



FCS/81/84

CHANCELLOR OF THE EXCHEQUER*Prime Minister*

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*See attached (v. gloomy)  
assessment of the Polish economy  
just received from Warsaw*

*Ambs*POLISH ECONOMY

1. Since our last OD meeting on 20 May to discuss the Polish economic situation the situation in Poland has given increasing cause for anxiety. Both economic and political factors have heightened the sense of crisis. We are now entering a critical phase in the run-up to the Polish Party Congress.
2. I believe that the Congress may represent the first and last opportunity for the supporters of a more liberal and popularly supported administration in Poland to establish their position and obtain the mandate they need to offer the country firm leadership, on which both economic and political stability will ultimately rest. I believe that it is in the broadest Western interest that they should be given this chance.
3. But the Poles' economic problems are now so acute that immediate disaster threatens. There is the risk of default or a moratorium, leading to economic collapse and political unrest, which in turn could scarcely fail to precipitate a Soviet intervention. Our whole strategy for handling the Polish crisis since last autumn would then have failed, and we should have entered a new and potentially fateful period in post-war relations in Europe.
4. Western Governments have done their part in responding to Polish appeals, but the banks, particularly the American banks, have so far been less helpful. This and other factors have led to an acute liquidity problem. As you know the Poles have now

/asked



asked us and our principal European partners (and the Swiss Central Bank) for \$100 million each in short term financial credits. The French Finance Minister, M. Delors, has proposed that the Central Banks of the 15 creditor countries should jointly provide a credit to be syndicated by the BIS in order to meet the immediate requirements of the Polish Central Bank.

5. I recognise that the economic case for giving yet more help to Poland is weak, and that we cannot continue doing so indefinitely. But in the particular circumstances I describe, I believe that we should respond favourably. If each of the creditor countries were to contribute \$30 million the total figure would come close to that for which the Poles have asked. It should be in our power to raise this sum in the present very exceptional circumstances, and what I heard this week from the Polish Foreign Minister has convinced me that it would be right to make the necessary special effort. I very much hope that you will be able to agree to this.

6. I am copying this minute to the Prime Minister.

C  
(CARRINGTON)

Foreign and Commonwealth Office

22 June 1981

POLAND: ADVANCE COPIES

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~~SIR A ACLAND~~  
~~MR P H MOBERLY~~

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FM WARSAW 220700Z JUN

TO IMMEDIATE FCO

TELEGRAM NUMBER 455 OF 19 JUNE

AND TO PRIORITY DOT, ECGD, BANK OF ENGLAND, TREASURY, MODUK  
INFO PRIORITY PARIS.

YR TELNO 311 AND MONTGOMERY'S LETTER TO MELHUISE  
OF 11 JUNE: POLISH ECONOMIC PROSPECTS FOR 1981

IN THE CURRENT STATE OF CONFUSION AND UNCERTAINTY REGARDING  
POLAND'S SHORT-TERM ECONOMIC AND FINANCIAL CIRCUMSTANCES IT  
IS IMPOSSIBLE TO DO MORE THAN UPDATE SUCH INFORMATION

AS WE HAVE ON THE CRITICAL AREAS OF THE ECONOMY: ATTEMPT  
A HIGHLY SPECULATIVE LOOK AT WHAT MIGHT HAPPEN IN THEM  
OVER THE NEXT 6-12 MONTHS: AND HAZARD A GUESS ON THE IMMEDIATE  
OUTLOOK AND THE CONSEQUENCES IF OUR WORST FEARS MATERIALISE.  
AS WE HAVE SAID PREVIOUSLY WE BELIEVE POLAND'S CURRENT PLIGHT TO BE  
UNIQUE FOR A POST WAR INDUSTRIALISED COUNTRY, ESPECIALLY  
A STATE TRADING ONE, AND WE SUSPECT STRONGLY THAT ALL  
CONCERNED ( NOT LEAST THE POLES THEMSELVES) ARE GROPING  
IN THE DARK.

