence does not. [Chemical weapons, when in the possession of both sides, may deter either of them using them, but they do not deter war per se.]

- Therefore what we want is to keep the peace and prevent war, so nuclear deterrence must be kept effective.

- As things stand today it is at least possible that if the only nuclear deterrents were strategic, then the Russians could put military pressure on Europe, or act in Europe, on the reasonable expectation that the US President will not launch ICBMs.

*

N.B. To talk of nuclear war escalating from tactical to strategic automatically, or even of the likelihood of escalation, is rubbish, although the Russians do peddle this now as a propaganda line.

MRMs are in Soviet terms "Operational-Tactical", i.e. they link tactics with strategy.

- The USSR will not be deterred by the threat of damage only to Eastern Europe or to the Soviet Army. Such damage they regard as undesirable, but they also think it acceptable. The reason for the existence of Eastern Europe is to soak up war before it reaches the USSR. The Russians are only deterred by damage to the USSR, and INF can do this.

4. If the US goes ahead, the logical step is for the PM to put together an European defence effort where Europe stands on its own feet and develops its own MRMs. If the US takes its own missiles out of Europe, we need missiles capable of reaching the Urals which are actually located in Germany.

5. The US may force Europe to become a unified military-political entity. This will make the world a less stable place, because 2 power blocs can balance easier than 3 (or 4).

6. Suggestions for speech re: above.

(a) Point out that world is not getting more dangerous.

(b) Escalation is not automatic.

"My prime concern is to keep the peace in the world and prevent a new world war"
- keep returning to this theme - this is the message that needs getting across.

"We are against the abandonment of MRMs because if we scrap that element of our nuclear deterrent, the Western deterrent as a whole has much more limited practical value".

What to say

1. There is no easy way out because of the 'Open Door' presented already by the US.

2. Avoid being rushed - "Too important an issue for rash actions". "If the Russians' proposals are serious and in good faith, they will leave them on the table and will wish to enter into serious negotiations." "If they try to rush

it means that they are not sincere or else that they are trying to steal a march on us."

3. G may be being rushed by his own need for success in Foreign Policy, but he dare not make concessions which do not bring gain to USSR. He is not guaranteed tenure of office like President Reagan! If he gives away security, the military will topple him from power.

4. MRMs are crucial link between tactical and strategic missiles. To take out IMF alone will upset the nuclear balance. See FT 26/2/86 p2 attached.

5. Disposing of nuclear weapons will lay us open to conventional attack, so scope exists for linking their abolition with conventional force reductions, perhaps whilst leaving residue of MRMs but see attached notes of the problems of conventional force reductions.

6. Effective monitoring and verification are essential for mutual confidence, whatever is agreed.

7. Point out the need to tie the US to Europe for our security.

8. Cautious agreement in principle could be followed by long negotiations - certainly longer than the 6 months the US proposes. It is very important to keep close watch on Soviet proposals and progress of negotiations.

N.B. The Soviets will be prepared to wait for longer than we are.

Conventional Balance: Important considerations.

1. There is an imbalance of combat power between East and West. We have more men but fewer tanks and guns. This gives Soviets a great advantage in high speed war.

2. Conventional reductions can be in terms of men, equipment or formations.

(a) Men

To benefit from manpower reductions we would need to restructure NATO along WP lines with more reliance on reservists. If this were done, then manpower reductions would hurt the Russians more than us. It might also encourage NATO to make much needed restructuring of forces and it would save money. But it would be painful for the NATO military.

(b) Equipment

Taking out a high proportion of any one type of weapon system is best way to imbalance the Soviet force structure and reduce their combat power. This would affect them more than it would us.

(c) Formations

We have already accepted without fuss a massive increase in Soviet conventional forces (26-30 divisions since 68) and in addition an increase in the strength of each division, without any corresponding increase in NATO forces.

3. Reduction of forces across the board reduces force to space ratio and makes it more difficult for us to defend Europe. This is as important as force to

●
force ratios, but is often forgotten.

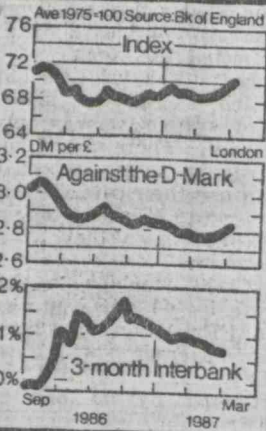
- if we accept a reduction in force density it makes destructive manoeuvre battle over Germany inevitable in event of war, or it makes fixed defences essential. The latter would require an amendment to the German constitution.

