PO-CH/NL/0323 PT A

Part. A

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

Begins :25/3/87.
Ends :3/11/87.

PO -CH /NL/0325

PART A

Chancellor's (Lawson) Papers:

INITIATIVES FOR RELIEVING INTERNATIONAL DEBT IN EUROPE

DD's: 25 Years

[signature]

1/11/95.

PO -CH /NL/0325
PART A

9/2567

8

FROM: MISS HIGGINS
DATE: 25 March 1987

approved draft

1. Mr MOUNTFIELD
2. PS/ECONOMIC SECRETARY

cc PS/Chancellor
PS/Sir P Middleton
Mr Lavelle
Mr Evans
Mrs Case
Mr Walsh
Mr Pitcairn

CALL BY MR WOJCIK ON ECONOMIC SECRETARY

pronounced how?

The Polish Minister for Foreign Trade will be calling on the Economic Secretary at 11.15am on Friday 27 March. The call is primarily a courtesy call and is the final official meeting of his three day visit to the UK.

2. Mr Wojcik (pronounced Vui-chik) will already have seen Mrs Chalker on Thursday where he will have discussed EC/Poland matters, together with general bilateral issues. Financial questions on the IMF and the economy will be steered towards the Economic Secretary. This call provides a further opportunity to get across the message that Poland needs to regularise its external payments situation by honouring its obligations within its ability to pay. Before any longer term settlement can be arrived at, Poland will need to implement the necessary adjustment measures. An IMF programme would provide a framework for this.

3. The Economic Secretary should be aware that Treasury officials have met the Polish authorities on a number of occasions, most recently Mr Dorosj (Deputy Minister of Finance) called on Mr Mountfield on 20 March.

4. The brief includes

(i) Points to make

(ii) Background briefs on Polish Economy, Financial issues and the internal situation.

5. Details of other Ministers and businessmen that Mr Wojcik will be seeing will be forwarded to your office tomorrow, when the details are received from the DTI, who are arranging his visit.

6. Mr Mountfield and Mr Pitcairn will support the Economic Secretary at the meeting and will brief him beforehand if required.

Guy Westhead

PP MISS A HIGGINS

4166/046/AC

CONFIDENTIAL

Points to Make

1. Welcome Poland back into membership of the IMF/IBRD and hope that this will help Poland get to grips with its economic problems. It is in our long-term interests to help restore the Polish economy.

2. Has Poland now decided to seek an IMF Standby Arrangement? UK would support such a request in principle, although we reserve our position on the terms until we have seen the IMF report.

3. Necessary adjustment policies seem certain to cause temporary hardship to sections of the population. How can more resources be switched into exports without causing popular unrest?

4. Aware of efforts made to regularise debt position since negotiations were resumed in 1984. HMG anxious to play a constructive and helpful part in this difficult process. We expect Poland to honour its payment obligations within its ability to pay as a demonstration of its good intentions.

5. Need to regularise position on 1986 and 1987 payments. Longer term settlement must await IMF staff recommendations. UK will continue to try to play helpful role in Paris Club. UK would be glad to talk bilaterally with your colleague Mr. Dorosj.

6. No UK political bar on new credits. Our policy determined solely by commercial/prudential criteria.

7. [If pressed on longer term credit/debt relief]. Recognise that a substantial improvement in Poland's debt repayment capacity will require long-term assistance (whether debt relief and/or new credits). But until appropriate IMF-supported programme in place, insufficient assurance that breathing space thus gained would be used to best advantage.

8. [If pressed that other countries have provided credit]. UK made conditional offer last June of £20m short-term line of credit. Regret Poland unable to fulfil conditions but understand that Poland's requirements are more substantial and long-term.

3980/20

Tony K.

FROM: P J CROPPER
DATE: 30 JUNE 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Hudson
PS/IR

Julian

HUNGARIAN TAX REFORMS

The Chancellor may not have noticed the attached FT article on 23 June.

2. It would appear that Western civilisation is spreading to Hungary, in the form of VAT and Income Tax.

3. Might it be worth asking the FCO for a note? (Why?)

P J CROPPER

H.M. CUSTOMS & EXCISE
PRESS & INFORMATION
OFFICE
23 JUN 1987
KING'S BEAM HOUSE,
MARK LANE,
LONDON, EC3R 7HE

FINANCIAL TIMES
23 JUN 1987

Hungarians braced for tax upheaval

By Leslie Colitt in Budapest

HUNGARIANS are bracing themselves for a fiscal upheaval as the Communist leadership prepares to introduce VAT and other Western-style taxation for the first time in Eastern Europe.

The central tax office is to open its doors on July 1 in Budapest while hundreds of tax inspectors are being trained and a powerful new computer to process tax forms has been purchased with the help of funds from the World Bank.

