

Prime Minister

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CHANCELLOR OF THE EXCHEQUERPossible BIS Loan to Hungary

1. As you know, the Governors of the BIS member banks are due to meet in Basle on 27/28 September to discuss, among other things, a possible further \$300 million facility for Hungary.
2. Malcolm Rifkind wrote to Leon Brittan on 7 July emphasising the importance we attach to helping Hungary to avoid being pushed into rescheduling. My officials have also been in touch with yours. I remain strongly of the view that the Hungarian economic experiment deserves support. In spite of its present difficulties, the system does work, and provides a valuable model of the market-orientated approach to economic management to which other East European countries may turn as a way of solving their own economic problems. The political consequences, as we have seen in Hungary, can be far-reaching.
3. The Hungarians appear to be genuinely determined to overcome their present difficulties; and you will by now have seen Budapest telnos 266 and 267, which record the considerable efforts the Hungarians are making. But in the short term they need help: if reform fails, Soviet-style orthodoxy can be the only winner, with all that this means in political as well as economic terms for Eastern Europe as a whole.
4. The BIS banks have deferred a decision on the \$300 million standby loan once already this year. Without a clear lead from the BIS, further lending from commercial banks seems unlikely. If on the other hand the BIS could agree now to make the loan available, then we would hope that commercial banks would also be encouraged to make some further loans to Hungary, thus enabling it to pull through until IMF funds become available next year.
5. I am of course aware that, as Leon Brittan pointed out in his letter of 9 August, the Bank of England has already made an important contribution to the previous BIS loans for Hungary. But the chief purpose of these loans was to tide Hungary over until she could draw upon the IMF funds, which now seem likely to be delayed.



It would be a doubtful economy if, having helped Hungary through the past six months, the West were now to withdraw its support and Hungary were to be forced into rescheduling as a result. It would also seriously reduce the creditors' prospects of being repaid not only by Hungary but by other Eastern European borrowers. A further financial crisis would almost certainly ensue, and the banks' increased reluctance to put any more funds in Eastern Europe could well precipitate defaults and/or requests for rescheduling by others.

6. Financially, economically and politically, therefore it is surely to the West's advantage to see Hungary overcome its present difficulties. I strongly hope that you will feel able to encourage the Bank of England to participate in this further loan.

7. I am copying this minute to the Prime Minister, the Secretary of State for Trade and the Governor of the Bank of England.

(FRANCIS PYM)

Foreign and Commonwealth Office
22 September 1982