

EXECUTIVE SECRETARIAT

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Remarks:

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 Executive Secretary
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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

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May 10, 1982

MEMORANDUM FOR NANCY BEARG DYKE
Assistant to the Vice President
for National Security Affairs

L. PAUL BREMER, III
Executive Secretary
Department of State

DAVID PICKFORD
Executive Secretary
Department of the Treasury

ROBERT P. MEEHAN
Assistant for Interagency Matters
Office of the Secretary of Defense

RAYMOND LETT
Executive Assistant to the Secretary
Department of Agriculture

HELEN ROBBINS
Executive Assistant to the Secretary
Department of Commerce

WILLIAM V. VITALE
Director, Office of the Executive Secretariat
Department of Energy

WILLIAM SCHNEIDER
Associate Director for National Security
and International Affairs
Office of Management and Budget

THOMAS B. CORMACK
Executive Secretary
Central Intelligence Agency

DENNIS WHITFIELD
Executive Assistant to the USTR

ROGER PORTER
Special Assistant to the President
for Policy Development

JAMES BURNHAM
Special Assistant to the Chairman
Council of Economic Advisers

CHARLES F. STEBBINS
Executive Assistant to the Chairman
Joint Chiefs of Staff

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SUBJECT: Versailles Summit: Briefing Materials for
President's Trip to France, June 4-6, 1982

As agreed at the April 28 meeting of the Senior Interagency Group for the Versailles Summit, the Department of State circulated on April 30 the draft briefing papers for the President's briefing book as received by COB April 29. Papers received subsequent to that date are attached to this memo.

Initial drafts of papers are still outstanding on the following subjects:

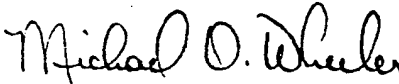
| <u>Papers not received</u> | <u>Drafting Agency</u> |
|------------------------------------|------------------------|
| CBI | USTR |
| Multilateral Food Corps | AID |
| R&D Investment | Commerce |
| International Aspects of High Tech | Commerce |
| Southern Africa | State |

The indicated agencies should submit these drafts immediately even if they are preliminary or await the completion of studies or other events. They can always be updated later.

All agencies are requested to review the total package of briefing materials and to refine papers for which they are principal drafters to insure that the prescribed format is rigorously followed and that the substance of the papers is in tune with the briefing book as a whole. In addition, agencies should update all papers for which they are principal drafters, taking particular account of developments at the international meetings during the week of May 10.

Final papers in original form, cleared at the Deputy Assistant Secretary level, are due to Marshall Casse (Department of State, Room 7250, 632-1089 or 2811) by COB, May 17 FIRM. Issue and background papers that do not depend on meetings the week of May 10 should be forwarded by Friday, May 14. The papers should rigorously follow prescribed format and typeface. Drafting and clearance information should be shown on a separate sheet with the title of the paper repeated at the top of the drafting info page.

The Versailles SIG will meet at 4:00PM Tuesday, May 18, in Room 305 of the Old Executive Office Building to review the status of the briefing materials and to receive a report of the final meeting of the Personal Representatives.


Michael O. Wheeler
Staff Secretary

Attachments
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U. S. Economic Situation

The decline in real GNP during the first quarter was at an annual rate of 3.9%, somewhat better than the initial estimate of a minus 4.5%. More important, the entire decline was accounted for by a massive liquidation of inventories, much of it in automobiles. Excluding the inventory swing, so-called "final sales" rose at an annual rate of 1.9%, led by personal consumption expenditures (food, autos, and the like). Most other categories registered slight declines.

Outlook. Should inventory liquidation come to a halt this month or even slow down substantially, prospects for a modest second quarter increase in GNP will be good. A second half rate of increase in the vicinity of 5 percent now appears within reach. (The April Blue Chip survey of private forecasters shows a modest upturn in the second quarter and a second half of 1982 with a 4-percent-plus rate of growth.)

