THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

EHG(B)(82)7A COPY NO

25 March 1982

EUROPEAN COUNCIL, BRUSSELS
29/30 MARCH 1982

EAST-WEST: EAST EUROPEAN INDEBTEDNESS

Brief by the Foreign and Commonwealth Office

OBJECTIVES

1. To exchange views on the problem of Western exposure in Eastern Europe.

POINTS TO MAKE

2. Problem of East European indebtedness needs to be handled with caution. We wish to avoid a general collapse of confidence. We should seek to ensure that our debt exposure in Eastern Europe is at a level which they can service. In the longer term our economic relationship with Eastern Europe may have to be reviewed.

3. Eastern European countries should be treated on their merits. We should be prepared to differentiate in favour of those countries whose economies are basically sound and in particular where their political policies are directed at achieving some degree of independence from Moscow.

4. Western creditors have agreed to suspend negotiations on rescheduling official debt in 1982 in view of failure of Polish government to meet the three Western criteria. In the case of Romania we have insisted that they seek multilateral rescheduling.

/5. Hungary

5. Hungary is different. Hungarian economy basically sound, a model for other East European countries. Important to consider possibility of helping, in concert with others. Attitude of US crucial. Need to persuade Americans to differentiate publicly in favour of Hungary on question of credit for Eastern Europe. Should Presidency speak to Americans? Important for confidence that Hungary's application to IMF should be agreed quickly.

6. Have partners heard any reports of these difficulties affecting the GDR or Czechoslovakia?

BACKGROUND

Reference

(a) Eastern Europe: Convertible Currency Debt 1980

7. This subject is included at the suggestion of Herr Genscher. He drew attention to Hungary's financial difficulties as representing an acute political problem. The Germans will see Hungary's predicament as symptomatic of wider difficulties in their policy of creating links with Soviet Union and Eastern Europe. Our reasons for wishing to help Hungary are both political and economic. Politically, we wish to encourage the sort of reforms that have been carried out in Hungary. From an economic point of view we regard Hungary's policies as sound. Equally, if Hungary were forced to apply with Poland and Romania for rescheduling of offical debts it could precipitate a general financial crisis in Eastern Europe.

8. Hungary. Representatives of the Hungarian National Bank have approached Western Central Banks, seeking support of some $500 million over the next six to nine months to counter a short-term liquidity problem, caused by withdrawals of deposits by OPEC countries and by the Soviet Union. Some $100 million of this would be needed in both March and April.

9. Hungary's economic policies have previously inspired special confidence in the West. We have in the past encouraged the Hungarians' development of a 'socialist market economy',

/hoping

hoping that it would serve as a model to other Eastern European countries. Hungary's application for membership of the IMF represents an attempt to escape from reliance on the CMEA system, and would be a significant political gain for the West.

10. If Hungary's application is rejected as a result of current difficulties, the Russians will exploit this to prove their claim that the IMF is a capitalist institution dominated by the US.

11. Hungary might be helped by a syndicated loan by the Bank for International Settlements (BIS) backed by central banks with a government guarantee. This would, however, involve difficult decisions for many governments including ourselves. The key to easing the Hungarians' difficulties is the attitude of the United States. An improvement in banking confidence will require a public indication by the United States that they have no wish to see credit for Hungary stopped, whatever their views on credit for the USSR and Eastern Europe in general.

12. The US position on the question of Hungary's IMF application is still unclear. Clear US support would be of particular value.

13. Poland owes some $28.5 billion to Western creditors. Poland's hard currency requirement in 1982 is estimated at some $10.3 billion. In 1981, Poland's government-guaranteed debt was rescheduled. The Poles are on the point of reaching a similar agreement with the commercial banks. Following the imposition of martial law, the group of sixteen Western Creditor Governments have suspended negotiations for rescheduling official debt in 1982. This position was confirmed on 18 March. The creditors are however aware that this means the Poles are in effect obtaining 100% de facto debt relief.

/14. Romania's

14. Romania's total hard currency indebtedness at the end of 1981 was some $9.8 billion. Nearly $6.6 billion of this is owed to the banks. Romania was prevented from drawing on her IMF stand-by facility in November 1981 when she was found to be in arrears on her payments to her creditors. The Romanians have now approached the French chairman of the Paris Club (the group of Western creditor countries, which meets under French chairmanship), about holding a Paris Club meeting as soon as possible. The Chairman told them that they must first put their affairs in order with the IMF.

15. The Romanians have been negotiating with an ad hoc group of Western banks and have now reached agreement in principle upon terms for rescheduling 80% of their commercial bank debt in 1982. The agreement has yet to be approved by all the banks.

16. Yugoslavia's total hard currency indebtedness is some $18.6 billion. An IMF programme is in place. But there are doubts about whether the Yugoslavs' targets can be met.

17. All debtor countries rely on credtors' willingness to roll over short-term credit facilities. Withdrawal of deposits by OPEC, USSR, and Western banks may be embarrassing other CMEA countries besides Hungary, but we have no information on this. Most at risk are probably the GDR and Czechoslovakia.

18. The recurrent failure of Soviet agriculture has forced the Soviet Union to spend large quantities of hard currency on agricultural imports. They have been forced to sell large quantities of gold to finance their import bill. Their income from oil revenues will decline throughout the 1980s: and although there seems little danger of the USSR defaulting on its debts, the Russians may have difficulties by the mid-1980s in raising sufficient funds to finance the likely trade deficit.

FOREIGN AND COMMONWEALTH OFFICE
25 March 1982

Eastern Europe: Convertible Currency Debt 1980

	Estimated gross convertible currency debt at 31st Dec. Total (of which short term)		Convertible currency Gross Debt/export ratio (1)	Convertible currency Debt Service (1)(2	
				merchandise trade	total export earnings
	$bn	$bn	%	%	%
Bulgaria	3.8	n.a.	126	32	31
Czechoslovakia	4.8	n.a.	107	23	21
GDR	12.7	n.a.	219	55	37
Hungary	8.3	n.a.	169	35	31
Poland	23.1	1.8	312	100	80
Romania	9.5	2.1	146	28	19
Yugoslavia	16.8	1.4	300	45	18
(Total)	(79.0)				