AND AGRICULTURAL PROSPECT

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#### INDUSTRIAL AND AGRICULTURAL PROSPECT

2. INDUSTRIAL OUTPUT IS CONTINUING TO DECLINE AS THE EFFECTS OF SHORTAGES OF IMPORTED RAW MATERIALS AND COMPONENTS BITE EVER MORE DEEPLY. THESE SHORTAGES AFFECT BOTH INDUSTRIES PRODUCING INVESTMENT GOODS AND THOSE PRODUCING FOR DOMESTIC CONSUMPTION AND EXPORT, ALTHOUGH THE SHORTAGES FOR THE FORMER ARE PROBABLY MORE PRONOUNCED. JARUZELSKI TOLD THE SEJM ON 12 JUNE THAT INDUSTRIAL PRODUCTION IN THE FIRST 5 MONTHS OF 1981 WAS 12% DOWN ON 1980 WITH THE FIGURES FOR MAY SHOWING AN EVEN SHARPER DOWNTURN OF 18%. EVEN IF THE DECLINE IS SOMEHOW ARRESTED, INDUSTRIAL PRODUCTION IN 1981 IS LIKELY TO BE AT LEAST 15 PER CENT LOWER THAN IN 1980. COAL PRODUCTION, A CRITICAL FACTOR, WILL PROBABLY NOT EXCEED 165 MILLION TONNES AND COULD BE LESS. THE POLES HOPE TO EXPORT 18.5 MILLION TONNES OF COAL THIS YEAR, OF WHICH ROUGHLY HALF WOULD BE TO THE WEST, BUT IN ORDER TO ACHIEVE THIS THEY WILL HAVE TO DIVERT SUPPLIES AWAY FROM THE DOMESTIC MARKET FIRM ACTION WILL BE NEEDED TO BRING THIS ABOUT AND DETAILED PLANS HAVE STILL TO BE ANNOUNCED.

AGRICULTURAL PROSPECTS 43043'3,5 - 84)6 7480:8 'DOT ON THE HORIZON AT PRESENT, BUT EVEN WITH A GOOD GRAIN HARVEST POLAND WILL STILL REQUIRE SUBSTANTIAL IMPORTS OF GRAIN AND FODDER IN 1981/1982 TO REBUILD HERDS AND MAINTAIN FOOD SUPPLIES. IT WILL TAKE SEVERAL YEARS OF GOOD HARVESTS BEFORE SUPPLIES OF MEAT IMPROVE SIGNIFICANTLY. SO FAR THIS YEAR WE BELIEVE POLAND HAS IMPORTED APPROACHING DOLLARS 1 BILLION OF FOODSTUFFS AND EVEN THIS HAS BEEN INSUFFICIENT TO PREVENT SHORTAGES. THE PROSPECTS FOR IMPORTS FOR THE REST OF THE YEAR HINGE ON THE AVAILABILITY OF CREDIT AND THE POLES ABILITY TO UTILISE IT WITHOUT IMPORTS EG OF MEAT AND FODDER, THE EXISTING SHORTAGES WILL GET WORSE. AS FAR AS WE CAN JUDGE THE AUTHORITIES ARE DISTRIBUTING IMPORTED FOOD AS SPEEDILY AS THEY CAN IN ORDER TO KEEP THE RATIONING SYSTEM IN SOME SEMBLANCE OF OPERATION.