VAT and personal taxes for wage earners will be accompanied by the lowering of corporate taxes in order to reward efficient companies. Companies which previously paid a 55 per cent tax on earnings will pay some 40 per cent.

The gap in revenue is to be made up by reducing subsidies to both producers and consumers. As elsewhere in Eastern Europe the Hungarian Government receives most of its revenue from company taxes while individuals pay little or no tax.

Understandably ordinary Hungarians and the nation's many inefficient companies are less than enthusiastic about the government's fiscal plans.

Mr Miklos Pulai, Deputy Chairman of the National Planning Office, who is in charge of the tax programme, explained that VAT and the simultaneous elimination of most consumer goods subsidies would result in a 5 per cent "overnight" price increase. This plus other price rises would mean a record consumer price increase of more than 10 per cent next year against an expected 7 per cent this year.

"We will be crossing the Hungarian psychological border," he noted drily in an interview.

Some senior party officials are concerned that taxation — coming on top of declining real income in recent years — could lead to a backlash from the population. But government officials say the political leadership under Mr Janos Kadar is determined to press forward.

Mr Pulai said there has been no decision yet on income tax progression but that it would probably start at 20 per cent and run up to 60 per cent.

THE TIMES
23 JUN 1987

Split over Pentagon call to ban Iran trade

From Michael Binyon
Washington

The Reagan Administration is deeply split on whether the United States should continue trading with Iran at a time when it is seeking mandatory sanctions in the United Nations to enforce a ceasefire in the Gulf War.

Mr Caspar Weinberger, the Defence Secretary, is calling for a ban on all exports to Iran, except medicines and humanitarian goods. But the State and Commerce Departments want to continue the present low level of trade as a way of keeping open a relationship with the private economy in Iran and American-trained technocrats there. The issue has come to a head because of the present crisis in the Gulf.

The Pentagon was deeply unhappy with the Administration's authorization in March of export licences for the sale of $900,000 of computers to Iran. Mr Weinberger appealed to the National Security Council to take up the question and submit a report to President Reagan for a decision.

Last month the NSC sent the White House its classified inter-agency report on Iranian trade. This acknowledged the split in the Administration, sources said, but was so vague that it was sent back for redrafting. The Pentagon is using the delay to press for a cut-off in trade.

Since the fall of the Shah, US trade with Iran has dwindled to a fraction of what it was. Last year Iran bought only $34 million (about £20 million) of US goods, mainly small machinery and agricultural products. America, however, spent $600 million on oil, carpets, caviar, gems, glassware and nuts.

Meanwhile, the US is said to have rejected an informal request by Liberia for protection for about 80 US-owned tankers flying the Liberian flag in the Gulf. Other countries whose flags of convenience are flown by US ships, such as Panama and the Bahamas, will also be turned down if they request protection.

● **VIENNA:** Two Green members of the Austrian National Assembly have demanded a parliamentary inquiry into allegations that Herr Alois Mock, the Foreign Minister, and Herr Karl Blecha, the Interior Minister, were involved in a cover-up over illegal arms deals with Iran worth £40 million (Richard Bassett writes). Both ministers have consistently denied such allegations.

Inland Revenue

Policy Division
Somerset House

Pps

Mr Scholar (not copied)
Is it consistent with the Hungarian policies of the Revenue Depts? What other Govts ~~do~~ we advise?

FROM: J P B BRYCE
DATE: 16 JULY 1987

PS/CHANCELLOR

HUNGARIAN TAX REFORMS

1. In his minute of 30 June, Mr Cropper drew attention to an article in the Financial Times about the forthcoming fiscal reforms in Hungary. We do not have very much direct information about the Hungarian reforms, but one of the members of this Department has been, in a personal capacity, assisting the Hungarian authorities on the introduction of a personal income tax under an IMF technical assistance programme. A member of Customs and Excise has a similar role in relation to the introduction of VAT.

!

?

X

2. The first thing to note is that the tax reforms are an integral part of the more general economic reforms of wages, prices and "ownership", by which is meant ultimately decentralisation of ownership. A further component is the banking reform which began in the first half of the 1980's with the introduction of a two-tier banking system - consisting of a central bank and commercial banks guided by business considerations - which should lead to an integrated retail and wholesale banking system and which will eventually be a primary source of investment capital for industry.