The case for a consumer-led recovery remains strong. We are now seeing real increases in consumer incomes, thanks to a lower inflation rate and tax cuts. This situation will be reinforced in the second quarter with the likelihood of continued favorable results on inflation and the effects of the 1982 tax cut.

The timing, near-term strength and sectoral composition of the upturn will be influenced by further progress on interest rates. There have been some recent declines in both short- and long-term rates since mid-February that are encouraging -- if sustained. Three-month Treasury bills are off more than a full percentage point, corporate bonds down about 1%, and sensitive mortgage rates are down about the same.

However, interest rates remain high, relative to current inflation rates. High real rates are characteristic of a significant disinflationary period, reflecting a slow change in inflation expectations. In addition the high real rate of interest may also be related to uncertainty, which is adding a large risk premium to the level of interest rates, particularly long-term rates. Substantial uncertainty currently surrounds both fiscal and monetary policy.

Current internal Administration projections call for a year-over-year fall in real GNP in 1982 of between 1/2% - 1% and an increase in 1983 of 4%. Prices, as measured by the GNP deflator, should rise about 7% in 1982 (year-over-year), and 6% in 1983.

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OVERVIEW: "NORTH/SOUTH" ISSUES

I. U.S. OBJECTIVES AND INITIATIVES

Principal U.S. Objectives

Foster a new pragmatism on "North/South" issues, a process which was begun at Ottawa and continued at Cancun.

Champion open trade, free capital flows, and LDC domestic economic policies compatible with private enterprise as the most effective path to accelerated economic growth and development in developing countries (LDCs).

Recognize the need for continued concessional aid flows to the poorer countries but within real budget constraints in donor countries.

Supplementary Objectives

Preserve unity among the seven participants and narrow the differences in general orientation toward LDCs.

Resist diplomatic pressure to agree to Global Negotiations (GNs) in the UN General Assembly prior to the fulfillment of US understandings.

Resist commitment to new institutional structures before their need has been demonstrated (Common Fund, IBRD Energy Affiliate, Global Foreign Exchange Earnings Stabilization Schemes - "Global Stabex").

Initiatives

Discuss our initiative for a round of trade negotiations on market access by developed and developing countries which the US is considering for the GATT ministerial.

Ensure that other participants understand the Caribbean Basin Initiative (CBI) and agree to participate in appropriate ways.

Discuss the multilateralization of the Presidential task forces on food and agriculture and obtain approval for follow-up action.

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II. BACKGROUND AND PRE-SUMMIT PREPARATION

"North/South" is a misleading short form expression to mean the full breadth of the industrial countries' economic and political relations with the LDCs. There is no real category of North or South. Both "groups" are composed of highly varied and heterogeneous nations.

Pre-Summit preparations have revealed a major difference in general orientation toward LDCs between the US and a majority of the other participants. The basic paper drafted by Italy (tab) uses the words overall, integral, organic, and strategic to describe the kind of dialogue needed with the LDCs. All summit participants, with the exception of the US and UK, favor the current proposal of the LDCs (Group of 77) for a round of GNs (see issues paper), and they want Versailles to give "positive signals" about things the industrial countries can do for the LDCs.

We believe that this approach ignores the positive contribution of existing international economic institutions to the dialogue. Moreover, we cannot commit ourselves to launch GNs prior to the fulfillment of the US understandings (see issues paper). Instead of searching for "positive signals," we believe the summit should help set aside outworn concepts (e.g. that industrial countries owe concessions to LDCs and that aid can be greatly increased) and inspire new thinking (e.g. that domestic policy is the key to development and that the private sector can supply significant new funds).

III. OTHER COUNTRY OBJECTIVES AND STANCE ON THE U.S. OBJECTIVES

France hopes to form a unified EC policy on North/South issues before the Summit and to push it through the Summit. Emphasis will be on GNs, concessional aid, to include IDA, and energy assistance. France desires to de-emphasize trade to protect domestic unemployment and the EC's Common Agriculture Policy (CAP). The French will not be receptive to the US approach in North/South relations. They will push more government involvement in the world economy, not less.