- Conversely if we increased our operational reserve in Northag (say by the basing in Europe of the US 3rd Corps) thus releasing the three 'doubled hatted divisions' to do their primary job, then any Soviet reply in kind (by adding another army or two to their forces) would not really worsen NATO's case because we would have improved our force to space ratio, and the Russians would find it difficult to place and use more forces in the space available in Eastern Europe.

FT. 3rd March 87

FINANCIAL, ECONOMICS CORRESPONDENT

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strongly.
At last month's meeting of finance ministers from the leading industrial nations, the Chancellor indicated he had set a ceiling for sterling's value in order to preserve the competitive gains flowing from last year's devaluation.
A reduction in the target for

next year's public sector borrowing requirement could provide the trigger for lower interest rates, which would then be presented as an endorsement by financial markets of the Government's policies.

The general expectation in the City is that the Chancellor will have room to lower the target by £2bn to £5bn, and still have scope for tax cuts of £3bn.

The present healthy state of public finances was underlined yesterday when the Bank of England announced the issue of £1bn of 9 per cent Exchequer stock 2002.

Dealings in the issue will begin tomorrow but buyers will have to make only a part-payment of £20 per £100 of stock. The balance of £76 per £100 is not payable until April 27, indicating that the authorities' funding programme for the present financial year is more or less complete.

Separately, the bank con-
Continued on Back Page
Money markets, Page 33;
Oil price falls, Page 32

between INF and conventional forces, officials said: "We have always identified the fact that, before you could move to extremely low levels of nuclear weapons, you would have to solve your conventional force imbalance."

These considerations have also been stressed in the generally favourable reactions to Mr Gorbachev's proposal from the US's European allies. There was only one dissenting voice in the welcoming chorus—that of France.

After meeting Mr Paul Nitze, President Reagan's special arms adviser, and Mr Richard Perle, the US Deputy Defence Secretary, in Paris, Mr Jean-Bernard Raimond, French Foreign Minis-

Akhromeyev, Soviet Armed Services Chief of Staff, confirmed that the proposed INF deal would not involve British and French nuclear forces, but stressed that, sooner or later, they would have to be placed on the negotiating table.

Mr Alexander Bessmertnykh, a Deputy Foreign Minister, made it clear that Moscow expected a positive gesture from the US on the whole complex of arms control issues in return for Mr Gorbachev's offer on INF.

"We proceed from the viewpoint that the important new Soviet initiative will motivate the US to take reciprocal steps on the whole question of nuclear and space weapons"
European reaction, Page 2

buys US bond broker

BANKING CORRESPONDENT

exchange... ker, has... ne of the... the US... t... se British... Treasury... (£50.5m)... terest in... l by the... e remain-... e shared... ew York... Over six... out the... be deter-... ability... the first... y Exco... er at the... itish and... shipping... company... an, who

founded Exco in the 1970s. It will be financed from the substantial cash resources B&C acquired with Exco. Completion is expected by the end of May.

Details of RMJ's profits were not available yesterday but Mr Peter Goldie, managing director of B&C, said he expected the company to increase B&C's earnings per share by 5 per cent to 10 per cent.
Mr Richard Lacy, Exco's chairman, said the deal would provide "the missing link" in Exco's plan to have a securities broking capability in leading financial centres, in addition to its foreign exchange broking business. Exco has a presence in Tokyo, and RMJ recently received the approval of the Japanese authorities to open a Tokyo office. Mr Lacy said that the businesses would continue

to operate separately.
RMJ claims to have about 30-35 per cent of the US Treasury bond broking market. It also handles securities issued by federal agencies, including federally-backed mortgage securities. The acquisition includes RMJ's 70 per cent interest in a software house specialising in the financial services industry.

The acquisition means that three of the four major US Treasury bond brokers will be British owned. Mercantile House owns FBI, and Mills & Allen owns Garban. The fourth, Cantor Fitzgerald, remains independent. In addition, ICH owns a minority stake in a smaller US government broker, MKI.