---

c PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cropper
Mr Scholar
Mr Hudson
PS/Customs & Excise
Mr Painter
Mr Taylor Thompson
Mr Beighton
Mr Driscoll
Mr Bryce
Mrs Smyth
PS/IR

3. It is very difficult to make any meaningful comparison with the UK since Hungary is a "socialist" economy and exceptionally centralised. There is no real corporate tax system as we know it. Instead, enterprises in the various sectors (agriculture, industry, trade etc) are subject to a complex regime of "regulation" which combines levies, taxes and subsidies in a quite bewildering way. It will be a major achievement for the Hungarians if they can get away from the sectoral approach and tax enterprises on a uniform basis. Work in this area is at a fairly early stage. In the meantime, the cut in the rate of profits tax is very difficult to evaluate. It will mean different things in different sectors.

4. On the fiscal side, the reform package includes the introduction of a value added tax and a personal income tax; both to be introduced on 1 January 1988 and administered by the new administration which is being set up. Each tax will replace a variety of taxes. In the case of the personal income tax, these include a rudimentary "general income tax" (which is precisely not that) which applies only to certain incomes outside the "socialist sector". The innovatory aspect of the tax is that it seeks essentially to replace a hotchpotch with a single tax that will apply to the whole population.

5. The Chancellor will not be surprised to learn that the details of the personal income tax are the subject of a lively political debate throughout Hungarian society. Individual pressure groups - agriculturalists, artists, home buyers, savings institutions - are all fighting their corner. As a result, a lot of the details remain to be settled.

6. What is not in dispute, however, is that the "tax unit" is to be the individual - not the family or married couple. Tax will start at about 20 per cent at about 80-90 per cent of average wages and rise to perhaps 60 per cent at about 10 times that figure. We understand that various possible scales have been published and are under discussion. Tax will be deducted at source from wages and other taxable income where possible. It is

not yet certain whether a full self-assessment scheme will be introduced.

7. This is of course no more than an outline of the proposed reforms, and we would be very happy to try and find further information on any particular aspect which the Chancellor might wish to pursue.

J.B.

J P B BRYCE

393/33

FROM: S P JUDGE
DATE: 17 July 1987

PAYMASTER GENERAL

PS/C&E

cc: PS/Chancellor
Mr Scholar

HUNGARIAN TAX REFORMS

The Paymaster General has seen Mr Bryce's submission of 16 July to the Chancellor, and would be grateful for a brief note on the VAT aspects of this. The Paymaster does not want anyone to go to too much trouble on this.

2. The Paymaster found it interesting that people in Hungary can earn ten times average earnings.

S P JUDGE
Private Secretary

UNCLASSIFIED

1. Alex
2. b/f with response p/

FROM: A W KUCZYS
DATE: 20 July 1987

MR SCHOLAR

REVENUE DEPARTMENTS

The Chancellor has noted, in Mr Bryce's minute of 16 July on Hungarian tax reforms, that:

> "...one of the members of this Department has been, in a personal capacity, assisting the Hungarian authorities on the introduction of a personal income tax under an IMF technical assistance programme. A member of Customs and Excise has a similar role in relation to the introduction of VAT."

2. Is this consistent with the manpower problems of the Revenue Departments? What other Governments are we advising?

A W KUCZYS

cc PS/Chancellor
PS/C&E
Mr Knox
Mrs Strachan
Mr Scholar
Mr Nash
Mr Russell
Mr Jefferson-Smith
Mr Howard
Mr Wilmott
Mr Cockerell
Mr Bryce IR
Mr Driscoll IR

29/7/87.

Mr Judge
PS/PMG

HUNGARIAN TAX REFORMS

The Paymaster asked for a brief note on the VAT aspect of tax reforms in Hungary. I am replying since I was seconded to the International Monetary Fund to act as consultant to the Hungarian government on the implementation of VAT.

Background

Mr Bryce's submission of 16 July provides a general background to the tax reforms but the following additional information may be of interest. Decisions taken by the Hungarian government in 1968 which permitted a degree of privatisation and subsequently the setting up of "special groups" in industry and on collective farms which could work for the personal profit of the groups' members have led to a radical change in the nature of industrial life in Hungary. The taxation system has not developed along the same liberal lines as the economy and now constitutes a restraint on further growth and risks provoking discontent amongst workers because of its unfairness.

The words "taxation system" are misleading. The present system is an over developed and extremely complicated machinery for controlling both prices and production. The turnover tax has some hundred different rates and gives rise to liability problems that make UK VAT problems seem simple. There also exist a range of production, wage and profit taxes of breathtaking complexity. Such a regulatory system is at odds with an economy now much more sensitive to market forces both national and international and it no longer works. For instance it is common for state enterprises to incur tax bills they cannot meet because they are not permitted to raise prices even though their goods are in short supply. When this happens there is a negotiation with the authorities over what should be paid. The Paymaster found it interesting that people in Hungary can earn ten times average earnings. In fact because of the ability of individuals to participate in one or several profit making groups there is no ceiling to the income they can earn. The present incapacity of the system to properly tax the incomes of the new wealthy class had led to social unrest and has been an additional incentive to adopt a new and more equitable tax structure.

