

PRIME MINISTER

MEETING WITH THE EGYPTIAN PRIME MINISTER

You are seeing Dr. Lutfi for 45 minutes before lunch tomorrow. He will be accompanied by the Egyptian Ambassador and an adviser. The Chancellor of the Exchequer and our Ambassador (Sir Alan Urwick) will also attend.

You might begin by enquiring after his back. He was in hospital in London for treatment in January/February, but left before you were able to see him. He is having it checked up this time.

The main purpose of his call is to brief you on the Egyptian economy and negotiations with the IMF. You will recall that you discussed this with President Mubarak in July (a note on the meeting is at the back of the folder). He complained that the conditions which the IMF were trying to set on cuts in subsidies, increases in interest rates and unifying exchange rates were too tough and would cause instability in Egypt. He also alleged that the UK Director was discouraging the IMF from showing flexibility. You can deal firmly with this latter point: like other donors, we are waiting for proposals from the IMF before taking up a firm position. But you will want to leave him in no doubt that agreement with the IMF is an essential step if Egypt is to receive Paris Club rescheduling and additional aid. As you told President Mubarak, it is important to set tough targets.

You might also take the opportunity to mention the forthcoming GATT negotiations. The Egyptians have thrown in their lot with India and Brazil in opposing the inclusion of services in the new GATT round. This is ridiculous, because services now amount to 20 per cent of world trade. A GATT round without services would drastically diminish the attraction for us (and would affect our ability to earn the income which enables us to give aid). The Americans might well pull out altogether.

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As you will recall, Lutfi is not well briefed on Arab/Israel  
and Iran/Iraq, but you may like to refer to both issues  
briefly, at the end. You are seeing King Hussein on  
20 September.

CDP

C.D. POWELL

9 September 1986

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Foreign and Commonwealth Office

London SW1A 2AH

9 September 1986

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Dear Charles

Visit of Egyptian Prime Minister

/ Following Caroline Ryder's letter of 20 August, I enclose a brief, agreed with DTI and HM Treasury, for the Prime Minister when she sees Dr Lutfi at 12 noon on 10 September. We understand that Dr Lutfi will be accompanied by the Egyptian Ambassador and Mr Farghal, a Counsellor to Dr Lutfi. On our side the Chancellor and Sir Alan Urwick will be present.

I am copying this letter and its enclosure to Tony Kuczys (HM Treasury), Tim Walker (DTI) and Michael Stark (Cabinet Office).

Yours ever

(R N Culshaw)  
Private Secretary

C D Powell Esq  
PS/10 Downing Street

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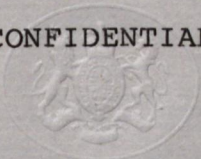
MEETING BETWEEN THE PRIME MINISTER AND THE EGYPTIAN PRIME MINISTER,  
10 SEPTEMBER 1986

OUR OBJECTIVES

- To ascertain Egyptian government's intentions regarding the economy; to urge Egypt to come to terms with IMF, assuring him of UK's continued support for economic adjustment, but without raising hopes of new capital aid.
- To get Egypt to play a constructive role at the GATT Ministerial.
- To underline HMG's concern to help promote constructive initiatives on Arab/Israel and seek Egyptian views, particularly on Taba and the prospects for success of current US diplomacy.
- To express concern at course of the Iran/Iraq conflict; to avoid raising hopes of active EC mediation during UK Presidency; to reiterate our strict policy on arms supplies to each side.

ARGUMENTS TO USE

- Exactly one year since we met in Cairo. Delighted to meet again, especially in view of EC Presidency. Valuable recent meetings with President Mubarak, Field Marshal Abu Ghazala and Dr Al-Baz. Mr Renton to visit Egypt this month.
- Welcome your commitment to economic reform and measures already taken. Prospects for a strategy agreed with IMF? Convinced this is essential first step towards recovery. Would increase prospects for longer-term prosperity, give vital boost to international confidence and unlock door to new resources.
- Recognise importance to West of Egypt's stability and prosperity. Assure you of UK's continued support (in EC, IMF and bilaterally).
- GATT Ministerial next week in Uruguay crucial for future of world trading system. Hope Egypt will use her influence to secure launch



of new GATT round.

