

THE WHITE HOUSE
WASHINGTON

MEMORANDUM OF CONVERSATION

SUBJECT: Luncheon Meeting with Chairman Gorbachev of the USSR

PARTICIPANTS: The President
James A. Baker, Secretary of State
John H. Sununu, Chief of Staff
Brent Scowcroft, Assistant to the President for
National Security Affairs
Paul Wolfowitz, Under Secretary of Defense for
Policy
Reginald Bartholomew, Under Secretary for Security,
Assistance, Science and Technology, Department of
State
Robert D. Blackwill, Special Assistant to the
President for European and Soviet Affairs
Interpreter

Mikhail Gorbachev, Chairman of the Supreme Soviet
of the USSR
Eduard Shevardnadze, Minister of Foreign Affairs
Aleksandr Yakovlev, Chairman, International Policy
Aleksandr Bessmertnykh, First Deputy Minister of
Foreign Affairs
Anatoliy Chernyaev, Aide to the General Secretary
B. Chernavin
Anatoliy Dobrynin, Adviser to the Chairman
N. Kruchina
Valentin Falin, Chief, International Department
Sergey Akhromeyev, Adviser to the Chairman
Vadim Zagladin, Adviser to the Chairman
Viktor Karpov, Deputy Minister of Foreign Affairs
Yuriy Dubinin, Ambassador to the United States
Interpreter

DATE, TIME December 2, 1989, 1:30 p.m. - 2:45 p.m.
AND PLACE: Cruise Ship Gorky

The President: Your meeting with the Pope went well. It got very good press in the U.S. (U)

Chairman Gorbachev: It went over the limit prescribed. It was a very substantial meeting. (U)

The President: Did you and Minister Shevardnadze talk about the Middle East while we were having our one-on-one? (CT)

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Secretary Baker: We spent the whole time on our CW proposal. Foreign Minister Shevardnadze suggested a directive to the ministers from the two leaders. (C)

The President: The Lebanon situation is of heartbreaking concern to us. We have lots of interest in a peaceful resolution but very little influence. (C)

Chairman Gorbachev: We are doing much to improve the situation there. (C)

Minister Shevardnadze: We received a request from the President (of Lebanon) to issue a statement of support. He made a similar request to you. (C)

The President: We have already done that. (C)

Chairman Gorbachev: We made a statement to this effect with President Mitterrand and on our own. The President of Lebanon feels that our meeting could helpfully issue statement of support. I would like to see this. Perhaps we could make an oral statement for the press reaffirming our previous statements. (C)

The President: I like the idea. (C)

Minister Shevardnadze: The Lebanese President writes that he intends to use force against Aoun. (S)

The President: That would mean Syrian force. He doesn't have many foot soldiers. The outpouring of friendship for you in Italy was wonderful. It came through on our television. (S)

Chairman Gorbachev: I have warm memories of the meetings I had in New York City and the warm feelings toward me. (U)

The President: Very good. (U)

Chairman Gorbachev: When our cars were on the way to Governors Island, we learned of the earthquake in Armenia. I talked to Ryzhkov on the way. That night we were told 35,000 to 100,000 died. We were shocked and immediately took the decision to fly home. (C)

Secretary Baker: What was the final count? (U)

Chairman Gorbachev: 24,000. I haven't seen anything like it in my life. (U)

The President: How is it now? Are you getting housing for the people? (U)

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Chairman Gorbachev: We have a program worked out, but we had to be sure that the new houses were protected against earthquakes. That doubled the cost. There have been some delays, but work is progressing well. Chernobyl cost 8 - 10 billion rubles, including compensation to people affected. Restoring Armenia cost 12 to 14 billion rubles. There has also been a drop in oil prices. All of the above means for the next five year period we have some difficult choices. (C)

The President: What gets you on budgeting is these unforeseen circumstances. Our savings and loan problems are costing \$50 billion. (C)

Chairman Gorbachev: That is not much considering the size of your economy. Did this happen when you (Secretary Baker) were Secretary of Treasury? In Italy, I saw a lot of products and few customers. In our country, it is the opposite. Your shops have merchandise. Ours have none. The main problem is the deformation of the market, the great ruble overhang. We have been given a lot of advice. First, let the market decide, and let it absorb excessive liquidity -- a free market. I asked our economists where in the world there is a completely free market in the last ten years. They could give me no example. If we followed that advice, within a week the workers would be in the streets bringing the downfall of any government. Others advise that we buy 16 to 20 billion rubles of consumer goods. To these advocates I say: 1) we can't allow vital questions for our country to be decided elsewhere; (2) if we agreed to such a course, it would be a major blunder and it would make our restructuring more difficult. We need to wean our people away from a leveling principle. They need to learn how to work, to depend on themselves. Our society is changing and we must change our thinking. (S)

