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Ref. A03777

PRIME MINISTER

Poland: Economic Assistance

(OD(80) 74)

BACKGROUND

✓ On 23rd October OD agreed that we should help Poland economically, but only to the extent justified by our economic circumstances and by the parallel response of our main partners. The approach proposed in the Lord Privy Seal's minute to you of 20th October was broadly approved and officials were asked to do further work on that basis.

2. A report by an official Working Group has now been circulated under cover of OD(80) 74. Its final paragraph (on page 11) sets out the immediate questions for Ministers. Paragraph 4 of the covering paper recommends possible answers. We think that officials will be briefing their Ministers to endorse these recommendations, although they have not formally been agreed with the Departments represented on the Working Group (Treasury, Foreign and Commonwealth Office, Trade, ECGD, Industry, Agriculture, Defence Economic Intelligence and the Bank of England) who naturally wished to protect their Ministers' freedom of decision.

3. There are two main areas of underlying Departmental disagreement.

- (a) The Foreign and Commonwealth Office regard the political imperative as paramount: Poland must be helped, to avoid excessive dependence on the Russians and/or economic collapse leading to disorder and Soviet invasion. The Treasury and Bank wish to limit the economic risks for Britain, and are inclined to argue that the Russians could and should be bluffed into carrying more of the financial can for their protege.
- (b) Less obviously, the Bank and some Treasury officials regard a re-scheduling operation as the only sensible way for the West to "get off the escalator" of giving the Poles even larger loans (each of which will be used mainly to pay interest on earlier loans). ECGD and other Treasury officials prefer the refinancing route, as being less certain to involve losses for ECGD and therefore the PSBR.

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4. But everyone agrees that we should not at this stage go beyond a package covering the first half of 1981. In that timescale the row at (b) above will not surface, because no rescheduling operation could be set up so quickly; and the gap between the two sides at (a) above will still be pretty small. Both rows, however, will be audible as background noise during your discussion.

5. The immediate decisions sought in OD(80) 74 are required for the next meeting of the creditors' club in Paris. We have just heard that that meeting has been postponed from 11th-12th December to 22nd-23rd December, but Ministers will not have another convenient opportunity to consider the matter in the interval. If the Russians invade (or the Polish authorities crack down), all bets are of course off and assistance policy starts again from scratch. That is itself the best reason for not looking too far ahead at this stage - as our fellow creditors, led by the French, seem likely to agree.

HANDLING

6. You should ask the Foreign and Commonwealth Secretary to open the discussion; he might be followed by the Chancellor of the Exchequer and then by the Governor of the Bank of England (if you have agreed to his being present) and the Secretary of State for Trade (who speaks for ECGD as well as the Department of Trade). You may also like to see if the Secretary of State for Industry and the Minister of Agriculture (who have both been invited) wish to contribute on respectively the British exports at stake and the scope for Community-organised food aid.

7. You may then wish to assess briefly how your colleagues' minds are moving on the longer-term issues. In particular:-

- (i) Do they accept the paper's analysis of Poland's long-term debt problem?
- (ii) Do they at this stage see rescheduling or continued refinancing as the long-term solution?
- (iii) What do they think of the "umbrella theory" - that the Soviet Union will always keep Poland economically afloat? Can we rely on it? If so, would we like the consequences?
- (iv) If the West is to undertake a massive rescue operation for Poland's economy, how can we in this case seek to attach even the sort of frail strings which the IMF machinery imposes on Western debtors like Turkey? If we cannot, will she ever set her economic house in order?



8. Against this background, you will wish to seek clear decisions on the specific points listed in paragraph 29 of the Working Group's report:-

- (i) Should ECGD continue cover?
- (ii) Should we confine our present efforts to the first half of 1981 (the "medium term")?
- (iii) Should we offer in that context both a measure of refinancing and some new credit?
- (iv) Should we, without getting out of line with our partners, be prepared to meet the Poles' refinancing and new credit requests in full (pro rata) for the first half of 1981, if that seems necessary in order to achieve the politico-economic holding operation we want, while making clear that we would prefer if possible to go rather less far?

CONCLUSIONS

9. Subject to the discussion, you may feel able to lead your colleagues to agree:-

- (i) That the answers to each of the questions in paragraph 8 above should be "yes" (as recommended in paragraph 4 of OD(80) 74's cover note).
- (ii) That the Foreign and Commonwealth Secretary should instruct our representatives at the Paris meeting accordingly.
- (iii) That officials should report further to Ministers on the longer-term policy problem as soon as Polish prospects and the attitudes of our fellow creditors are clearer.

ROBERT ARMSTRONG

9th December, 1980