Italy will back the French. They have emphasized to us the importance of a "bella figura" on North/South, i.e. the symbolic importance of doing something positive to look good. As the drafters of the North/South discussion paper (tab), they suggest the following possibilities: GNs, World Bank energy affiliate, support for LDC food strategies, increasing the international food reserve, concluding an International Wheat Agreement, increasing IMF resources, implementing the UN negotiated Common Fund for commodity agreements.

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Canada and Japan will also identify with the French point of view. Canada will hold this position primarily because of the strong feelings Trudeau has in fostering North/South relations through political symbolism. Japan will stress that its dependence on the South for energy, resources and markets necessitates a harmonious atmosphere.

We can expect UK support for our position on GNs. Mrs. Thatcher has a strong view on the necessity to protect the UN specialized agencies. The FRG will be the only summit participant enthused about our emphasis on trade. All the other summit countries are troubled by relatively high unemployment which makes trade liberalization politically difficult.

IV. DISCUSSION OF OBJECTIVES

-- There is a necessity to foster a new pragmatism in economic relations with developing countries. Budgets are going to be limited. Growth will be slow.

-- We must use all the resources available: Trade, foreign investment, and, where justifiable, concessional aid. The Caribbean Basin Initiative (CBI) is an example of such an integrated approach.

-- However, neither the CBI nor any other program will work if domestic development policies do not make sense. Development is a national phenomenon.

-- The US does not believe that GNs will necessarily foster more economic growth. There are major risks to the specialized agencies that need to be overcome. We are willing to join in GNs if our understandings are met.

-- We must deal with real problems faced by the LDCs. I hope you will join the US at the GATT Ministerial this fall in working on LDC trade issues.

-- We would like to see the multilateralization of the agricultural task force concept which was developed at Cancun by President Reagan.

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DRAFT key issue paper for Versailles Summit:

N.B. This draft assumes that we will have responded to the G-77 text by tabling a NSC-approved text of our own in late May.

GLOBAL NEGOTIATIONSI. ISSUE

Other Summit participants want the summit to agree on visible "symbols" of our political support for developing countries (LDCs). Because the issue of global negotiations (GNS) in the UN General Assembly has been pending since 1979 and because all but the US and UK can accept the text of a new UNGA resolution on GNS which the LDCs proposed on March 31, the other participants are likely to bring considerable pressure to bear on us to announce some form of decision which would clear the way for our accepting a version of the March 31 text.

II. ESSENTIAL FACTS

GNS was a major issue at the Ottawa summit. At the Cancun summit, participants agreed to support "at the UN, with a sense of urgency, a consensus to launch GNS on a basis to be mutually agreed and in circumstances offering the prospect of meaningful progress." Since Cancun, GNS have been under continuous discussion in New York. On March 31 the LDCs (Group of 77) finally responded to the amendments the US offered December 9 on the basis of a draft resolution by UNGA President Kittani. The March 31 text is acceptable to most countries but not to the US because:

- 1) it launches a formal UN Conference for GNS before procedures, agenda, and timeframe are agreed;
- 2) it leaves open the relationship between the conference and the specialized agencies of the UN system;
- 3) it refers directly to the 1979 resolution on GNS with the words "in accordance with" (we proposed "noting"); and
- 4) it implies a package agreement which means that the results of negotiations in the specialized agencies could be reopened at a political level.

In late May, the NSC approved and USUN tabled a new US text which draws from past language but protects the US substantive position. We simultaneously urged other industrial countries not to isolate us by voicing acceptance of the G-77 text or by tabling texts of their own which would not be acceptable to us.

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The proposed US text attempts to meet the G-77 in two places: By "bearing in mind" the 1979 resolution and by saying that GNs will commence at the earliest possible date after procedures, agenda, and timeframe are agreed. The latter point is a non-substantive addition to please the G-77 moderates who are concerned that we will not move promptly once the preliminaries are in place.