- Deep concern at lack of progress on Arab/Israel before Israeli rotation. No sign of PLO adopting more constructive approach. Note moves towards agreement over Taba. What are the prospects? Is a Peres/Mubarak summit now on the cards? Know that Americans have been trying to promote Egypt/Jordan joint approach: welcome briefing and your perspective of progress made.

- Actively looking with European partners for ways to help the parties to move forward. Will continue this effort. In close touch with US also. Working bilaterally and through EC to improve conditions in Occupied Territories, as move towards, not substitute for, Israeli withdrawal.

- Increased activity and tension in Iran/Iraq conflict worrying. UN Secretary General reiterated on 13 August his readiness to work with the two governments. His efforts represent best chance of progress when chance for mediation opens up.

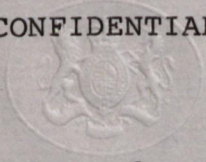
#### TACTICAL ARGUMENTS

- West cannot rescue Egypt from economic crisis. But can continue to provide support for action by Egyptian government.

- Fine balance between need for economic reform and threat to stability. But need to set tough targets. Long-term benefits of bold measures will outweigh short-term political risks.

- See no realistic alternative to Paris Club rescheduling. [If necessary] To ensure equality of treatment for creditors, not our policy to agree bilateral rescheduling outside Paris Club framework. Orderly rescheduling in best interests of all.

- Will aim to maintain an effective bilateral aid programme into the future, especially in field of technical cooperation. Will do best to promote bilateral trade (Trade balance has been in Egypt's favour this year). But concerned that progress on Cairo Wastewater project (which I inaugurated in September) threatened by failure to budget



for local cost contributions: hope for detailed progress at Joint Commission this month.

- Our bilateral food aid limited. Priority used for emergencies. 1986 programme already fully committed.
- Will remain major contributor to multilateral aid, especially through EC. [If discussed in detail] Recognise Egypt's continuing need for EC food aid to support progress towards self-reliance: but essential Egyptian Government does more to encourage local food production. UK supported early discussion of proposal to increase allocation agreed recently to 170,000 tons of food aid cereals.
- New Mediterranean Financial Protocols still under discussion within Community. Budgetary constraints are severe but want to see benefits of new protocols directed to poorer countries, including Egypt. Hard to see STABEX-type arrangements applying to Egypt.
- Policy on ECGD cover similar to other Western insurers: will continue to hold exposure within prudent limits. Hope defence tranche will be used.
- We sell more defence equipment to Iraq than to Iran.

#### HIS OBJECTIVES

- To explain Egypt's latest attitude towards negotiations with the IMF on an economic adjustment package; to seek UK help in ensuring IMF pay due regard to Egypt's difficulties and risk of provoking political disorder.
- Perhaps to express reservations about inclusion of trade in services in new GATT round.
- Perhaps to reiterate long-standing Egyptian call for a European initiative on Arab/Israel
- To express concern at cause of Iran/Iraq conflict and (perhaps) to urge EC involvement in mediation during UK Presidency.

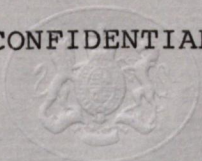


## OUR RESPONSE

- Sympathy with Egypt's economic difficulties. But IMF package, essential first step to allow Egypt towards economic recovery and obtaining necessary additional foreign assistance. Cannot intervene in detailed negotiations between Fund and authorities.
  
- Services must clearly be an integral part of new GATT round. Over 20% of world trade.
  
- Determined to work to help the parties to the Arab/Israel dispute to solve their differences. But role of outsiders limited. What positive trends in relationship between the parties do you identify which we could seek to strengthen?
  