#### BALANCE OF PAYMENTS PROSPECTS

3. ACCORDING TO THE LATEST POLISH TRADE STATISTICS, IN THE FIRST FOUR MONTHS OF 1981 POLAND HAD AN OVERALL TRADE DEFICIT OF ABOUT DOLLARS 2.4 BILLION, OF WHICH DOLLARS 655 MILLION WAS WITH NON-SOCIALIST COUNTRIES. HEAD OF THE FOREIGN TRADE RESEARCH INSTITUTE TOLD MELHUISE IN CONFIDENCE RECENTLY THAT HE WAS FORECASTING A HARD CURRENCY RECEIPT

FOREIGN TRADE RESEARCH INSTITUTE TOLD MELHUISH IN CONFIDENCE RECENTLY THAT HE WAS FORECASTING A HARD CURRENCY DEFICIT THIS YEAR IN THE REGION OF DOLLARS 2-3 BILLION. HOWEVER THE POLES INABILITY TO RAISE NEW CREDITS, AND THE POSSIBLE UNWILLINGNESS OF HER SOCIALIST PARTNERS TO SUSTAIN A HIGH LEVEL OF TRADE SURPLUSES WITH POLAND FOR THE REST OF THIS YEAR, MAY SET A MUCH LOWER LIMIT ON THE SIZE OF THE POLISH TRADE DEFICIT. OF COURSE, THE RESULTANT CUTTING-OFF OF SUPPLIES OF DESPERATELY NEEDED RAW MATERIALS, COMPONENTS AND AGRICULTURAL INPUTS WOULD HAVE DISASTROUS EFFECTS ON POLISH INDUSTRY, AGRICULTURE, EXPORTS AND DOMESTIC SUPPLIES. THE FALL IN NATIONAL INCOME COULD THEN WELL BE IN THE REGION OF 25 PER CENT SUGGESTED BY WILLIAMSON.

#### FINANCIAL SITUATION

4. DESPITE THE SERIOUSNESS OF THIS OUTLOOK, DIFFICULTY FROM THE POINT OF VIEW OF THE POLISH AUTHORITIES THE MOST PRESSING WOULD SEEM TO BE IMMEDIATE LIQUIDITY PROBLEMS AND POLAND'S ABILITY TO RAISE NEW FINANCE OVER THE COMING MONTHS. THE AIDE MEMOIRE REQUESTING THE IMMEDIATE DEPOSIT OF DOLLARS 100 MILLION OF SHORT TERM MONEY WITH BANK HANDLOWY ( OUR TELNO 437 ), THE PLEASE MADE BY KARSKI TO POWNALL IN POZNAM ( OUR TELNO 452 ) AND THE SUBSEQUENT AMPLIFICATION OF POLAND'S NEEDS, ALL POINT TO INCREASING DESPERATION OVER THE PROSPECTS, NOT JUST FOR THE NEXT SIX MONTHS, BUT FOR THE NEXT FEW WEEKS. WE BELIEVE THAT THE POLES ARE FACING GREAT DIFFICULTY IN MEETING THEIR FINANCIAL COMMITMENTS FALLING DUE IN THE IMMEDIATE FUTURE. (WE UNDERSTAND FOR EXAMPLE THAT THE BANK HANDLOWY HAS ALREADY EXCEEDED THE REDEMPTION DATE OF A DOLLAR 30 MILLION FLOATING BILL). UNLESS POLAND IS ABLE TO SECURE ACCESS TO SUBSTANTIAL AMOUNTS OF SHORT TERM FINANCIAL CREDITS AT ONCE THERE MUST BE A VERY REAL RISK OF DEFAULT. IN SUCH A SITUATION WE THINK THE POLISH AUTHORITIES WOULD INSTEAD TO DECLARE A UNILATERAL MORATORIUM. IN ANY CASE THE WITHDRAWAL BY WESTERN BANKS OF NORMAL BANKING FACILITIES TO THE BANK HANDLOWY, AND THE RELUCTANCE BY COMMERCIAL BANKS TO GUARANTEE LETTERS OF CREDIT ETC, MUST BE CREATING ENORMOUS PROBLEMS FOR THE BANK HANDLOWY IN ITS CONDUCT OF DAY TO DAY BANKING ACTIVITY, WITH THE CONCOMMITANT RISK OF DEFAULT BY ACCIDENT.