Exco background, Page 22;
Lex, Back Page

CONTENTS

left of a tribal 20
still in the slow 21
ominee shareholder 11
nation order ... 11

Technology: how Japan has opened its lines of communication 15
Management: US venture capital moves 'non-tech' 16
Editorial comment: Mr Craxi goes with honour; settling the teachers down 20

European News ...	2	Money Markets ...	33	UK News:	
FT Actuaries ...	34	Overseas News ...	3	General	8-11
Foreign Exchanges ...	33	Parliament	14	Labour	12
Gold Markets ...	32	Recent Issues ...	34	Unit Trusts	35-37
Intnl. Companies 26-30		Share Information 38, 39		Weather	40
Leader Page	20	Stock Markets:		World Trade News	6
Letters	21	London	34	World Value E... ..	33
Lex	40	Wall Street	31	ANNUAL STATEMENTS	
London Opts.	34	Bourses	31	Leading Leisure ...	24
Management	16	Technology	15	Throgmorton Dual	
Men and Matters ..	20	TV and Radio	19	Trust	22

market and latest share index 01-246 8026; overseas markets 01-246 8086



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Best article we have seen on the subject

OVERSEAS NEWS

Robert Mauthner on the Soviet leader's surprise offer over nuclear forces
Gorbachev U-turn on European arms cuts

W Europe welcomes Soviet initiative

MR MIKHAIL GORBACHEV'S offer at the weekend to negotiate a separate agreement on the elimination of intermediate range nuclear forces (INF) in Europe is a major reversal of recent Soviet policy, though it is not a new proposal. Before last October's abortive Reykjavik summit between President Reagan and Mr Gorbachev, Moscow had indicated frequently that it was prepared to do a separate deal on INF and its position remained ambiguous even in the immediate aftermath of that traumatic meeting. During a tour of Western capitals in the wake of the summit, Mr Viktor Karpov, the former chief Soviet arms negotiator in Geneva, since replaced, still gave the impression that a separate INF agreement was on the cards. It was only subsequently that Mr Gorbachev confirmed the stance, which he had adopted at Reykjavik, that a substantial reduction of strategic offensive weapons, an agreement on the restrictions to be placed on President Reagan's space-based defensive system (SDI) and a deal on medium-range missiles must be treated as an indivisible package. That has been the Soviet position until Mr Gorbachev's surprise announcement on Saturday. In the meantime, however, the Western allies

have been able to put some order in their own house, after the disarray in the Nato camp when the sweeping proposals tabled by President Reagan at Reykjavik became known. The idea that western Europe might, within 10 years, be deprived of an effective strategic nuclear umbrella and medium-range missiles, coupled with a dangerous inferiority in conventional forces, sent a shiver down the spines of governments. Only a month after Reykjavik, Mrs Margaret Thatcher, the British Prime Minister, packed her bags for the US with the specific purpose of pinning down President Reagan on what he was prepared to offer the Russians and to make sure European interests were safeguarded. Out of that visit to Camp David came a joint statement which has served as the blueprint for the Western arms control position since. The two leaders confirmed that Nato's strategy of forward defence and flexible response would continue to require effective nuclear deterrence and that reductions in nuclear weapons increased the importance of eliminating the disparities in conventional forces. On the specific issue of nuclear arms control, any mention of a total elimination of strategic offensive weapons



Mrs Thatcher: key role

within 10 years—an idea floated briefly in the euphoric early stages of Reykjavik—was carefully avoided. Instead, President Reagan and Mrs Thatcher agreed on the following arms control priorities: a 50 per cent cut over five years in US and Soviet strategic offensive weapons; an agreement on intermediate range nuclear weapons with restraints on shorter-range systems and a ban on chemical weapons. These priorities were endorsed

and fleshed out at the Nato ministerial meeting in Brussels last December, when the allies expressed their full support for the envisaged elimination of US and Soviet longer-range INF in Europe and their limitation to 100 warheads in Soviet Asia and the US. At the same time they stressed that an INF agreement must not neglect Soviet superiority in shorter-range INF missiles and must provide for a commitment to follow-on negotiations in this field. Whatever the reservations and doubts they may have had about an INF agreement during the post-Reykjavik period of confusion, Nato's European members are now on record as favouring the elimination of medium-range nuclear weapons in Europe—the so-called zero option. The fact that Mr Gorbachev has said that he is prepared to begin talks immediately on "other theatre missiles" with a view to eliminating them, is an attempt by the Soviet leader to dispel the Europeans remaining fears about Moscow's superiority in short-range nuclear weapons. The reasons for Mr Gorbachev's change of heart can only be a matter of speculation, but it does appear to indicate a sense of urgency dictated by the domestic situation in the US.