- Iran/Iraq conflict is costly to both sides and to stability of whole region. All mediation efforts except UN Secretary General's have failed. Only he has confidence of both sides; 8 point proposals still on the table. EC should not muddy the water.

## PRESS LINE

1. Dr Lutfi visiting London privately (5-11 September). In his call on the Prime Minister on 10 September he gave her an account of the latest state of negotiations with the IMF over a package of economic adjustment measures for Egypt. The Prime Minister assured him of Britain's continued support, both through Britain's bilateral trade and aid relations with Egypt and in the context of Egypt's relations with the European Community and international financial institutions. The Arab/Israel dispute and the Iran/Iraq war were also discussed: the Prime Minister reaffirmed the willingness of Britain and the Twelve to support realistic initiatives to promote peaceful solutions.



## BACKGROUND

1. Dr Lutfi is coming to London from France, partly to consult his doctor about his back (for which he received hospital treatment here in January/February). He has asked to see the Prime Minister to follow up President Mubarak's tour of European countries in July to explain his government's intentions regarding the economy. A record of the Prime Minister's meeting with Mubarak is attached, together with a personality note on Dr Lutfi and a report from Cairo on the latest IMF mission to Cairo last month.

2. Though not the poorest of countries, Egypt suffers from longstanding economic mismanagement. With a \$40 billion external debt, a \$3.5 billion external current account deficit, 3% annual population growth and recent reductions in Egypt's foreign exchange earnings from oil, remittances from overseas workers, Suez Canal dues and tourism, the Egyptian government faces the dilemma of whether to opt now for IMF adjustment measures (including cuts in consumer subsidies, exchange rate unification/devaluation) which might endanger internal stability, or to go on deferring difficult and unpopular decisions and thus allow situation to exacerbate. Dr Lutfi appears to be cool towards opting for the IMF route.

3. The IMF's seal of good housekeeping, however, is an essential precondition for Paris Club rescheduling and significant new aid inputs. US aid (\$1 billion civil and \$1.3 billion military in FY87) is static, although some relief on military debt repayments may be possible. Prospects for new European aid are also slim. Since Mubarak's tour, only Italy has argued that the West should influence the IMF to adopt a softer line towards Egypt. We and other donors await Fund proposals before taking a firm position. Nevertheless, the Prime Minister will want to dispel firmly any misconception on Lutfi's part that the UK is less disposed than its partners to see Egypt benefit from assistance through the IMF or EC.

4. Because of competing claims elsewhere and the high level of US aid, UK bilateral capital aid to Egypt is set to fall over the next few years, though substantial technical cooperation will remain. The Prime Minister might raise with Lutfi the Egyptian failure to

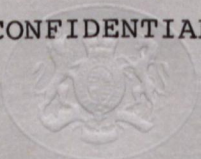


budget adequately local cost contributions towards Cairo Waste Water, our biggest development project in Egypt. ECGD cover is very tight, despite eleventh-hour agreement on cover for defence sales reached during Field Marshal Abu Ghazala's visit in June. ECGD's current and contingent exposure amounts to \$1.7 billion, equal to that of the FRG but less than that of France (\$6.1 billion).

5. New GATT round. Egypt has hitherto tagged along with the hardliners in Geneva (Brazil and India), in opposing a new round including trade in services. But there are signs that they are prepared to take a more flexible line at the Uruguay Ministerial, in the interests of achieving consensus.

6. Food Aid. Egypt's grain import requirements this year are likely to be some 7 million tonnes. Most of this will be provided by the US, either as food aid or commercially. The EC has agreed to provide 170,000 tonnes of grain as food aid. The Egyptians are looking to other donors to finance food aid shipments in order to minimise the amount they have to purchase commercially. The UK bilateral programme of some 110,000 tonnes of cereals is fully committed for 1986. We give priority to emergency needs and this year will be arranging shipments to Ethiopia and Mozambique. The balance will go to the World Food Aid programme. For some years the European Community has provided Egypt with substantial quantities of food aid. The latest EC food aid offer is linked to pressure from the Commission on the Egyptians to make major policy changes for encouraging local production of food.