The tabling of the new US text will not lead to GNs. It is a tactical move to preserve our substantive position and to protect President Reagan by throwing the ball back at the G-77 just before Versailles. A majority of G-77 members might be able to take the text, but, according to intelligence reports, a small group of OPEC and radical countries is still extremely unlikely to accept any text which preserves the US substantive position.

III. TALKING POINTS

Criticism: The US should be more "forthcoming" on GNs.

Response: Since Cancun, we have twice considered GNs at the highest level. In December, the NSC chaired by President Reagan approved amendments for the draft UNGA resolution offered by UNGA President Kittani. The Group of 77 responded on March 31. Our next step was delayed by the Falkland Islands, Middle East, and other crises, but the NSC agreed in May to table a new text.

Criticism: The Versailles Summit must agree to launch GNs in order to send a positive political signal to the LDCs.

Response: We are awaiting a G-77 reply in New York. Meanwhile, the US cannot agree to any language on GNs which goes beyond the co-chairmen's summary of the Cancun Summit.

Criticism: By not agreeing to launch GNs immediately, the US appears to oppose dialogue with the LDCs.

Response: This is nonsense. The US participates in international discussions with LDCs every day. At Cancun, President Reagan said the US favors a more formal dialogue -- bilaterally, regionally, and internationally. He gave four explicit understandings that would offer the prospect of meaningful progress.

U.S. point: We cannot agree to launch GNs until we know the procedures, agenda, and timeframe.

Likely foreign retort: We will work this out as the first phase of GNs. Agreeing to launch GNs is just a form of words and costs us nothing.

U.S. point: The recent draft by the G-77 does not protect the IMF, IBRD, GATT and other specialized agencies.

Likely foreign retort: The draft is imperfect, but we will work together to minimize the danger in the course of GNs.

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LIMITED OFFICIAL USEWORLD BANK ENERGY AFFILIATEISSUE

Other countries may urge the United States to reconsider its decision not to participate in a World Bank energy affiliate.

ESSENTIAL FACTORS

In 1981 the World Bank proposed to expand its FY 82-86 energy lending program from \$14 to \$30 billion and to create a leveraged energy affiliate to mobilize the required resources. The United States firmly opposes both and has worked instead to influence Bank policies to increase the total resources available for energy investment by structuring its operations in such a way as to catalyze more private investment. To date, however, Bank oil and gas exploration and development loans have continued to finance more than 40 percent of project costs compared to the 20 percent the Bank projected in 1977, and private participation remains limited.

Other Summit countries, particularly France and Italy, have given strong and consistent support to the affiliate concept as a means to raise new money for accelerated energy lending. They see such lending as important to improve LDC financial prospects, increase global energy supplies and improve export opportunities for equipment suppliers. Without USG participation, however, neither the Europeans nor the Saudis have been willing to commit funds to an affiliate. The Bank is still exploring ways to increase energy lending and may investigate a pool or trust fund concept.

TALKING POINTS

-- Development of LDC energy resources is important, but most energy investment funds must come from private sources. The MDBs should complement and catalyze private investment, where necessary, but at today's energy prices many projects are "bankable" in private financial markets.

-- We have urged the Bank to improve the effectiveness of its energy programs, within currently pledged resources. For example, the Bank should use its influence to encourage host countries to adopt energy pricing and investment policies which allow for greater private involvement. The Bank also should make greater use of creative co-financing mechanisms.

-- The Bank's objective should be to increase investment from all sources in economically viable LDC energy projects, not to increase its own lending.

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ENERGY SECURITY

I. ISSUE

To emphasize the importance of the market place in encouraging economically attractive energy alternatives and the need to continue efforts to minimize at acceptable costs the disruptive effects of energy shortfalls.