The President: In that regard Alan Greenspan's visit, for example, was very helpful. The visits of some U.S. business people are very helpful. I have respect for our systems being widely apart now as you work for change inside the Soviet economy. In the U.S. there is interest in enhancing trade, and hopefully it is in your interest if we have more exchanges and visits between our economic and business people talking exclusively about trade and economics. It would help for us to work together to advise our business people concerning their activities in the USSR. I don't have a formal proposal but these activities would serve what I want -- more trade and investment between our two countries. (C)

Chairman Gorbachev: That is exactly what we favor. As a general remark, we expect from the U.S. President is a political statement in support of what we are doing. Business circles in the U.S. have great potential and, as Ambassador Dobrynin can testify, are eager to move forward. That is why I attach great significance to what you said today about the economic measures you have in mind. (C)

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The President: We have to move toward more compatibility of the systems, instead of the current polar situation. This can be done without putting down the other guy. Regarding statistics, we do not have perfect accuracy, but we have some pretty good people. I would like them to sit down with your folks. This is good for the investment climate. Jim Baker is reminding me of the list of ten areas in this domain where we can cooperate. (C)

Chairman Gorbachev: In some of those areas, we have ongoing cooperation. But we can do better on banking activities and fiscal issues. For example, the people of Milan have started a business school in Moscow. (C)

Secretary Baker: Foreign Minister Shevardnadze and I discussed this before in Wyoming. As a former finance minister, may I say this: this morning you mentioned ultimate convertibility of the ruble. We totally agree that is the direction you should try to go. To get to convertibility will probably require you to establish a price system. I am quite aware that economists will say to do that now and politicians will say that it's not possible. (C)

Chairman Gorbachev: Yes. (U)

Secretary Baker: Before you do that you must take care of the ruble overhang. I wonder what steps you have decided on to take care of the ruble overhang and wanted to urge you not to forget the potential use of gold -- or gold backed bonds as instruments. You could get rid of some of that overhang without dangerous side effects. (C)

Chairman Gorbachev: On this score, we are already undertaking initial measures. We are doing this within the framework of next year's plan. We want to reduce our budget deficit by 60 billion rubles, by one-half. We want to restrain the rise in profits and earnings. So we must, first, exert strict control of excessive ruble overhang through proper taxation and, second, introduce bonds or securities that would pay a certain percent of interest. We must also use up excessive rubles by making people buy bonds that would guarantee delivery of a car from a new plant we intend to build. We are reducing our volume of industrial investments to funnel them elsewhere. We also are making the military sector produce consumer goods. In one case, we gave a government order to 325 military enterprises to produce food processing equipment. On December 12, the Congress of Peoples Deputies will go to work on our financial situation and promote economic reforms. There is one suggestion of selling land to the people. We are not agreeing to this. Rather, we will lease, with the right of inheritance. We are moving toward private property, but very small and with no big business. Our eventual goal is to make all these enterprises act within the market after market mechanisms have been installed. In Italy, Soviet businesses operate in just this way. (S)

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The President: If more privatization can be encouraged, this would be better for international trade, at least with the U.S. It would attract capital from our country in tremendous volumes. (c)

Chairman Gorbachev: If we have property of stockholders, for example, there are such examples in the U.S. In the U.S. it is difficult to find pure, genuine private property in U.S. -- perhaps only on a family farm. What counts is the degree of economic independence. What is important is to be able to dispose of the means of production and products, but this could be through leasing, cooperatives, or stockholding. Naturally, we need widespread banking and credit institution systems. If we take, Mr. President, the example of the U.S., there are many variants. The ways applied in the U.S. -- or, say, U.K. -- vary. Italy is different still. Sweden has mostly cooperatives. The main thing is to have many options, not to foreclose options. We have to allow certain variants to take shape. (c)

The President: But the Swedes do best when they privatize, as in Saab. Then, the worker has a real reason to work.

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