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22 October 1980

CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

POSSIBLE ECONOMIC ASSISTANCE FOR POLAND

Note by the Secretaries

Circulated herewith are copies of minutes to the Prime Minister from

- A the Lord Privy Seal dated 20 October;
- B the Chancellor of the Exchequer, dated 22 October; and also
- C a letter from the Secretary of State for Trade to the Lord Privy Seal, dated 22 October.

These will be discussed at the meeting of the Committee on Thursday, 23 October.

Signed ROBERT ARMSTRONG
R L WADE-GERY
R M HASTIE-SMITH

Cabinet Office

22 October 1980

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A

Prime Minister

POSSIBLE ECONOMIC ASSISTANCE FOR POLAND

You will recall that in his message to you of 27 August President Carter referred to Poland's likely need for further economic and financial assistance from the West and suggested that our aid should be designed to encourage the Poles to undertake a more fundamental and systematic reform of their economic system. In reply, you said that you looked forward to hearing what the President had in mind (we have had no response), that you would welcome any proposal for ensuring that our help went to benefit the Polish people rather than to the shoring up of an unreformed system, but that we would have to take care to avoid accusations of interference.

2. The Polish Ambassador called on me last week to put forward, on the instructions of his Prime Minister, a number of specific requests for economic assistance from the UK. The details are attached at Annex A. The Ambassador made it clear that, while the subject would not be formally on the Agenda, the Poles would want to pursue it during the Foreign Secretary's visit from 29-31 October. We shall therefore need a line before then. Officials from a number of Departments have now looked at this.

3. The Poles have told us that they are making similar approaches to the US, France, FRG and Italy, and they seem to have been in touch also with Austria, Belgium, Norway and Sweden. The Americans have already given us details of the informal requests they have received (which include one for \$3 billion in further /credits

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credits on favourable terms), but they have not indicated how they intend to respond. We shall be following this up with them and comparing notes also with other countries involved. We should coordinate our response closely. It may suit the Poles to try to handle the matter by separate bilateral contacts, but there is no reason for us to go along with this provided we are discreet.

4. None of us will find the question easy. The Polish economy is in serious difficulty and the authorities have had to make concessions to consumers and wage earners which will make things worse at least in the short term. Poland needs external credits to stay afloat until the economy can be restored to health. That will take several years at best, and Poland will have difficulties in servicing her debts. It seems quite possible, as indicated in the press, that Poland's hard currency debt may rise from \$22 billion at present to \$30 billion or even more in the next 3-5 years - assuming lenders are found. We do not have the same means of ensuring that Poland will adopt sensible, and, if needed, painful policies of adjustment as we do when the IMF is involved, and it is generally accepted that the Russians would not tolerate a Polish move to join the IMF in the present circumstances. Further, the political situation in Poland remains precarious, and it is impossible to say at this stage whether the significant move towards democracy represented by the events of the last few weeks can or will be maintained.

5. Yet what is happening in Poland is of major political importance not only for that country but for Europe. The West has a substantial interest in any loosening of the Soviet system. To achieve this the reforms already agreed will have to be consolidated. The Poles cannot do this without financial assistance. We can safely assume that the Russians will not provide the requisite /economic

economic aid without setting very harsh conditions. If we refuse to help therefore the implication will be that we are indifferent to events there, which is not the case. Without outside assistance the Poles will be forced to crack down economically. This would provoke more strikes and probably Russian intervention, with all the dangers that that would entail. The end result would be the opposite of what we and other Western countries have been trying to encourage in our policy towards Eastern Europe.

6. There are other considerations to bear in mind. There will be financial limits to what individual countries can do. And there are a number of dangers which each will wish to avoid: in particular that of committing money over a long period without the possibility of withdrawing if economic or political conditions should change for the worse; and of making concessions to the Poles which have been refused, or could not be offered, to countries who might consider they had a better claim and whose cases could not plausibly be distinguished. We should watch carefully the use to be made of any British money provided, given the glaring facts about the nature of the Polish economy and our wish to avoid shoring up an unreformed system. We could also look for ways of helping Poland in ways which do not involve government guarantees or spending public money for example by helping them with their marketing in hard currency areas. Any assistance we do make would have to be in instalments, so that it can be withdrawn if the Poles or the Russians crack down. And of course even with Western financial aid there can be no guarantee that the Russians will not intervene.