II. ESSENTIAL FACTS

1. There are abundant and economically attractive energy resources within the West.

2. Despite a welcome respite from oil market turbulence, the chance of sudden and potentially major disruptions in oil supply still exist. The U.S. has encouraged all countries to ready themselves by increasing oil stocks. In cases of large-scale oil disruptions, the IEA and EC emergency sharing systems remain the principal intergovernmental mechanisms for sharing the burden among industrialized countries. We have encouraged European countries to diversify their gas supplies and to implement measures which will reduce their vulnerability during disruptions in gas supplies.

III. TALKING POINTS

-- Energy security involves both reliance on market forces and a prudent concern for political and strategic forces.

-- Energy security objectives can be achieved by relying on market to encourage development of energy supplies and more efficient use.

-- Western countries should commit themselves to increase indigenous energy production, thereby reducing dependence on less secure sources.

-- Recognizing that the energy market remains inherently unpredictable, Summit countries should reaffirm their commitment to the IEA oil emergency sharing system, take steps to increase stocks, and continue efforts to enhance Western natural gas security.

Criticism: The U.S. has not done enough to enhance its own and world energy security.

Responses: 1) U.S. oil imports have dropped to one-third the level of the late 1970's. 2) Our Strategic Oil Reserve has more than doubled during the last year. 3) U.S. coal exports are helping to meet the energy requirements of Europe and Japan. 4) We are achieving energy security through the initiatives of a strong and powerful private sector responding to clear market forces.

CENTRAL AMERICA/CARIBBEAN

I. ISSUE

Weak European support for our policies.

II. ESSENTIAL FACTS

Most European governments know the need for more assistance, like in the Caribbean Basin Initiative, but could do more themselves. In Central America, except for the U.K., they have been helpful because of vocal domestic opposition. Schmidt's desire to be helpful is one such casualty. The Mitterand government, on the other hand, openly opposes our policies. The Salvadoran elections have put Europeans somewhat on the defensive in criticizing us.

Our policies are working in El Salvador: the first fair elections in fifty years; a moderate, civilian government of national unity dedicated to continuing agrarian reforms and the democratic process; the military clearly committed to the democratic process and eliminating human rights abuses. Military effectiveness has improved. The guerrillas suffered serious political defeat in the elections, but continue their violence. We favor bringing the left into the electoral process; they should not be negotiated into power. Nicaragua is still frightening its neighbors and drawing closer to Cuba. Latin America is supporting reform and democracy in El Salvador and opposes Nicaraguan intervention and repression of liberty. Even Mexico is having doubts about

its posture. We will continue to offer economic and limited military assistance to threatened democracies; American troops are not wanted or needed.

III. TALKING POINTS

U.S. Point: Democracies are in economic trouble and their security is vital to us. The U.S. and its CBI partners are doing their part. Greater economic assistance and trade opportunities from Europe and Japan are needed, particularly for El Salvador, Costa Rica, and Honduras.

Response:

- Europe's major obligations are elsewhere.
- U.S. interest rates cause much of the problem.

European Criticism: U.S. should not resist progressive, revolutionary forces but give them an alternative to Cuba and USSR.

Response:

-- Recent elections in Costa Rica, Honduras and El Salvador destroyed the myth that the left had popular support.

-- Nicaragua shows the danger of helping Marxists take power.

-- We do not want to divert military resources to defend our third border.

KEY ISSUES (CHINA)

I. ISSUE

Tension with Beijing over U.S. arms sales to Taiwan threatens a deterioration in U.S.-China relations. Failure to resolve this issue could lead to a substantial retrogression of relations and make strategic cooperation difficult.

II. ESSENTIAL FACTS

Beijing views this administration's policies, in particular our continuing arms sales to Taiwan, as betraying a fundamental disregard for China's sovereignty and an active desire to perpetuate Taiwan's separation from the mainland. We have agreed to discussions with China in an effort to bridge our differences. China has publicly indicated it may downgrade relations with the U.S. if the issue is not resolved.