Value Added Tax

A principal worry in advising the Hungarian government was that it would not relinquish control over consumer prices and would adopt a VAT system with a multiplicity of rates to control production. Fortunately the authorities decided to allow prices to float and this opened the door to an orthodox VAT system.

There will be three rates - 20%, 10% and zero. The tax population is estimated to be around 150,000. There will be the standard exemptions for financial services, health, education, rented accommodation and cultural activities etc. Zero rating will apply to some foods (dairy products), construction materials, pharmaceuticals and household energy. Childrens clothes will <u>not</u> be zero rated.

Many changes to Hungarian law are made necessary by the introduction of VAT and PIT. Provision for bad debts has to be introduced. The concept of joint and several responsibility has to be clarified in relation to profit earning "special groups" otherwise there will be problems with tax enforcement. Similarly the procedures for bankruptcy and liquidation have to be changed, especially in the light of recent banking reforms.

Conclusion

The Hungarian authorities are committed to the introduction of VAT and PIT by 1 1 88. There are doubts as to their capacity to meet this deadline and a postponement is not unlikely. In any event there will be considerable social and administrative turmoil when the changes are introduced. Other eastern bloc countries are studying the Hungarian experiment closely and if it is successful are likely to follow suit.

If the Paymaster requires further information I shall be happy to provide it.

I SAVINS

29 July 1987

V391.54

pmp

PAYMASTER GENERAL

FROM: S P JUDGE
DATE: 31 July 1987

MR SAVINS - C&E

cc PS/Chancellor
Mr Scholar
Mr Bryce: IR
Mr Driscoll: IR
PS/C&E

HUNGARIAN TAX REFORMS

The Paymaster General found your minute of 29 July to me fascinating. He would be grateful for a further report in, say, March next year on progress in implementing the reforms.

S P JUDGE
Private Secretary

Please look at this! Hooray!

P/S ack
PST
N.

THE WHITE HOUSE

WASHINGTON

August 25, 1987

Dear Mr. Lawson:

On November 24-26, 1986, a unique gathering took place in Paris, France. For the first time in history, cabinet-level ministers and leading business executives from seven countries gathered for the purpose of promoting private sector initiatives.

This unique International Conference on Private Sector Initiatives explored ways that government and the private sector can work together to promote:

- o Charitable Giving;
- o Voluntarism;
- o Public/Private Partnerships; and
- o Corporate Social Responsibility.

President Reagan has encouraged this program in America and has recently worked with other world leaders to promote it in their countries.

Enclosed is a copy of the Report of the International Conference on Private Sector Initiatives. I hope you find it interesting and informative.

If you would like additional information about organizing a private sector initiatives program or have any questions about this Conference, please feel free to contact us at:

Office of Private Sector Initiatives
The White House
Washington, D.C. 20500
(202) 456-6676

Sincerely,

Fred Ryan

FREDERICK J. RYAN, JR.
Director of Private Sector Initiatives
Director of Presidential Appointments
and Scheduling

The Right Honorable
Nigel Lawson, M.P.
Chancellor of the Exchequer
Parliament Street
London SW1P 3AG
England

Enclosure

3764/006/

CONFIDENTIAL

FROM: P D P BARNES
DATE: 16 September 1987

MEETING HELD IN ROOM 51/2, PARLIAMENT STREET AT 10.30 am ON FRIDAY 10 SEPTEMBER 1987

Present: Economic Secretary
Mrs Case
Mr Jaggers - Bank of England
Dr Timar - President of the National Bank of Hungary
Dr Karczag - Managing Director, National Bank of Hungary
Dr Domokos - Hungarian Ambassador
Mr Simor - Senior Manager, National Bank of Hungary.

ECONOMIC SECRETARY'S MEETING WITH PRESIDENT OF NATIONAL BANK OF HUNGARY

Dr Timar thanked the Economic Secretary for seeing him. He said that he had also visited the Bank, the Foreign and Commonwealth Office, and the National Westminster Bank.

IMF

2. Dr Timar explained the background to Hungary's current negiotations with the IMF. Since 1968, the Hungarians had been attempting to steer their economy away from centralised direction towards more market disciplines. Czechoslovakian developments had slowed the progress of reform in the early 1970s but the momentum had now revived. Recent developments included the introduction of a two tier banking system in which two departments of the National Bank had been split off and established as independent commercial banks, leaving the National Bank to concentrate on its central banking functions. The Hungarian Government was now attempting to reform the tax system by introducing VAT and personal income tax. These reforms were giving rise to unprecedented opposition, since a quarter of companies were predicted to be losers from the change. The Government was nonetheless hopeful of securing the passage of the Bill. The Government wanted the IMF's support for these reforms and were negotiating for a Stand By Arrangement of $1½ billion over three years, although they hoped that they would not need to make use of this facility. Dr Timar said that he hoped he could count on UK support for these reforms,

which were the most radical in Eastern Europe and in which a number of other Socialist countries had expressed interest.