5. AGAINST THIS BACKGROUND, THE NEWS THAT 11 LEADING  
BANKS ARE SHOWING GREAT RELUCTANCE TO PROCEED

5. AGAINST THIS BACKGROUND, THE NEWS THAT 11 LEADING US BANKS ARE SHOWING GREAT RELUCTANCE TO PROCEED WITH THE BANKS RESCHEDULING EXERCISE ON TERMS ACCEPTABLE TO THE POLES MUST HAVE COME AS A GRIEVOUS BLOW, NOT ONLY FOR WHAT IT IMPLIES FOR POLAND'S ABILITY TO FINANCE HER ENORMOUS PAYMENTS GAP, BUT ALSO THE MORALE AMONG THE RELATIVELY SMALL GROUP OF POLISH MINISTERS AND OFFICIALS ENGAGED IN ALL OF THE CURRENT FINANCIAL EXERCISES. IT SEEMS UNLIKELY THAT THEY CAN EXPECT SALVATION FROM THEIR SOCIALIST PARTNERS - THE SIGNS ARE THAT THE LATTER HAVE GONE AS FAR AS THEY ARE PREPARED TO IN PROVIDING FINANCIAL ASSISTANCE TO POLAND, AND THAT THEY TOO ARE RESIGNED TO WHAT INCREASINGLY SEEMS LIKELY TO HAPPEN. THE UMBRELLA THEORY SEEMS TO BE WILTING.

#### GENERAL ECONOMIC PROSPECTS

6. IF THE WORST SHOULD HAPPEN, AND POLAND GOES INTO DEFAULT OR DECLARES A MORATORIUM, WE ASSUME THAT ALL FURTHER FINANCIAL ASSISTANCE AND NEW CREDITS WILL BE WITHHELD, LEAVING THE POLES AND THEIR CREDITORS TO PICK UP THE PIECES AS BEST THEY CAN. IT IS DIFFICULT TO PREDICT WHAT WOULD THEN HAPPEN TO THE POLISH ECONOMY. FOR EXAMPLE WOULD THERE BE SCOPE FOR POLAND TO USE SUCH EXPORT EARNINGS AS MAY BE GENERATED TO PAY FOR IMPORTS IN CASH, OR WOULD ANY EARNINGS BE APPROPRIATED BY POLAND'S CREDITORS TO MEET INTEREST PAYMENTS ETC ON THE ACCUMULATED DEBTS? IF THE LATTER, THEN WIDE AREAS OF POLISH INDUSTRY WOULD CEASE TO FUNCTION

AS THEY RAN OUT IMPORTED ESSENTIALS: THE REBUILDING OF ANIMAL NUMBERS WOULD BE SET BACK BY FODDER SHORTAGES: AND THE CONSUMER WOULD FACE EVEN WORSE SHORTAGES, FOR EVERY THING FROM DRUGS TO FOOD. THE EXTENT OF THE DECLINE WOULD DEPEND ON MANY FACTORS, INCLUDING THE POLES ABILITY TO BOOST PRODUCTION OF ITEMS WHICH DO NOT REQUIRE IMPORTED INPUTS, AND THE LEVEL OF HELP RECEIVED FROM COMECON COUNTRIES. AT BEST, POLISH OUTPUT MIGHT BE SOME HALF TO TWO THIRDS OF ITS POTENTIAL. EVEN AGRICULTURE WOULD BE AFFECTED BY SHORTAGES OF VITAL INPUTS, ALTHOUGH FARM LABOUR WOULD BE BOOSTED BY UNEMPLOYMENT. IN THIS QUOTE DOOMSDAY UNQUOTE SCENARIO BOTH INTERNAL AND EXTERNAL POLITICAL AND SOCIAL MANIFESTATIONS WOULD BE WHOLLY UNPREDICTABLE, BUT ARE UNLIKELY TO FAVOUR THE MAINTENANCE OF INTERNAL STABILITY.