Western analysts of Soviet policy have felt for some time that Mr Gorbachev was anxious to do a deal quickly with President Reagan and not wait for his successor for two main reasons. An arms control agreement would have to be concluded by this summer if it was to be ratified before the presidential election in 1988 and not become the subject of electioneering. A new president would take some time before undertaking serious negotiations on arms control. An agreement would thus be delayed by something like two years if it were not reached within the next few months. At the same time, Mr Gorbachev might have calculated that President Reagan's troubles over the arms-for-Iran affair would make him more anxious to bow out with a major foreign policy success, such as an arms control agreement. The disadvantage of Mr Gorbachev's latest proposal, from his point of view, is that it has taken the spotlight away from the demand that the US should abandon its intention to develop, test and eventually deploy space weapons. Now that Mr Gorbachev has broken one of the links in his Reykjavik package the pressure on Washington to hold back on SDI is bound to ease.

WESTERN EUROPE yesterday welcomed Mr Mikhail Gorbachev's offer to move ahead with a separate agreement on intermediate range missiles as a major breakthrough in the superpower arms control stalemate. Mr Hans-Dietrich Genscher, the West German Foreign Minister, reflected a feeling of satisfaction and relief among the allies, saying the proposal cleared the way for an agreement to abolish all US and Soviet medium-range missiles in Europe. In a statement, Mr Genscher called for speed negotiations in Geneva between the superpowers to tip an accord. In Brussels, Lord Carrington, secretary-general of Nato which has urged Moscow to negotiate a separate INF accord, said Mr Gorbachev's proposal appeared to be "substantial step forward." In Britain, a Foreign Office spokesman said Mrs Thatcher who is due to visit Moscow at the end of the month, has been placed in a particularly strong position to help move the superpower talks forward. Any removal of medium range missiles would directly affect West Germany, Britain, Italy and Belgium which have already stationed 316 US cruise and Pershing-2s under a 1979 Nato deployment decision. The Netherlands has pledged to start stationing cruise missiles next year. But the Dutch Defence Minister Mr Wim Van Eekelen, asked in a radio interview yesterday if the chances of deployment had receded with the Gorbachev offer, replied: "Yes, think so." Mr Gorbachev, in a shift of Soviet policy, said on Saturday night that Moscow was ready to negotiate a separate agreement with the US to remove medium-range missiles in Europe. Apart from removal of cruise and Pershings in Western Europe, such an agreement — known as the "zero option" — would mean the abolition of about 270 Soviet SS-20 missiles directed at the West, Nato says. Nato diplomats expect a focus of the Euro-missile debate to turn now to the question of Soviet SS-21, 22 and 23 short-range missiles. Czechoslovakia and East Germany.

Western military fears deal on medium-range missiles

BY DAVID BUCHAN, DEFENCE CORRESPONDENT

BENEATH the overwhelmingly strong political pressures on the West to embrace the new Soviet offer of an early and separate agreement eliminating medium-range nuclear weapons from Europe lie growing anxieties about the military consequences of such a deal. These anxieties, harboured by the Nato military in general and by one country in particular, West Germany, have grown as the prospect of the West's own zero plan of 1981 has come nearer realisation. Gen Bernard Rogers, the top Nato commander, summed up the concern last week when he said: "If medium-range missiles were cut to zero, and nothing were done to reduce the Soviet superiority in shorter-range nuclear and conventional forces, then we would be worse off than in 1979"—the date Nato decided to deploy the medium range Cruise and

Pershing 2 missiles. Whatever happens to the nuclear and conventional balance, Gen Rogers and some others (not only in the military) would like to keep in Europe some medium-range weapons capable of hitting Soviet soil, which at present only Cruise and Pershing missiles can do. Their argument is that a deterrent must threaten the Soviet Union itself and that Nato's flexible response strategy requires weapons able to hit Soviet soil, short of invoking the main US (or British or French) nuclear arsenals.