In the discussions leading up to normalization of relations, the U.S. clearly stated its intention to continue the sale of carefully selected defensive arms to Taiwan. We have, however, been prudent and discreet in our approach to arms sales to Taiwan, and the record shows we have been sensitive to Chinese concerns. The visit of Vice President Bush is an effort to improve communication and demonstrate the high value the U.S. puts on relations with China.

III. TALKING POINTS

Criticism: Continued U.S. arms sales to Taiwan jeopardizes U.S.-China relations and violates China's sovereignty.

Response:

-- The U.S. made clear its position on continuing arms sales to Taiwan when Sino-U.S. relations were normalized in 1979, and Beijing went ahead knowing our intentions. The record shows that we have been prudent and discreet in this area and have taken careful account of Chinese concerns.

Criticism: Is China likely to downgrade relations with the U.S.?

Response:

-- Neither we nor the Chinese desire a setback and are making a major effort to bridge our differences on the issue of arms sales to Taiwan. Should there be a setback, we will seek to limit its effect, as I expect Beijing also to do.

Criticism: Has recent tension between the U.S. and China allowed Moscow to improve its relationship with the PRC?

Response: China has responded coolly to the recent Soviet offer to improve bilateral relations. We would not be surprised to see some marginal improvement in trade or other non-political relations, but there is no indication of Chinese reassessment of Moscow or anything other than superficial moves.

BILATERAL ISSUES PAPER: JAPANI. STATE OF RELATIONS

Our relations with Japan are generally sound, and the Japanese have cooperated with us on a wide range of international issues. Nonetheless, trade and, to a lesser degree, defense issues continue to generate substantial concern on both sides of the Pacific.

II. KEY ISSUES

Trade - The \$18 billion U.S. trade deficit with Japan in 1981, in conjunction with the world-wide recession, has led to unprecedented pressure for expanded access to the Japanese market. Despite a series of sectoral crises, the trade problem has on the whole been fairly well-managed, with steady liberalization of the Japanese market over the past decade. Much of the difficulty on the Japanese side lies in traditional preference for Japanese suppliers, while the weak yen impairs U.S. competitiveness. Agriculture remains the sector most visibly closed to imports. Unfortunately it is also the most politically sensitive sector and the most difficult to liberalize. Japan's response to U.S. and European requests for an overall liberalization program is expected to come before the Summit. If it is not a significant step forward, the trade issue could become the focus of even more intense concern. Depending on the nature of the Japanese measures, the U.S. should express its satisfaction (or dissatisfaction) and encourage Japan (and other countries) to continue strenuous efforts further to liberalize any remaining areas not fully open to foreign competition.

Defense - The U.S. is continuing to press Japan for a more equitable sharing of our common security burden. Critics have focused particularly on Japan's relatively low level of defense expenditures, less than one percent of GNP. In fact, the Japanese defense effort has been improving steadily in recent years. Recent defense budgets have shown real growth rates of 4.5 percent at a time when most other GOJ budget items have been held to zero growth. We are focusing on the plans for roles and missions appropriate for the Self Defense Forces rather than specific budget amounts or percentages of GNP devoted to defense. We should urge further development of Japan's defense capabilities, in a manner consistent with its political constraints.

Fisheries - Japan and the U.S. have settled into an unhappy marriage of convenience. To ensure access to the U.S. 200-mile fishery conservation zone, Japan has committed itself to greater market access for U.S. fish products, more

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cooperation with U.S. fishing operations, and payment of higher fees. The current economic slump has severely hurt the U.S. fishing industry and even very cooperative Japanese policies may not be sufficient to avoid continued conflict. Japan must be reminded that the U.S. has a policy calling for development of our domestic fishing industry but will cooperate with other nations while pursuing that goal.

Nuclear cooperation - When we concluded in 1981 a three-year agreement which allows Japan to reprocess spent nuclear fuel in its Tokai Mura pilot-scale reprocessing facility, we agreed to enter into discussions on a new, more liberal arrangement which would cover new facilities for an indefinite period. Once our policy on the use of plutonium in the civil nuclear power fuel cycle is decided, we do not expect serious problems in reaching agreement. We should give assurance that the U.S. fully appreciates Japan's desire for a longer-term arrangement which will allow full development of the nuclear power industry in Japan and that we will pursue discussion toward that end as soon as practicable.