3. The Economic Secretary thanked Dr Timar for his clear exposition. He said that the experience of the UK Government enabled him to understand the difficulties that lay in the path of radical reforms. He was sympathetic to Hungary's attempt to gain an SBA and expressed a hope for a successful conclusion to their negotiations.

Exports to the EEC

4. Dr Timar said that he would like to try to end the discrimination suffered by Hungarian exports to the EEC, which was inappropriate to a participating member of the GATT. Negotiations on this had been dragging on for some time. The Hungarian terms of trade had been poor for the last 12 years, in respect of manufactures as well as commodities, although the Hungarians had been particularly badly affected by the fall in the prices of meat, grain, and aluminium which were amongst their main exports. Hungary currently had a trade surplus with the Socialist Bloc but this could not continue indefinitely and they hoped negotiations could be concluded quickly to boost their exports to the West. Such a development would clearly also help their financial position.

5. The Economic Secretary said that primary responsibility on this subject fell to Mr Mellor. He hoped that, subject to satisfactory agreement on the details, the negotiations would be successful, since it was in everybody's interest for Hungary to balance its trade account by boosting exports.

International Debt

6. Dr Timar said that he thought that it was important to find an organised solution to the problems of international debt before the purchasing power of the world economy shrank further. Hungary had been affected by international debt problems through the contraction of exporting opportunities in Brazil, Argentina, and Africa.

7. The Economic Secretary drew attention to the Chancellor's initiative on Sub-Saharan Africa, for which the UK thought that

specific debt relief would be necessary. For the rest of the world, where debts were mainly to commercial banks, the Economic Secretary said that the UK would want to see a solution along commerical lines, perhaps involving debt/equity swaps, and would always subject to the agreement of the IMF to any of the the proposed programmes of reform. He thanked Dr Timar for coming.

PB

P D P BARNES
Private Secretary

cc PS/Chancellor
PS/Paymaster General
Sir G Littler
Mr Lavelle
Mr Evans
Mr Mountfield
Mrs Case
Miss Higgins

RC2.72

pse send booklet to library.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

16 September 1987

Frederick J Ryan Jr
Director of Private Sector Initiatives
Director of Presidential Appointments
and Scheduling
Office of Private Secretary Initiatives
The White House
Washington DC 10500
USA

RP

Dear Mr Ryan,

The Chancellor of the Exchequer has asked me to thank you for your letter of 25 August and the attached report of the International Conference on Private Sector Initiatives. The Chancellor read the report with interest.

Yours sincerely,

Cathy Ryding

CATHY RYDING
Assistant Private Secretary

FREE TRANSLATION

13/10/87

"My Dear Colleague,

As you are no doubt aware, the Portuguese Government approved on 31st March, 1987, a programme of macroeconomic policies for the next 4 + 4 years, regarding the correction of structural problems of the Portuguese economy. It is called the PCEDED - Programme for Structural Correction of the External Deficit and Unemployment.

The July elections of 1987 did not affect the implementation of this strategy of controlled progress and the Government did not only maintain the PCEDED but it also included it in its programme, already approved by Parliament.

I have therefore much pleasure in offering you a copy of the english version of the PCEDED, which I am sure will be of interest to you.

With my very best regards.

not attached (can show you if you want)

Miguel Cadilhe
Minister of Finance of Portugal"

MINISTÉRIO DAS FINANÇAS

GABINETE DO MINISTRO

Sua Excelência o Chanceler do Tesouro

LONDRES

Lisboa, 13 de Outubro de 1987

Meu Caro Colega

Como certamente é do seu conhecimento, o Governo Português aprovou, em 31 de Março passado, um programa de política macroeconómica para os próximos 4 + 4 anos, atinente à correcção dos problemas estruturais da economia Portuguesa. É o chamado PCEDED - Programa de Correcção Estrutural do Défice Externo e do Desemprego.

As eleições de Julho de 1987 em nada afectaram a prossecução desta estratégica de progresso controlado e o Governo não só manteve o PCEDED como o consagrou no seu Programa, aprovado oportunamente pelo Parlamento.

Tenho, pois, o prazer de lhe oferecer um exemplar da tradução em língua inglesa da Súmula do PCEDED, certo que estou do seu interesse.