7. The balance is not easy to strike. But, at the end of the day, I believe that at least the Americans, the French and the Germans will conclude (as President Carter and Herr Schmidt have already indicated) that something should be done to help the Poles and to /provide

provide concrete evidence of Western interest in their future. All three have recently provided some extra finance for Poland, either new money, guarantees or refinancing. We shall be expected to play our part, and I think on balance that we should.

8. If you and other colleagues agree this general conclusion, neither the Foreign Secretary during his visit to Warsaw nor the Minister of State for Trade (who will be leading our team at the Annual Anglo-Polish Joint Commission in Warsaw on 10-14 November) need be drawn into too much detail on what we may be able to do. But they will need to have guidance on the points on which they could indicate our willingness to enter into more detailed discussion with the Poles. I would suggest the line at Annex B. I am sorry that the Polish approach has not given us much time before the Foreign Secretary sets off on 27 October.

9. I am sending copies of this minute to Geoffrey Howe, Keith Joseph, John Nott, Peter Walker and Sir Robert Armstrong.

: J.H.S.

20 October 1980

ANNEX A

The following are the requests put by the Polish Ambassador on 13 October:-

- (a) some postponement of the repayment of ECGD guaranteed debt in 1981 and 1982 (the Poles say they are not proposing an actual moratorium);
- (b) an agreement on the availability of further credit from ECGD which would assure the Poles of credits for certain commodities, particularly chemicals, fibres, steel and grain, over the next three years;
- (c) 5 year repayment periods for these new ECGD credits from 1981 (including two year grace periods);
- (d) the lowering of the permitted minimum size of contract which can be covered by ECGD guarantees;
- (e) liberalisation of British quotas for imports of Polish leather goods and small television sets;
- (f) British support in GATT for the suspension until the end of 1982 of the Poles' minimum import growth quotas.

ANNEX B

The following is the line suggested as guidance for the visits to Warsaw of Lord Carrington and Mr Parkinson (references are to the Polish shopping list at Annex A):-

- (a) Any suggestion of a moratorium or postponement of the repayment of ECGD guaranteed debt would cause us considerable difficulty. Such a proposal would almost certainly have to be negotiated multilaterally with other creditors; it would limit our ability to provide further export credit; and there would be an immediate effect on public expenditure. Agreement to some amount of refinancing would avoid these difficulties. We could consider offering an ECGD guarantee of new bank loans of a certain amount, and the financial liability would thus be a contingent one. Such financing should in the first instance be offered only for 1981. This would exert a degree of leverage on the Poles, and give us the flexibility to withdraw later if economic or political conditions required it. But I think we should recognise that even on optimum performance by the Poles, refinancing will be needed in 1982 as well, and probably beyond. If we agreed to proceed on this basis, we could tell the Poles that this was a subject which we would be prepared to explore further at official level after the Joint Commission. There would thus be plenty of time for the departments involved to agree a detailed brief, and we should of course wish to make sure that the Poles gave us as clear as possible an indication of their economic plans.

- (b) We could agree in principle to further credits for the commodities in question, but would once again prefer to avoid committing ourselves for more than one year at a time.

/We

ANNEX B (contd)

We could, however, say that we would expect the arrangements to roll over, other things being equal. We could offer to explore further with the Poles, as for (a) above. When we came to work out the detailed brief for these discussions, we should consider how far we could place the emphasis on items such as grain and agricultural machinery, which both make economic sense and are of direct benefit to the Polish people.

- (c) Grace periods cause serious difficulty. But we may be able to move towards 5 year repayment periods, more especially if other Western countries are prepared to do so too.
- (d) I understand that there need be no objection to this if it is a point to which the Poles attach importance.
- (e) Keith Joseph will wish to comment, but I understand that these are particular sensitive areas. If this is so, and we can agree to the reasonably forthcoming line suggested above on the other points, I would suggest that we tell the Poles quite clearly that this is not an area which we can usefully pursue.
- (f) This is a point for the European Community, but we should be able to tell the Poles that we understand their difficulties and will work with our partners for a mutually acceptable solution. We presumably accept that the Poles are not going to be able to meet their GATT import growth commitment while they restore their balance of payments to equilibrium, and the latter is clearly the more important.