7. Arab/Israel. Egyptian policy has been to promote the re-establishment of cooperation between Jordan and the PLO (broken off by King Hussein on 19 February). This has looked increasingly unrealistic. They have also urged Arafat to accept SCR 242 and called for closer European involvement in the peace process, but it is not at all clear what this could realistically be expected to achieve. Agreement has been reached with Israel on the terms of arbitration on Taba, but choice of arbitrators is outstanding and maps must be selected as a basis for their work. It appears that these remain serious obstacles to signature of the agreement, which could open the way for a Peres/Mubarak summit. Mubarak is under



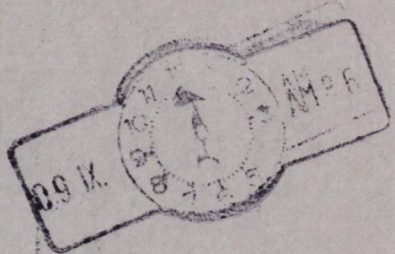
some pressure to agree to a summit to ease congressional approval of debt rescheduling. The US have been trying to promote a joint Jordan/Egypt/Israel statement on the principles for moving to a negotiated Arab/Israel settlement, but Hussein is understandably cautious.

8. The European Commission has announced proposals for improved aid to the Occupied Territories and access for produce. It is strongly in our political interests to urge the Commission to press ahead with them as a practical demonstration of our concern for Palestinians at a time of virtual stalemate in the peace process. Urgent consultations of the proposals is underway in Whitehall.

9. Iran/Iraq. The last month has seen increased attacks by both sides on targets in civilian areas and a further escalation of attacks on shipping in the Gulf. A major Iranian offensive is expected this autumn. Both sides are suffering economically because of the oil price decline. Egypt has maintained her firm support for Iraq.

NEAR EAST AND NORTH AFRICA DEPARTMENT

September 1986



cc Subject

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Subject Filed on  
EGYPT: Visits by  
President Mubarak. Pt 2



cc PC

10 DOWNING STREET

LONDON SW1A 2AA

*From the Private Secretary*

17 July 1986

Dear Robert,

PRIME MINISTER'S MEETING WITH THE EGYPTIAN PRESIDENT

The Prime Minister saw President Mubarak for an hour and a quarter this evening. Only note-takers were present.

The Prime Minister recalled her meetings with Field Marshal Abu Ghazala and Mr. Al-Baz, both of which she had found useful and constructive.

Egyptian Economy

The Prime Minister said that she understood that the Egyptian Government had approached the IMF for help. She had considerable sympathy with Egypt's difficulties. A number of misfortunes had struck simultaneously: the decline in oil prices, a falling off of tourism and a drop in revenue from the Suez Canal.

President Mubarak confirmed that the Egyptian economy faced serious problems. Moreover, Egypt's loans were not well phased and repayments would be at a peak over the next three years. Egypt had therefore been in discussion with the IMF and had reached satisfactory conclusions on most points. However, there were two outstanding difficulties. The first was the IMF's demand that interest rates should be increased from 11 per cent to 20 per cent. This would stop investment in industry and would drive up prices. Secondly, the IMF wanted Egypt's various exchange rates to be unified in the course of a single year. This too would lead to a very steep rise in prices. Were the Egyptian Government to accept the IMF's prescription on these two points, there would be a grave risk of instability. They were prepared to move as fast as politically feasible to implement the IMF's recommendations. But to accept them as they stood would lead to a repeat of the 1977 riots. Egypt would be thrown into turmoil and the whole area would be affected. Economic reform had to be tackled sensitively. Timing was very important. For instance he planned to increase electricity prices next April when the university students would be busy with exams and the chances of disorder thus diminished. He was therefore seeking the help of Egypt's friends to

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persuade the IMF to negotiate more reasonably on these two points. He understood that the British and German Executive Directors were offering the strongest resistance to flexibility on the IMF's part. He well understood that the IMF's recommendations were in Egypt's interests. He wanted to implement them as rapidly as possible. But the people had to eat, and he simply could not move as fast as the IMF wanted.