Com os melhores cumprimentos

Miguel Cadilhe
Ministro das Finanças de Portugal

FROM: P MOUNTFIELD
DATE: 22 October 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler o/r
Mr H P Evans
Mrs Case
Mr J Halligan

Ch/ Content with Mr Mountfield's line?
AS 22/10

BL ✓

POLISH DEBT

The Paris Club plans a two-day negotiation with Poland next week. This note brings you up to date on recent developments, and seeks your agreement to the line we should take.

Polish Economy

2. The trend this year has been disappointing. The current account deficit for the first half (in convertible currencies only) was about $0.4 bn, compared with last years deficit of $0.7 bn (0.9 per cent of GDP). Imports are rising faster than exports and the trade surplus was down to $450m but the weaker position on the trade account has been offset by an improvement in net private transfer receipts. Poland is running an increasing trade surplus with the other Eastern-Bloc countries, allowing it to unwind the accumulated deficits built up in earlier years. Domestically, although industrial production is up, bad weather hit harvests, so that agricultural imports may be higher than they were last year.

Overall Debt Position

3. Poland has an external convertible currency debt of about $35 bn (45 per cent of GDP). This compares with foreign exchange reserves of $1.3 bn. Of this $21.5 bn is owed to Paris Club creditors and $11.5 bn to the commercial banks. ECGD has about $1.4 bn at risk and British-owned banks about $0.6 bn, making a total UK exposure of $2 bn.

New Economic Measures

4. Against this unpromising background, the government is pressing ahead with the next stage of its 'economic reforms'. These are on the pattern which is also appearing in USSR, Hungary, and to some extent Yugoslavia: a much more market-oriented system. However, the inevitable first cost will be a steep increase in consumer prices, as past distortions are eliminated and subsidies removed. Jaruzelski intends to secure popular support for his package by a referendum at the end of November. If successful, this will give the regime a degree of legitimacy which it lacks at present, and secure public acquiescence in (if not support for) the necessary measures. But, given the failure of the 1981 reforms which had similar objectives the prospects of these new reforms working cannot be high.

Prospects for a Fund Programme

5. It is not clear how far these measures have been discussed informally with the Fund. They involve a return to current account surplus only by 1991 (rather than 1992, as previously) and seem unlikely to be acceptable to the Fund, who believe a much earlier return is possible. In any case, there is no immediate question of a Fund Programme, though the FCO have received some private indications from the US that they have now removed their absolute veto. We suspect that the timetable will postpone a final decision until the end of 1988 - ie after the US Presidential elections. Mr Whittome of the IMF will be in Warsaw next week, and has promised to keep Mr Lankester in touch with developments.

Bank Negotiations

6. This has not held up the banks, who have pressed ahead with a long-term debt restructuring exercise covering all \$9 billion of maturities due out to 1992 (though there is a break-clause which requires an IMF programme to be in place by 1989). This rescheduling uses up most of the Polish payments capacity,

certainly in 1987 and 1988, and probably in later years unless there is an unexpected improvement in the trade position. British banks went along with this enthusiastically.

Paris Club

7. That left very little for the Paris Club, who are once again at the back of the queue. For this we have only the Americans to blame: their block on a longer-term rescheduling agreement last year allowed the banks to get ahead of us again. The Paris Club has so far rescheduled Poland four times and all their maturities over the period 1981-86 have been rescheduled at least once. The total value of debt rescheduled to date is $15.5 bn, and ECGD's share of this is $0.9 bn. Poland, of course, has accumulated arrears on these reschedulings of about $3 bn. The Paris Club has more or less agreed on its offer to the Poles: to reschedule 100% of all debt falling due in 1987 and 1988, both new maturities and sums falling due under earlier rescheduling agreements. This totals about $2.4 bn, of which about $1.4 bn is previously rescheduled debt and $1 bn is unrescheduled debt. Our price for this would be a substantial down payment on the accumulated arrears. We originally asked for $500m, but Poland has protested strongly at this, and indeed this may be hard to attain, short of re-opening the negotiations with the banks.

UK Line

8. On previous occasions, you have agreed that we should accept any deal which secures some cash return to the UK, the bigger the better, and that we should press for greater parity of treatment with the banks. I suggest we follow the same line on this occasion. If you agree, I propose to try to redress the balance with the banks a bit. The method would be to insist on such large down payments of arrears that Poland would be forced to renegotiate the deal with the banks next year. (The

Bank of England warned me that the reaction from the commercial banks would be very hostile: they argue, that in addition to rescheduling, they are continuing to make trade lines available, whereas governments have cut off export credit facilities.) I do not expect much support for this line, but I think we should try, and fall back gracefully on consensus if we fail. I also propose to make it clear that the UK will not participate in any rescheduling for maturities beyond the end of 1988 without an IMF programme in place. (This is also the position of France, FRG and, I believe, Japan (though the latter has not yet shown its hand).

