

NOTE FOR RECORD

Copies to The Governor
Mr Blunden
Mr Loehnis o/r
Mr George
Mr Cooke
Mr Balfour
Mr Holland
Mr Somerset
Mr P J Bull

HUNGARY

ADL rang me from Washington this morning. He first reported his visit with Walsh to Leland. This has been recorded in some detail in the attached telegram. The main points to emerge were (a) confirmation that the IMF application would probably go through all right but (b) a warning that the US position on whether to agree to a drawing later on was very much reserved and (c) that nobody could be sure that Weinberger would not sound off in public against not only "differentiation" but perhaps the actual BIS operation.

ADL had talked to the Ambassador, who was fully briefed and fully sympathetic but very pessimistic about the possibilities of muzzling Weinberger or more generally dissuading those elements in the Administration that were inclined to take a doctrinaire view. Specifically, he did not think that Harry Taylor would get the assurances he sought from Clarke, but he thought nevertheless it was not worth his (the Ambassador's) weighing in at this stage.

A man from Manufacturers Hanover will be talking with Fekete in Zurich this week and will be reporting back to Taylor on Friday. I agreed with ADL that I would call Taylor myself tomorrow to see how he got on with Clarke and that it might be worth setting up a further call on Friday.

ADL had talked to de Fontenay, the man who had led the IMF Mission to Hungary, who had surprised ADL by suggesting that

he thought that the situation could be held simply with the \$100 mn from the BIS and the \$100 mn from the banks if Taylor could raise that.

On publicity, Taylor remained firmly of the view that the announcement of an operation of only \$100 mn from the BIS would be likely to be counterproductive. (I spoke about this later to the Governor and I think it is our view now that it might be better not to try for explicit announcements. Both the success of Hungary's application to join the Fund and the BIS operation are pretty well bound to get known in due course. It is probably better just to let this happen.)

On more general topics, ADL reported a general air of bafflement and gloom in both New York and Washington. He found (as Douglas Wass also told me in a separate conversation he had found) Wall Street pretty concerned about the risks of financial crises. Volcker struck him as very tired and Wallich's characteristically careful and fair account of the domestic and international scene, though intended to cheer ADL up, had in fact had the opposite effect. I asked him whether Volcker and Wallich had expressed any view on the country he was then about to visit (Mexico) because Whittome had surprised me by being unconcerned. ADL said both Volcker and Wallich were very far indeed from being unconcerned.

@wm

Jet

25 APR 1985

31 March 1982

RR ROME

RR VIENNA

RR BUDAPEST

RR MOSCOW

RR WARSAW

GPS 728

Carey Fry
Tuyford ECGR
D & B Jones J/Enegy.
~~McMahon~~
Gilchrist B/England.
(24)

CONFIDENTIAL

FM WASHINGTON 302333Z MAR 82

TO PRIORITY FCO

TELEGRAM NO 1036 OF 30 MARCH

INFO PARIS, BONN, ROME, VIENNA, BUDAPEST, MOSCOW, WARSAW

CREDITS FOR EASTERN EUROPE

1. LOEHNIS (BANK OF ENGLAND) ACCOMPANIED BY COUNSELLOR (ECONOMIC) CALLED TODAY ON LELAND (ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, US TREASURY).

2. ON THE BUCKLEY MISSION, LELAND SAID THAT THE US TEAM HAD STRESSED TO EUROPEAN GOVERNMENTS THAT CURRENTLY ECONOMIC RESOURCES WERE FLOWING TO THE EAST SOLELY BECAUSE OF THE FINANCIAL GUARANTEES OF WESTERN GOVERNMENTS. PRIVATE BANKS WERE NOT AT PRESENT WILLING TO LEND WITHOUT GOVERNMENT GUARANTEES. IF IT WERE NOT FOR OFFICIAL CREDITS, THE EASTERN BLOC WOULD HAVE TO PAY FOR IMPORTS IN HARD CURRENCY. IN THE CASE OF THE SOVIET UNION, THIS WOULD REDUCE THE AMOUNT OF RESOURCES AVAILABLE FOR THEIR MILITARY BUILD-UP.

3. LELAND MENTIONED TWO ASPECTS OF US ATTEMPTS TO TIGHTEN UP ON OFFICIAL CREDITS TO THE SOVIET UNION. THE FIRST WAS THAT, WHEN THE OECD EXPORT CREDIT CONSENSUS MEETING RECONVENED IN MAY, THERE SHOULD BE A REALLOCATION OF COUNTRIES TO CATEGORIES, WITH THE SOVIETS MOVED UP TO THE TOP CATEGORY. THE TOP CATEGORY CONSENSUS INTEREST RATE SHOULD ALSO BE RAISED TO AS NEAR MARKET RATES AS POSSIBLE, WHICH HE THOUGHT MIGHT INVOLVE AN INCREASE OF 1 AND A HALF PERCENTAGE POINTS.