But in reality this argument has lost out to the pre-eminent political interest in taking the only arms control deal at present on offer. Without medium range missiles on either side, the West would still face a four or five to one inferiority in shorter-range missiles (defined as less than 1,000 kilometres). It would have around 100 nuclear-capable Lance missiles operated by various Nato countries and 72 Pershing-1 missiles in the hands of the West German air force, as against about 900 shorter-range missiles on the Soviet side.

Aware of growing Western concern on this score, Mr Gorbachev proposed at the Reykjavik summit a freeze on shorter-range weapons at their current level and subsequent negotiations to reduce them. He also promised in his weekend statement that as soon as a medium-range missile accord was signed, he would move out of East Germany and Czechoslovakia SS12/22 missiles put there in 1983 as a counter to Cruise and Pershing. If Mr Gorbachev's promises to date could be translated into a firm and verifiable agreement, this would probably satisfy most Nato governments, but not West Germany. The latter, on Nato's front line, is insisting that a medium-range missile accord must include a firm commitment to follow-on negotiations to reduce not only Soviet SS12/22 and

SS-23 missiles but also some 600 Scud B rockets with a range down to around 300 kms. Other Nato governments, Britain included, feel that such a condition may be impossible to reach, reaching the main goal of a medium-range missile accord. Other Nato countries also happen not to be directly threatened by the Scud. A Nato-Warsaw Pact conventional balance would be far harder to negotiate. The issue, unlike that of shorter-range nuclear weapons, has not been formally tied by Nato to a medium-range missile accord. But the Soviets would have to show clearly their willingness to make progress in the new Vienna discussions about reducing conventional forces from the Atlantic to the Urals, if they are to ease the Western military's deep qualms of being left without their "nuclear underwear" in the face of heavy Soviet conventional superiority.

"The argument is that a deterrent must threaten the Soviet Union itself and that Nato's flexible response strategy requires weapons able to hit Soviet soil, short of invoking the main US — or British or French — nuclear arsenals."

Banco Santander:

The Spanish bank with the highest market value

Consolidated Financial Highlights (US dollars* in millions)

	At 31st December		Increase %
	1986	1985	
Total Assets	20,946.8	17,460.8	19.9
Customers' deposits	12,895.7	11,824.3	9.1
Loans and discounts	7,955.5	6,434.7	23.6
Shareholders' equity	951.8	886.4	7.4

Row possible over I

BY SIMON HENDERSON

A DIPLOMATIC row between the US and Pakistan is possible after a confused denial to a newspaper claim in an interview with Pakistan's top nuclear scientists that his country has the capacity to make an atomic bomb. Dr Abdul Qader Khan, who runs a uranium enrichment plant outside Islamabad which has not been visited by international inspectors, has denied the comments attributed to him by the Observer in London. But his explanation is at odds with the comments of a Pakistani journalist who was also at the interview. In the Observer article,

written by Mr Kuldeep Nayyar, former editor of the Dehli-based Statesman newspaper, Dr Khan was quoted as saying that Pakistan had the bomb. It was producing highly enriched uranium suitable for nuclear weapons, and was ready to reprocess plutonium, other potential nuclear explosive. He said Pakistan would need to test a bomb, except in a laboratory. Dr Khan said from Islamabad yesterday that he had only met Mr Nayyar because he had brought to his home by Pakistani newspaper editor who was delivering a wedding

Haughey's vote pro

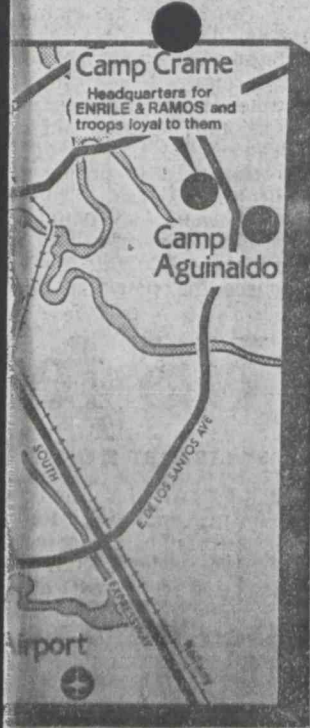
BY HUGH CARNEY IN DUBLIN

MR CHARLES HAUGHEY'S difficulties in securing election as Prime Minister when the Irish parliament resumes on March 10 after last month's

Mr Haughey remains favourite. No other party leader has any chance of success. If he were defeated or it was a tie, a serious dilemma

intensifies

FT. 26/2/86



back. Banks in the capital were closed as were many shops.