Longer-term

9. If we can get a Paris Club agreement settled, which will take us through to the end of 1988 and to a Fund programme, we shall shortly have to consider what might follow. I believe the right answer is probably a package, combining a longer-term debt restructuring arrangement with a limited IBRD loan programme (concentrating on expanding Polish export capacity) with some co-financing by commercial banks and export credit institutions. It may be possible, under an earlier and abortive plan, to regard this as a form of 'project finance' with the proceeds segregated into a special account and insulated from future rescheduling requests. We are a long way from the need for decisions on such an approach, but you should know that this is the way things are moving.

Recommendation

10. I suggest you confirm that I should continue to negotiate along the lines set out above.

PM

P MOUNTFIELD

RJ4.15

CONFIDENTIAL

MP

FROM: J M G TAYLOR

DATE: 23 October 1987

MR MOUNTFIELD

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr H P Evans
Mrs Case
Mr J Halligan

POLISH DEBT

The Chancellor has seen your minute of 22 October, and is content with the line you propose to take.

JT

J M G TAYLOR

Cathy

Portuguese Embassy,
11, Belgrave Square,
London, SW1X 8PP

26th October, 1987

Dear Chancellor,

I have pleasure in enclosing a letter addressed to you from the Portuguese Minister of Finance, Mr. Miguel Cadilhe, together with Volume I of "Strategy of Controlled Progress" that accompanied the letter. A free translation of the enclosed letter is attached.

Yours sincerely

(João Hall Themido)
Ambassador of Portugal

The Rt. Hon. Nigel Lawson, MP,
The Chancellor of the Exchequer,
The Treasury,
Parliament Street,
London, SW1P 3AG

FROM: P MOUNTFIELD
DATE: 2 November 1987

CHANCELLOR OF THE EXCHEQUER

Good: I note X:

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr H P Evans
Mrs Case
Mr J Halligan

POLISH DEBT

The Paris Club reached a successful agreement with Poland last week. It was well within the terms you agreed. I attach the reporting telegram.

2. Two points are worth stressing.

a. The new Polish economic team seems determined to press ahead with the reform package (a more market-orientated approach; a strong adjustment programme, involving elimination of subsidies, reduction of budgetary deficits, etc and an increased hard-currency export surplus). Its ability to carry this through will depend on public support, and the referendum due at the end of this month will be an important marker. But this time, unlike 1981, I think they mean business.

Let's hope so: it would be the 1st time!

b. US opposition has eased a bit, but is still a problem. The deal we have reached, covering all debt maturing up the end of 1988, gives Poland a reasonable breathing space. But the US will not allow it to be described as an interim settlement pending an IMF programme - which is what it is. US representatives tell me, and Mr Whittome of the Fund confirms, that despite the reform programme, and the accompanying political reforms, the US is not committed to an IMF programme for Poland next year. This veto is the result of Secretary Baker's personal intervention: Schulz would have no objection. If it is maintained, we may need to ask you, in concert with Balladur and Stoltenberg, to intervene with Baker early next year. Without an IMF programme, the Polish recovery effort will falter and fail - and the UK won't get its money back.

PM

P MOUNTFIELD

OUT TELEGRAM

Classification	Caveat	Precedence
CONFIDENTIAL		IMMEDIATE

ZCZC
CONFIDENTIAL

FM FCO
TO IMMEDIATE WARSAW
INFO UKDEL IMF/IBRD
TELNO
OF 021000Z November 87

POLAND : PARIS CLUB RESCHEDULING NEGOTIATIONS: 29/30 OCTOBER

Summary

1. Agreement reached on package involving Polish payments of dollars 1010 million in respect of arrears and 1987 and 1988 maturities but dollars 130 million of the payment to be delayed until 31 March 1989. 5 year grace period, 5 year repayment period. Negotiations difficult but conducted in constructive manner. Poles notably more open than on previous occasions.

Details

2. The main elements of the agreement are as follows:

a. Relief on 100 per cent of all arrears of Principal and Interest incurred up to 31 March 1987 (except for 50 per cent of arrears incurred up to 31 March 1987 on the 1981 agreement). Moratorium interest on this amount of dollars 590 million to be paid in 1988. Relief also on 100 per cent of Principal and Interest on 1988 maturities. Moratorium interest of dollars 130 million on this amount to be paid by 31 March 1989.

b. 5 year grace period and 5 year repayment period with

Catchword: first

File number	Dept	Drafted by (Block capitals)	Telephone no

Authorised for despatch by: Initials Date/time

For COD use only	Comcen reference	Telegram number	Processed by

XY48 (REV)

Classification	Caveat	Precedence
CONFIDENTIAL		IMMEDIATE

first payment due on 30 June 1993 and final payment due on 31 December 1997.

c. 50 per cent of the arrears incurred by 31 March 1987 on the 1981 agreement totalling $290 million to be paid in four equal amounts on 30 November 1987, 31 December 1987, 31 January 1988 and 29 February 1988.

