



FCS/85/138

CHANCELLOR OF THE EXCHEQUER

Polish Debt

1. Thank you for your letter of 10 May in which you recommend that we should hold to our present approach on Polish debt rescheduling and new credits.
2. I agree with your assessment of the risks and difficulties inherent in our approach and I do not dissent from your conclusion that we should hold to our present course. However, we should recognise that in addition to the risks you mention, there could in the event of a de facto Polish default be adverse consequences for our general policy of seeking to build closer relations with Poland and the other countries of Eastern Europe. A default would represent a severe setback for the more liberal elements in the Polish administration and could call in question the future of economic reform and the strategy of seeking assistance from the IMF. It would be likely to increase Polish political and economic reliance on the Soviet Union. And it could also lead to increased instability in Poland, which could in turn have a destabilising effect on East/West political relations.
3. I agree with your view that in isolation a Polish default would have a serious but containable impact on UK banks and the banking system. But it might be difficult to limit the impact if another major debtor were running into difficulty at the same time. A coincidence of defaults could pose real problems for international debt management.
4. Despite these risks I, like you, consider that there is no alternative to sticking to our present approach. At present there

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is no assurance that Poland could make effective use of substantial injections of new credit, even if these were available. The amount of credit which Poland is seeking is large and the timescale required to achieve a turnaround in Polish economic performance is very long. None of the other major Western creditor governments appears disposed to offer more than a token amount of new credit. In these circumstances, and in the absence of effective policies by the Polish Government - either to implement economic reform or to achieve internal reconciliation - I see no justification for the UK to adopt a more accommodating line.

5. I am copying this letter to the Prime Minister, to Norman Tebbit and to the Governor.

A handwritten signature in black ink, appearing to be 'G. Howe', written in a cursive style.

(GEOFFREY HOWE)

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Indebtedness

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20 MAY 1985