Mr Enrile and General Ramos controlled an increasing number of men as more senior officers defected to their side. Also at their immediate disposal were a dozen helicopters and the bulk of the air force.

The allegiance of the army under General Josephus Ramos, however, still appeared loyal to Mr Marcos. General Fabian Ver, Mr Marcos' armed forces chief, was believed to be still at his post.

Despite fears of an attack, however, a mood of rising expectation was spreading among people keeping vigil outside Camp Crame for a third night. Mrs Aquino was already being called president and the elements of the military which had turned against Mr Marcos were being described as the "new armed forces."

Mrs Aquino appealed to military officers and men to join her ranks. Opposition members of the National Assembly met to discuss reconvening as soon as possible. At least half a dozen members of Mr Marcos' party have joined their ranks which previously numbered about 80.

The crisis for the Marcos government is complicated further by the widespread criticism of the regime by Philipines' embassy staff abroad, such as in the US, Hawaii, Paris, London, Brussels and Bonn.

The Philippines' ambassador to London and 11 embassy staff yesterday called for Mr Marcos

Continued on Back Page

Philippines in crisis, Page 2

US tables plan to scrap intermediate missiles

By Stewart Fleming in Washington and Robert Mauthner in London

US NEGOTIATORS at the Geneva arms control talks have tabled "a concrete plan" calling for elimination of US and Soviet intermediate range missiles, including ground launched cruise missiles in Europe and Asia over a three-year period, President Ronald Reagan said yesterday.

But in his response to last month's proposal by Mr Mikhail Gorbachev, the Soviet leader, which would lead eventually to the elimination of all nuclear weapons, Mr Reagan said certain elements of the Soviet plan were "clearly not appropriate for consideration at this time."

"In our view the total elimination of nuclear weapons will require at the same time the correction of the conventional and other force imbalances, full compliance with existing and future treaty obligations, peaceful resolution of regional conflicts and a demonstrated commitment by the Soviet Union to peaceful competition."

The Nato allies welcomed the US proposals, but the Soviet news agency Tass said they were no more than a propaganda move.

The proposals, leaked extensively in the US press, were confirmed in letters sent by President Reagan to his principal allies, including Mrs Margaret Thatcher.

Although several European Nato members and Japan had expressed reservations about the US's original proposal to abolish medium-range missiles in Europe, while cutting the equivalent Soviet Asian-based SS 20s by only 50 per cent, the three-stage plan is much more to their liking.

The Foreign Office said it formed "a good basis for negotiation" and stressed that it was the result of intensive consultations within Nato. Britain and France are particularly relieved that President Reagan has turned down Mr Gorbachev's proposals in January that British and French nuclear forces be frozen as part of his plan to abolish medium-range nuclear weapons.

The Reagan plan was also welcomed by the West German Government as "a realistic formula," but there is continuing argument within the ruling centre-right coalition about the desirability of eliminating all US medium-range weapons in Europe.

What is worrying the Euro-

Continued on Back Page

less than two miles from camp.

Anti-Marcos forces fired rockets into the grounds of the presidential palace yesterday evening and firing was reported across town at Villamor Base in the afternoon. Firing started outside the presidential palace last night. At people were injured after police troops fired into a crowd of demonstrators.

International flights by Philippine airlines were cancelled yesterday and some scheduled arrivals were turned

Dollar falls sharply but Fed not alarmed

BY OUR FOREIGN AND FINANCIAL STAFF

THE DOLLAR fell sharply after a rise of 14 cents in north American foreign exchange last night as Mr

Stanton Martin, vice chairman of the U.S. Federal Reserve Board, said he felt a further fall in the currency would be a "cause for alarm" as long as it were accompanied by a continued flow of capital into the country.

The fall came to the end of a run which had seen sharp rises in many of the share prices of Europe, amid growing optimism about the likely improvement in company profits expected from the fall in prices. In London, the FT 100 Share Index rose 19.2 points to a record 1,275.2. Government bonds advanced.

In New York last night the market closed at DM 2.2615, slightly below the close in London where it had already risen 24 pfennigs on the day to DM 2.282. In the Washington market, the dollar fell sharply.

London to \$1.4635.