3. As a result Poland will pay dollars 145 million by 31 March 1989. It was made clear in a side-letter that the delayed payment of moratorium interest on the 1988 maturities would incur late interest and that those payments will not be rescheduled further.

4. An initial creditor request for payments to be made into a Special Account was dropped in the face of strong Polish opposition. There is no goodwill clause about creditor preparedness to reschedule future maturities. The Poles did not pursue this when the USA indicated that this would give them difficulties if it included the usual reference to the IMF. Bilaterals are to be concluded by 31 May 1988.

Comment

5. It was clear from the outset that Dorosz had come to the Paris Club with the serious intention of concluding an agreement. In a presentation, notable for being much more open and constructive than his previous appearances, he said that the aim of the recent economic reform was to increase the influence of market forces in the economy. Restoration of realistic prices was particularly important but this would depend upon approval in the forthcoming referendum. Poland hoped to conclude a Standby Agreement with the IMF as soon as possible and achieve balance of payment equilibrium by 1991. In response to comments that this date was unambitious Dorosz argued that balance by 1991 would require export volumes to grow by 6 to 7 per cent per year from now on, which was twice the expected growth of world exports over that period. Meanwhile Poland would need to ask Paris Club

27081 Dd8422716 50m 7/86 3656

YF37

creditors for a further rescheduling.

6. The creditors agreed at the outset to offer a rescheduling consolidating all maturities falling due until the end of 1988, as the Poles had demanded from the start of this round of negotiations. This was possible because the US had dropped its previous opposition to rescheduling beyond the first quarter of 1988. The question for the creditors was the amount of the downpayment to be demanded on the present arrears and the date up to which the remaining arrears should be capitalised. Several creditors expressed annoyance that, following the commercial bank rescheduling, the Paris Club were owed the most were again at the back of the queue for repayment. However, although no one said so in ~~terms~~ plenary session, it was realised that this had happened because the US had prevented an earlier agreement between Poland and the Paris Club and that the agreement with the banks could not be unwound, at least before 1989

7. The IMF estimated that Polish payments capacity to the Paris Club creditors in 1987 and 1988 combined was between dollars 0.8 billion and dollars 1.5 billion. This was after payments to the commercial banks and other, mainly socialist country, creditors. These estimates assumed a trade surplus at dollar 0.25 billion greater than the Poles had told the Paris Club would be generated. The wide range in the IMF estimates arose because of uncertainty about the likely extent of private transfers and short term capital inflows.

8. The creditors agreed to open with a demand for dollars 1.5 billion and settle for dollars 1 billion and a 10 year repayment period. This compared with the demand at the end of the previous negotiations for dollars 1.9 billion, which was made before the commercial banks rescheduling. The Poles opening offer was dollars 750 million compared with the previous offer of dollars 400 million and a 12 year repayment period. After four rounds of talks agreement was reached on the final package. This was not achieved

Classification	Caveat	Precedence
CONFIDENTIAL		IMMEDIATE

<<<< smoothly however. At one stage the Poles after having apparently agreed to pay dollars 1 billion appeared to retract their agreement, and reduced their offer to dollars 880 million and refused to pay anything in 1987.

9. The final agreement reflected the insistence of the creditors on receiving a substantial downpayment quickly and at least some money in 1987 with the Poles insistence on postponing at least some of the moratorium interest into 1989. Generally an acceptable outcome in all the circumstances but the resentment expressed at the inequality of treatment between the commercial banks and Socialist Country Creditors (who have received all amounts due to them from previous reschedulings on time) and the Paris Club (who have received very little of that due to them and that late) will be a factor in future discussions.

YYYY

HOWE

EED

NNNN

///
//
/

CONFIDENTIAL

pmp

FROM: J M G TAYLOR

DATE: 3 NOVEMBER 1987

MR MOUNTFIELD

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr H P Evans
Mrs Case
Mr J Halligan

POLISH DEBT

The Chancellor has seen your minute of 2 November, and has commented: 'good'. He hopes that the new Polish economic team do mean business. He also notes that he may need to intervene with Baker, in concert with Balladur and Stoltenberg, early next year.

J M G TAYLOR