



SUBJECT cc MASTER

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10 September 1986

*From the Private Secretary**Dear Robert,*

PRIME MINISTER'S MEETING WITH THE PRIME MINISTER OF EGYPT
ON 10 SEPTEMBER AT 1200

The Prime Minister received the Egyptian Prime Minister this morning. Dr Lutfi was accompanied by the Egyptian Ambassador and a notetaker. The Chancellor of the Exchequer and HM Ambassador in Cairo were also present.

Egypt and the IMF

The Prime Minister recalled that President Mubarak had briefed her in July on Egypt's economic problems and the state of negotiations with the IMF. She invited Dr Lutfi to bring her up to date.

Dr Lutfi said that it would not be accurate to speak of an economic crisis in Egypt. There was a difficult economic situation. The main reason was the collapse of oil prices. The most pressing problem was a lack of foreign currency. The Egyptian Government had prepared and was beginning to implement a serious economic reform programme. This was designed to increase agricultural and industrial production, to deal with the budget and balance of payments deficits and to curb high population growth. Particular measures were aimed at reducing Government spending, diminishing tax evasion, reducing energy consumption, encouraging exports, and - most important - reducing and eliminating domestic subsidies.

Dr Lutfi continued that an IMF technical mission had been in Cairo and had approved the Egyptian Government's programme, leaving only one major contentious issue to be resolved. This concerned the exchange rate. The IMF wanted the Egyptian Government to unify the Central Bank and free market rates in one year. This was politically impossible for the Egyptian Government since it would mean a 50 per cent increase in prices. They had therefore told the IMF that they would agree to unify the rates within three (or perhaps two and a half) years. The Egyptian Government fully recognised the importance of reaching agreement with the IMF as a precondition for receiving further

international assistance. He hoped that the British Government would encourage the IMF to show understanding for Egypt's political problems.

The Prime Minister said that the United Kingdom recognised that Egypt's situation was critical to the free world. We were very understanding of the Egyptian Government's problems. It was essential to the solution of these problems that there should be agreement with the IMF. The IMF would undoubtedly impose tough conditions but not so tough as to bring about political collapse. The IMF would need to be convinced not only that Egypt's reform programme was on the right lines but that it would be implemented in practice.

The Chancellor of the Exchequer said that it was a tremendous step forward that Egypt was negotiating seriously with the IMF. IMF approval of the Government's reform programme would unlock other doors to help. As regards unification of the exchange rates, no proposal had yet been made to the IMF Executive Board and the United Kingdom had not therefore been required to take a position. But a realistic exchange rate was an essential element in a reform programme and the sooner it was achieved the better. He acknowledged the political difficulties of a rapid move to unify the two rates. But there were political drawbacks also to drawing out the agony over a period of two or three years. Moreover, the IMF would lack confidence that a gradual narrowing of the gap between the two rates over an extended period would be definitely carried through to a conclusion.

Dr Lutfi agreed that it was important to have a realistic exchange rate, but stressed again the difficulties of getting there in one bound. He noted that Mexico had recently signed an agreement with the IMF after a certain amount of political pressure had been exerted on the Fund by the United States and others. Egypt was seeking similar help. The Chancellor pointed out that Mexico had been following tough IMF programmes for the best part of four years. He would be visiting Washington shortly for the IMF/IBRD meeting and would see the IMF Managing Director. He would do what he could to be helpful. But Egypt must be prepared to reach an agreement within the Fund's guidelines. The Prime Minister suggested that it might be easier to solve the exchange rate problem if Egypt were prepared to take a very substantial step towards unifying the rates in the first year.

Taba

Dr Lutfi said that he had spoken to President Mubarak this morning and had learnt that there was a good prospect that the negotiations on Taba would be concluded later today. In that event President Mubarak would meet Mr Peres tomorrow and Egypt's Ambassador to Israel would return to his post shortly thereafter.

Arab/Israel

Dr Lutfi said that Egypt was still trying to bridge the gap between King Hussein and Arafat. Egypt was in a unique position to help advance the Middle East peace process as the only country which enjoyed good relations with all the parties. The Prime Minister said that it was important to inject some momentum into that process, and make the fullest use of Mr. Peres' remaining time in office.

Terrorism

Dr Lutfi referred to President Mubarak's proposal for an international conference on terrorism and urged closer practical co-operation between Britain and Egypt. The Prime Minister stressed the need to bring the full weight of the law to bear on those engaged in terrorism.

GATT

The Prime Minister referred to the importance of including services fully in the GATT negotiations. Services constituted a steadily increasing proportion of world trade. Dr Lutfi made no comment.

Bilateral Relations

Dr Lutfi characterised relations as good and paid a tribute to the work of Sir Alan Urwick and Mr Sharara. He referred to the very fruitful and productive meetings which he had held with the Lord President, Mr Renton and Mr Raison.

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

your sincerely
Charles Powell

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Foreign and Commonwealth Office.