The comments on the dollar by Mr Martin to a meeting of state governors are likely to be interpreted as supporting the position of Mr James Baker, Treasury Secretary, who was perceived in the financial markets to be talking the dollar down during congressional testimony last week. An opposite view had been taken by Mr Paul Volcker, Fed chairman. He appeared concerned that confidence in the dollar is fragile and that the orderliness of the decline, and the steady flow of capital into the country, could be jeopardised by Fed policies perceived to be aimed primarily at lowering the currency's value.

The dollar's tumble came as both the Wall Street equity and credit markets were hitting records, continuing the recent

Continued on Back Page
Money Markets Page 41

BY LIONEL BARBER

SAATCHI AND SAATCHI, the fast-growing advertising and business services agency, announced a \$75m-plus (£51m-plus) acquisition in the US yesterday through its wholly-owned subsidiary, Dorland Advertising.

Dorland, the third largest UK advertising agency, is to be granted an option to buy full control of the advertising agency Dancer Fitzgerald Sample, which billed \$876m in 1985.

The new grouping creates an international advertising network called DFS Dorland Worldwide with billings of \$1.2bn, ranked 16th in the world, Saatchi said. On the stock market, Saatchi shares closed at 870p, up 23½ on the day.

The intricate deal aims to leave ownership and control of DFS with the US agency's key executives, while also allowing DFS Dorland, to operate autonomously from Saatchi's international network Saatchi and Saatchi Compton Worldwide.

In exchange for its option, Dorland will provide a \$75m loan to a company formed by

five DFS executives, to be called DFS Management Inc. These funds will then be used to acquire DFS from its existing shareholders.

Dorland will receive interest on its loan at a floating rate of up to 15 per cent per annum until such time as it exercises its option, at which point the loan would be waived.

A single further payment based on DFS's performance over the five years to December 1990 will probably be necessary. This would equal the amount by which DFS's aggregate earnings after tax exceed \$41m over the period, before payments on the Dorland loan.

In the 12 months to August 1985, DFS made profits of \$17.6m pre-tax, after adjusting

for bonuses and profit sharing. Net-tangible assets stood at \$34.7m.

Dorland's turnover has grown 30 per cent per annum since it was acquired by Saatchi in 1981, but it said that it needed an international link to maintain growth. Saatchi and Dorland, in spite of their ownership link, compete with each other in the UK; the idea is to repeat this pattern worldwide.

Despite the arms-length nature of yesterday's deal, Saatchi will retain financial control over the new grouping. The new network does not affect Saatchi and Saatchi Compton Worldwide's ranking of fifth in the world, Saatchi said.

Missiles Continued from Page 1

European countries most is that the elimination of medium-range missiles from Europe would leave them exposed both to the Soviet Union's short-range nuclear weapons based in eastern Europe and the Warsaw Pact's superior conventional forces.

However, UK officials have pointed out that President Reagan's proposals deal with these concerns, which were voiced during the meeting of Nato's special consultative group earlier this month.

President Reagan has proposed a freeze of short-range nuclear weapons at an equal ceiling for both the US and the Soviet Union, with the exact level to be subject to negotiation.

While no formal link has been established between agreements on strategic, medium-range, short-range and conventional forces, it is clear that they cannot be treated in isolation without upsetting the whole arms balance. The issue of so-called "collateral con-

straints" will therefore become increasingly important as the Geneva negotiations progress.

Under one option of the plan, the US is proposing that, in the first year which, it is hoped, will be 1987, the medium-range weapons of both sides in Europe should be reduced to 144 launchers each with proportionate cuts in Soviet Asian-based missiles.

The Soviet Union has 440 SS20 medium-range missiles, including about 250 in Europe and some 150 in Asia, with the rest in store.

The US has 168 Pershing-2 missiles in Europe and is working towards a target of 464 ground-based cruise missiles, making a total of 32 intermediate nuclear force weapons.

In the second year of the plan, the number of weapons would be halved again, dropping to zero in the third year.

Under a second option put forward by President Reagan, medium-range nuclear weapons in Europe and Asia would be reduced by equal amounts in three years "on a global basis."

Continued from Page 1 Shares

bull rally. In the equity market the blue chip Dow Jones Industrial Average ended the session 0.57 points higher at a record of 1698.28 having breached the 1700 level around lunchtime but fallen back when the rest of the market failed to follow suit.