Aid Cooperation - We have been working closely with Japan to coordinate and improve the effectiveness of our aid contributions, particularly in strategically important regions. Japan's aid budget has increased dramatically in recent years, and Japan has announced a number of changes welcomed by the U.S., including the untying of a larger percentage of aid funds from Japanese sales. It would be well to express appreciation for the expanded AID efforts and, in particular, for the responsiveness Japan has shown to the needs of strategically important states in the past several years.

Disarmament - Prime Minister Suzuki has made disarmament a major foreign policy focus as he finds himself under pressure to take an initiative at SSOD II to preempt Japan's opposition parties. While the US appreciates Japan's interest in disarmament, we feel that any unilateral action would hurt rather than help the effort in the long run. We are appreciative of the strong Japanese interest in this issue and should indicate a willingness to consult fully with Japan as the various initiatives move forward.

Law of the Sea - Japan has been less than fully supportive of U.S. positions during recent months, reflecting Japan's desire to protect its commercial interests in the deep seabed mining area as well as convince Third World countries of Japan's support for a consensus consistent with their concerns. It is important to express concern that the LOS negotiations not become a forum where one developed country is played off against another by the G-77.

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BILATERAL ISSUES: ITALY

I. STATE OF RELATIONS

Relations between the United States and Italy are excellent -- a fact highlighted by the highly successful state visit of Italian President Pertini to the United States in March. The relationship is based on strong ties of kinship, culture, and common commitment to democratic values. Italy has been among our most cooperative allies on issues ranging from Iran to Afghanistan and Poland. It was in the forefront of the 1979 allied decision to modernize intermediate-range nuclear forces (INF) in Europe and the effort to create an observer force for the Sinai. Italy has increased defense expenditures and is contemplating an expanded role in the Mediterranean. The supportive Italian attitude derives in part from a genuine sense of common purpose and obligation as an ally, and in part from a desire to prove its right to inclusion in the "inner circle" of allied consultation. Italy is relying heavily on your promise to Pertini that there will not again be allied summits of the "Guadeloupe" type with Italy excluded.

II. KEY ISSUES

Italy continues to make significant progress in the fight against terrorism. More than 300 arrests of suspected terrorists have been made since the dramatic rescue of General James Dozier earlier this year. However, the surprisingly large number of arrests has led many Italian officials to conclude that the problem had earlier been underestimated. The Red Brigades have shown a continued ability to operate in the wake of their Dozier debacle. Officials have therefore been careful to avoid premature claims of final victory over domestic terrorism. There has been speculation regarding possible links between Italian and foreign terrorist organizations. Hard proof of such ties has been elusive. We should acknowledge Italian success and encourage Italy to keep up the fight.

Most Italian leaders share the common European perception that our policy in Central America is misguided in failing to give sufficient weight to "liberation" forces on the left. The Spadolini government declined to send observers to the El Salvador elections, since the Socialists within the coalition had threatened to bring his government down on the issue. The Christian Democrats

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(DC) did send observers. The Italian government expressed gratification at the large turnout and evident fairness of the election, but concern that the results could put the right and radical right in a commanding position. We want to assure the Italians that we share their concern and have therefore let the political parties in El Salvador know how important it is to establish a strong government of national unity and continue the economic and political reforms already in progress, including early presidential elections. We should also show that we recognize that excessive social and economic inequalities are the breeding ground of revolution, and point to the Caribbean Basin Initiative as a major response to these underlying problems.

