



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000



PRIME MINISTER

Prime Minister

*The Chancellor would like to know that
you are broadly content with his approach.*

Print - 3/4

POLISH DEBT AND RELATED MATTERS

Yes no,

In my minute of 6 March I reported progress so far in the multilateral talks with Poland. These are now reaching a critical stage. And to some extent they have been overtaken by events. Arrangements have been made for OD to consider the position on 15 April (when you will unfortunately be abroad). Meanwhile you and OD might like a further interim report.

Official debt

2. It is quite clear that Poland cannot service or repay its debts over the next few years. An orderly and agreed programme of debt relief, matched by parallel action by the banks, is essential. Poland now recognises this. The Polish government is preparing a recovery plan which, if successful, would bring the current account back into balance in five or six years and allow a start in the repayment of debt. They are prepared to set firm targets to be written into the agreement, and to agree to regular monitoring discussions. Given the present political climate in Poland, we must all be fairly sceptical about their chances of success. It would be unrealistic to press for more rapid improvement. But I still believe we must press ahead with an intergovernmental arrangement.

Main features of agreement

3. After two meetings of the creditors' Task Force, the form of the agreement is becoming clear, but not its size. However, my officials think it is likely to include:-



- (a) relief of a high percentage (85 per cent or so) of principal and interest of officially-guaranteed debt falling due in the second half of 1981;
- (b) agreement in principle to extend this treatment to maturities in 1982 and 1983 if Poland meets its self-imposed targets;
- (c) a grace period of four or five years with repayment spread over a further four or five years;
- (d) commercial rates of interest during the period of postponement. (We may eventually have to consider some concessionality but this has not yet been proposed);
- (e) provision for regular review by a group of creditor countries before each extension;
- (f) no more favourable treatment to be given to other creditors; this includes the USSR as well as private banks;
- (g) a break clause - as yet undefined - which would terminate the agreement if the USSR invades or a repressive regime takes over in Poland. (This is politically important. But even in this worst case, we would still eventually have to do something about accumulated past debt);
- (h) no commitment to provide new credit; this would be left over for separate bilateral agreement. (We may have trouble with the French in maintaining this line but the Americans are with us);
- (i) creditors will be free to choose whether to reschedule



or refinance debts due to them. I shall shortly be writing to the Ministers concerned about this technical point.

All this is within the terms of the Ministerial agreement at OD on February 12 except that the proposed debt settlement was initially to be limited to 31.12.82. If the Task Force eventually makes firm proposals on these lines, I shall be advising colleagues to accept them.

Banks

4. Government and guaranteed debt is only about half of the total; the rest is almost all banking debt. After a slow start, the banks are now moving towards a parallel negotiation. They have set up a Task Force of their own to prepare the ground. The Bank of England believe there is a reasonable prospect of a settlement.

Immediate liquidity crisis

5. Last week the Polish Government called in the Western Ambassadors in Warsaw and told them it could not meet obligations falling due at the end of March. It sought an immediate postponement of debts due in the second quarter, acceleration of the long-term agreement described above, and further assistance. It also asked Governments to intercede with banks. In the time available it was not possible to agree formally postponement of payments due, and a technical default probably now exists (though not, so far, apart from some short-term maturities, on debts guaranteed by ECGD). But the German Government took the initiative in proposing to all other creditors that we should treat this as a purely technical delay in payment, not a formal default (which might have triggered a series of cross-default clauses in contracts and precipitated a general collapse). The creditors' Task Force endorsed this recommendation. So far it seems to have worked. And the banks are mostly taking a constructive and sensible line. We cannot rule out the



possibility of collapse but it looks less likely. It is still not clear why Poland ran out of cash so unexpectedly fast. One possibility is that the USSR, which has been bailing them out in the early months of the year, have now stopped doing so.

IMF

6. Poland has now talked openly for the first time of the possibility of rejoining the IMF. This is welcome. But it will not help in the short-term, and might take a year to negotiate.

Agricultural sales

7. Following the Maastricht summit, the Commission have put forward proposals for a further package of assisted food sales to Poland. This will be considered by the Council this week. I have written separately about some details of this package.

New credit

8. The Poles are pressing for new commercial credit to finance imports of food, raw materials and spare parts. They argue that these are essential if they are to maintain stability at home and build up exports. Since their economy, and especially the export sectors, is very import-intensive, there is something in this. But I am anxious not to increase our exposure more than we must in this very risky market. The £40 million we agreed for the whole of 1981 is now largely committed (about £8 million left). It may be necessary to reconsider the position once a satisfactory agreement has been reached on debt.

Next steps

9. The Task Force meets again on 8 April, and the 15 major creditors then meet the Polish side on 9 and 10 April. If a reasonable agreement emerges, they will then recommend it to Governments and return to Paris on 27 and 28 April to conclude the deal. I have arranged for a "note by officials" to be

CONFIDENTIAL



circulated to OD on 13 April (when I shall be abroad) giving details of the draft agreement. I shall make my own proposals at OD on 15 April, when I understand that the Home Secretary will be in the chair. Because of your own absence then, it would be particularly useful to know at this stage (and before the Task Force meeting on 8 April) whether you are broadly content with the way this is going.

I am sending copies of this minute to the Foreign Secretary and other members of OD, the Minister of Agriculture and Sir Robert Armstrong.

G.H.

(G.H.)

3rd April 1981