The Prime Minister said that agreement with the IMF was an essential step in restoring Egypt to economic health. Once such agreement was reached, it would unlock the door to further assistance. She could understand the political constraints facing President Mubarak. But the IMF would need to be convinced that he really had gone to the limits of what was feasible. This was something which had to be negotiated between Egypt and the IMF. It was important to establish tough targets. We recognised the scale of the difficulties which Egypt faced and acknowledged Egypt's strategic importance. She would look again at the instructions which had been given to the UK Executive Director but could not ask him to do anything basically unreasonable.

#### Taba

The Prime Minister asked about progress in the negotiations over Taba. President Mubarak said that the real problem lay with political manoeuvring in Israel. Likud wanted to create political problems for Mr. Peres and were seeking wording which would make it possible to reopen the whole Israel/Egypt border. But he was optimistic that agreement would be reached.

#### Arab/Israel

The Prime Minister gave President Mubarak a brief account of her visit to Israel and subsequent discussions with King Hussein. She had reached the conclusion that Mr. Peres' proposals for dealing with Gaza first were unlikely to lead anywhere. King Hussein was clearly not prepared to accept them. She was worried about the current hiatus in the peace process. But there was no prospect of any fresh initiative from the United States until after the Congressional elections.

President Mubarak said that he had undertaken not to enter discussions on Gaza except in agreement with King Hussein. Meanwhile he was pressing Arafat to take the step of accepting UN Security Council Resolutions 242 and 338. People in Egypt were fed up with the PLO and he had made clear to Arafat that the organisation was losing support. The Prime Minister said that the PLO must be brought to realise that unless they accepted 242 and 338 they would find themselves excluded from any negotiations.

President Mubarak railed against President Asad who had recently again tried to persuade Egypt to drop the Camp David Agreements and the Peace Treaty with Israel. He had

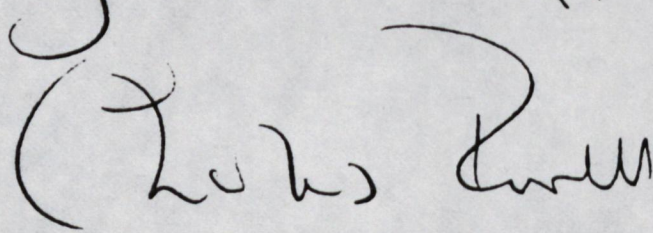
told Asad that Egypt respected its commitments and could not, like Lebanon, be bullied out of its agreements. President Asad and indeed the whole Syrian leadership were sly and corrupt.

Iran/Iraq

The Prime Minister said that she was concerned by indications that the Iranians might be gaining an upper hand in the conflict with Iraq. President Mubarak doubted whether either side was winning. Iraq's military performance was far from inspiring. They had totally failed to spot Iranian preparations for the invasion of Fao, even though these involved assembling some 5,000-6,000 small boats. He did not foresee any early end to the war. It was essential to maintaining Khomeini in power, although he believed that the regime would eventually be overthrown by the Armed Forces.

The Prime Minister told President Mubarak as he left that she would "see what she could do" about the IMF negotiations. She would therefore be grateful if the Chancellor could inform her in more detail of the precise position we are taking on the remaining points of difficulty. She thinks that the political constraints on President Mubarak must be given some weight although they cannot of course in themselves determine our position.

I am copying this letter to Rachel Lomax (HM Treasury), John Mogg (Department of Trade and Industry) and Michael Stark (Cabinet Office).

Yours sincerely,  


Charles Powell

R. N. Culshaw, Esq.,  
Foreign and Commonwealth Office.