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4. THE SECOND WAS THE AMOUNT OF OFFICIAL CREDITS. THE GERMANS WERE BEING THE MOST DIFFICULT ABOUT THE POSSIBILITY OF CUTTING THESE BACK (ALTHOUGH THE FRENCH HAD NOW REVEALED THAT THEY HAD A PROTOCOL COMMITTING THEM TO MAKING GENEROUS CREDITS AVAILABLE TO THE SOVIETS AT CONSENSUS INTEREST RATES). A PARTICULAR DIFFICULTY WAS THAT THE GERMANS BELIEVED THAT THE NATIONALISED FRENCH BANKS COULD MAKE LOANS TO FINANCE FRENCH EXPORTS TO THE SOVIET UNION WITH WHAT COULD BE REGARDED AS AN IMPLICIT GOVERNMENT GUARANTEE. TO CONSTRAIN THE AMOUNT OF EXPLICIT GOVERNMENT GUARANTEES FROM OTHER COUNTRIES WOULD THEREFORE LEAVE THE FRENCH AT AN ADVANTAGE. LELAND SAID THAT LAUTENSCHLAGER WOULD BE IN WASHINGTON LATER THAT WEEK, AND THAT HE HOPED TO MAKE PROGRESS ON THE GERMAN POSITION THEN.

5. ON THE PIPELINE, LELAND HOPED THAT THERE WOULD BE A RE-EXAMINATION OF THE FUTURE GAS REQUIREMENTS OF EUROPEAN COUNTRIES. CONTRACTS INCORPORATING AMERICAN TECHNOLOGY TO PROVIDE EQUIPMENT FOR THE PIPELINE CONTAINED RE-EXPORT RESTRICTIONS. UNLESS AGREEMENT WAS REACHED ON THE ENDING OF SUBSIDISATION AND REDUCTIONS IN GOVERNMENTS GUARANTEES ON CREDITS TO THE SOVIET UNION, THE UNITED STATES WAS LIKELY TO TAKE ALL THE ACTION OPEN TO IT TO MAKE THE CONSTRUCTION OF THE PIPELINE DIFFICULT.

6. LOEHNIS OUTLINED THE DANGERS FOR THE WESTERN FINANCIAL SYSTEM IF THE MAIN EASTERN EUROPEAN DEBTORS WERE ALLOWED TO GO INTO DEFAULT. LELAND SAID THAT THE WESTERN BANKS HAD MADE LOANS TO EAST EUROPE WITH THEIR EYES OPEN, AND HE WOULD HAVE WISHED THAT THEY HAD NOT DONE SO ON SUCH A LARGE SCALE. HE AGREED, HOWEVER, THAT IT WAS DESIRABLE TO MAXIMISE THE REPAYMENTS OF THESE CREDITS.

7. ON HUNGARY, LELAND SAID THAT HE THOUGHT THAT THE NEED FOR A DOLLARS 500 MILLION BIS LOAN WAS NOW LESS URGENT. HIS VIEW WAS THAT THE US SHOULD NEITHER CONTRIBUTE NOR STAND IN THE WAY OF THE LOAN, BUT HE DOUBTED WHETHER WEINBERGER WOULD WISH TO BE NEUTRAL. SUBJECT TO PRESIDENT REAGAN'S APPROVAL, THE UNITED STATES WOULD VOTE IN FAVOUR OF HUNGARY'S APPLICATION TO THE IMF AT THE MEETING OF THE BOARD OF EXECUTIVE DIRECTORS LATER THAT WEEK. THE PROVISION OF IMF FINANCIAL ASSISTANCE TO HUNGARY WOULD HOWEVER BE TREATED AS A SEPARATE QUESTION. THE US WOULD EXAMINE THIS IN THE LIGHT OF A NUMBER OF FACTORS, INCLUDING ANY EVIDENCE THAT HUNGARY WOULD PASS ON CREDITS TO THE SOVIET UNION AND THE PROGRESS THAT HAD BEEN MADE TOWARDS RESTRICTING OFFICIAL EXPORT CREDITS TO THE SOVIET UNION.

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TOWARDS RESTRICTING OFFICIAL EXPORT CREDITS TO THE SOVIET UNION.

8. LELAND'S REMARKS CONFIRMED WHAT BAILEY (DIRECTOR OF PLANNING
AND EVALUATION, NATIONAL SECURITY COUNCIL) TOLD MINISTER (COMMERCIAL)
YESTERDAY, TO THE EFFECT THAT THE CABINET COUNCIL ON ECONOMIC
AFFAIRS, CHAIRED BY TREASURY SECRETARY REGAN, HAD DECIDED TO AGREE
TO HUNGARY'S MEMBERSHIP OF THE IMF WITHOUT PREJUDICE TO THE US
POSITION ON AN IMF CREDIT FOR HUNGARY.

9. FCO PLEASE PASS TO CAREY (TREASURY), TWYFORD (ECGD),
D LE B JONES (D/ENERGY) AND MCMAHON AND GILCHRIST (BANK OF ENGLAND).

HENDERSON

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