In US credit markets prices bounded ahead in early trading and were further helped in afternoon trading by the unexpectedly sharp narrowing of the US budget deficit in January.

In London share markets Government bonds gained up to 1½ points and the yield of the FT-Actuaries 25 year high coupon gilt index fell to 10.08 per cent. Yields have not sustained a level below 10 per cent since the oil price shock in 1973.

Stock exchange trading volume was so heavy in Paris that the publication of closing prices was delayed by over an hour, to allow operators to handle the wave of buying orders.

Marcos Continued from Page 1

to "heed the clamour for a peaceful transition" of power.

The US announcement that it had urged Mr Marcos to try to facilitate an orderly transition of power indicated how intimately the US is involved in trying to use what it sees as its limited influence to avoid a bloodbath.

On Sunday afternoon President Reagan had met the full panoply of Administration foreign policy and national security officials for an hour and a half in the White House to hear a report from Mr Habib and to decide a course of action.

The statement issued after that meeting threatened to cut off US military aid to the Philippines if the government launched an attack on the rebels, but fell short of a clear demand for Mr Marcos to step down.

White House spokesman Mr Larry Speakes yesterday parried questions about what options the US was considering and whether it would offer Mr Marcos asylum in the US. No request had been made, Mr Speakes said.

He disclosed that the White

House had decided to send Mr Habib back to the Philippines and added that the US had received no response from Mr Marcos to its call for a peaceful transition. He said that US officials were in touch with opposition leaders.

Throughout the White House stressed that it was up to the people of the Philippines to decide on what government should take power.

The White House does not want to be seen pushing Mr Marcos too hard for fear that might make him more resistant to leaving.

SHARES YESTERDAY

(otherwise indicated)

+13	ICI	939	+ 39
+14	LASMO	158	+ 11
+11	Mount Charlotte	99	+ 6½
+11	Pearson	478	+ 15
+11	Photax (London)	73	+ 10
+15	Pilkington Bros	425	+ 25
+12	Redfearn Natl Glass	148	+ 14
+16	RTZ	614	+ 20
+9	Russell (A.)	130	+ 16
+10	SI	33	+ 10
+14	Stead & Simpson A	90	+ 12
+11	Thomson T-Line	163	+ 17
+12	Vickers	405	+ 35
+8	FALLS		
+27	Contl Microwave	310	- 30
+13	Lloyds Bank	470	- 18

UK TODAY: Mainly very cold but less so in NW. Snow showers in N. Strong winds in SW.

Y'day	midday	Y'day	midday	Y'day	midday
°C	°F	°C	°F	°C	°F
C	14 57	London S	2 36	Peking S	3 37
S	16 61	L. Ang. S	28 82	Perth F	23 73
F	4 39	Luxmbg. S	-3 27	Prague S	-7 19
C	12 54	Madrid R	10 50	Rykjvk. S	2 36
F	4 39	Majorca F	17 63	Rhodes S	17 63
C	16 61	Malaga S	21 70	Rome C	15 59
C	15 59	Mchstr. F	4 39	Salz'rg Sn	-3 27
S	-4 25	Melbne. S	22 72	S'ciscol F	10 50
C	3 37	Miami C	26 79	Singapr. F	32 90
S	16 61	Milan S	9 48	Stockhm. S	-11 12
S	1 34	Montr'l Sn	-2 28	Strasbg. S	-6 21
S	2 36	Moscow C	-8 18	Sydney C	20 68
S	-13 9	Munich C	-6 21	Tangier C	15 59
F	17 63	Nairobi S	29 84	Tel Aviv F	18 64
S	-5 23	Naples C	16 61	Tenaria S	21 70
F	2 36	Nwcastl Sn	1 34	Tokyo F	8 46
S	3 37	N Delhi S	20 68	T'rnto F	-2 28
S	14 57	N York S	3 37	Tunis S	-24 75
S	0 32	Nice S	15 59	Valencia F	17 63
S	24 75	Nicosia S	19 66	Venice S	6 43
S	20 68	Oporto C	13 55	Vienna S	-7 19
F	15 59	Oslo S	-6 21	Warsaw F	-7 19
S	7 45	Paris S	-1 30	Zurich Sn	-5 23

R—Rain, S—Sunny, Sn—Snow, on GMT temperatures.

Register
"Repr
Bracket