The Italians, like some of our other European allies, have suggested that U.S.-European consultations should be improved. In a speech at Georgetown University in February Foreign Minister Colombo offered a program for improvement in the form of a European-U.S. "friendship pact". We have told the Italians and our other European friends that we favor twice-yearly informal meetings of NATO Foreign Ministers, similar to such meetings now held by the EC. In addition, we have also proposed that Secretary Haig lead the U.S. delegation to semi-annual U.S.-EC consultations on economic and political issues. You should tell Spadolini that we agree U.S.-European consultations should be enhanced and that our views on NATO and EC consultations demonstrate this commitment.

The Italians share our outrage at the situation in Poland. Italy unambiguously condemned the imposition of martial law, the suppression of Solidarity, and the Soviet role. It willingly associated itself with the European Community consensus on sanctions. On restricting credits to the Soviet Union the Italians have assured us that they will go just as far as the industrialized nations as a whole can be induced to go. We should stress the need for Western unity behind measures sufficiently strong to send the proper message to Moscow.

Italy's relations with Libya have been strained but Rome has sought to keep lines of communication open to Qadhafi, both out of concern for the safety of the large Italian community in Libya and because Libya continues to be an important commercial partner. Libya has been pressing Italy for increased arms shipments. We hope Italy will stop its arms cooperation. We also hope it will not succumb to pressure for a Qadhafi visit.

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SECRETYour Meeting with British Prime Minister
Thatcher at the Versailles SummitSTATE OF RELATIONS

We have a "special" relationship with Britain. It is based on extremely close political, military-intelligence, economic and cultural ties. These ties are vital to our security interests in Europe and important to our objectives in most other areas of the world. The Falkland Islands crisis has resulted in some drop in public confidence in Great Britain concerning US willingness to stand by its allies. Mrs. Thatcher and most sophisticated people in Britain recognize that the US had to demonstrate initial public even-handedness in order to maintain some influence in Buenos Aires. There is still, however, lingering resentment by some back-bench Conservatives over this perceived even-handedness. If it continues, it could substantially reduce the UK's willingness to assist the US in world tasks not clearly and urgently linked to specifically UK national interests. Nevertheless, everyone in Britain continues to view the US as the key to Western security and has a strong emotional attachment to American cultural and social values.

KEY ISSUES

British Confidence in the United States:

In the wake of the Falklands crisis, Mrs. Thatcher will want further assurances that the special relationship between the US and the UK is strongly supported by the Administration. She should know that we greatly appreciate her personal support on the wide range international issues, especially for the Administration's firm posture toward the Soviet Union. Mrs. Thatcher should be told that you consider personal close ties with her essential to continued close British-American political and security cooperation.

US-EC Consultations:

Faced with difficult political and economic issues, the Belgians, Germans and Italians have suggested that US-European consultations should be improved. We have told our European friends that we favor twice-yearly informal meetings of NATO Foreign Ministers, similar to such meetings now held by the EC ("Gymnich" meetings). In addition, we have also proposed that Secretary Haig lead the US delegation to semi-annual US-EC consultations on economic and political issues (previously conducted by the Under Secretary of State for Economic

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Affairs). You should tell Mrs. Thatcher that we believe US-European consultations should be enhanced and our views on NATO and EC consultations demonstrate this commitment.

Your Visit to London:

Since you will be going to Britain a few days after this meeting, Mrs. Thatcher may be interested in touching on the major US and UK goals for the visit, and any outstanding questions on the schedule. Her government is concerned about large anti-American demonstrations planned to coincide with your visit, and the possible backlash of anti-British feeling in the US. She would like confirmation that you will emphasize, in your public remarks, the Administration's firm support for the UK, and for a vigorous US search for peace to complement our rearmament program.

Enforcement of US Laws in Britain:

Our bilateral relationship is clouded by our attempted extraterritorial application of US laws and other trade restrictions. The British believe that application of our regulations in Britain is contrary to international law, demeaning to the UK, and very costly to British industry. If the question is raised by the British, we acknowledge the fundamental difference of opinion. Our policy, however, is to consult with London as early as possible in order to avoid surprising the Thatcher Government, and to look for pragmatic solutions whenever possible to head off bilateral problems.

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