B

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PRIME MINISTER

POSSIBLE ECONOMIC ASSISTANCE FOR POLAND

Ian Gilmour minuted you on 20 October about the response which Peter Carrington should give when he visits Poland at the end of this month to the proposals for economic assistance which the Poles have put forward.

2. I agree with him that the questions raised are difficult. The political situation in Poland is unstable, and the concessions made to the strikers have made the country's foreign currency situation worse. There is no certainty at all that Poland will have the ability to meet its foreign currency indebtedness in the foreseeable future.

3. Our present level of exposure is very high - over £1 billion, and exceeded only by the French. The Polish proposal could increase our exposure to the extent that we agree to further credits for commodities. (Also, public expenditure would be increased, if these credits attracted interest rate support). Given the prospects for the Polish economy, I think we should be very cautious about doing this, in a situation where prudently we should be looking for a reduction. We must also bear in mind that Poland might set a precedent for our treatment of other countries.

/4. Politically the



4. Politically the United States and West Germany are more immediately concerned in the Polish situation. Neither, we understand, has yet had a formal request from the Poles. The Americans have been told informally what the Poles have in mind, and a telegram from our Embassy in Washington (No 4312 of 17 October) set out some of the US preliminary thinking. Apparently, in the State Department's view any restructuring must be multi-lateral (the normal procedure in these circumstances). It is not at all clear that the Americans are in a position to take very quick decisions.

5. I agree, of course, that we should do nothing to precipitate a further crisis in Poland, which might lead to Russian intervention. I accept that we may well have to give help to the Poles. But I do not think that we should get ahead of the other major countries involved. As Ian says, we should co-ordinate closely with the others, and this apparently is what the Americans want. Therefore I hope that while Peter Carrington can express sympathy and understanding with the Poles during his visit, he should not commit us in principle to any particular form of assistance. It seems entirely defensible that we are still considering their proposals. Meanwhile we should co-ordinate, in the most appropriate way, our thinking with that of the other major creditor countries.

I am copying this minute to Ian Gilmour, Keith Joseph, John Nott, Peter Walker and Sir Robert Armstrong.

G.H.

PS. cc also to other members of OD

(G.H.)

22 October 1980



From the Secretary of State

CONFIDENTIAL

The Rt Hon Sir Ian Gilmour Bt MP
Lord Privy Seal
Foreign and Commonwealth Office
Downing Street
London SW1

22 October 1980

Dear Ian -

POSSIBLE ECONOMIC ASSISTANCE FOR POLAND

Thank you for your minute of 20 October. I must say that in view of our existing £1 billion ECGD exposure in Poland I am not enthusiastic about increased cover. However, in the context of the refinancing package I am prepared to agree with the proposals in your Annex B; I have, however, one or two points to add.

We will need, I believe, to decide by the date of the Joint Commission on the size and shape of the credit package we are prepared to offer. The Poles have made it clear to officials that their purchasing contracts for 1981 are let during November and that they will need to know by then what they can expect from us.

As regards quotas, I would like to suggest that, subject to the views of Keith Joseph, we might be prepared to go a little way to help the Poles, perhaps by bringing forward to this year the concessions already agreed (but not yet tabled in Brussels) for 1981. These would not affect leather goods but would allow an additional 5 to 7% increase in imports of television sets.

I agree with your proposals regarding the Poles import commitment under the GATT. They have not in fact met it for some years and a temporary derogation until 1982 seems to do no more than admit the facts of life. We should, however, make clear that we see no



From the Secretary of State

link between the Polish import commitment and the phasing out of the Community remaining quotas on imports from Poland.

One final point. I am not entirely clear what is envisaged by your suggestion in paragraph 6 of your minute that we should help the Poles with their marketing in hard currency areas, but I think we should be very wary of accepting any commitment which would lead us to be, as it were, export managers for Polish products.

I am copying this to Geoffrey Howe, Keith Joseph, Peter Walker and Sir Robert Armstrong.

John Nott

JOHN NOTT