



Treasury Chambers, Parliament Street, SW1P 3AG

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30 September 1988

Charles Powell Esq
Private Secretary
No.10 Downing Street
London SW1

Dear Charles

PRIME MINISTER'S VISIT TO POLAND: UK ECONOMIC AND FINANCIAL POLICY

The Chancellor has seen Lyn Parker's letter of 22 September and has commented that any offer of financial support at this stage would be likely to weaken pressure on the Polish Government to strengthen its efforts at both political and economic reform.

He would be particularly concerned at any increase in ECGD's already large exposure to Poland. We have recently been warned by Polish officials that Poland is unlikely to be able to meet in full the payments due between now and March 1989 to Western government creditors under the Paris Club agreement signed in December 1987. This stems from a decision by the Polish government to increase imports of consumer goods in response to the unrest in August instead of servicing its debt.

The IMF is suggesting that Poland should increase its efforts to return to current account balance. This is clearly the essential first step in bringing Poland's excessive indebtedness under control. It will need tight fiscal and monetary policies as well as increased flexibility in the domestic economy. In the present political climate, it seems wiser to wait until we see what line the new Rakowski government takes before considering any fresh moves - whether on the IMF programme, on debt, or (more remotely) on new lending.

I am copying this letter to Lyn Parker (FCO), Neil Thornton (DTI), D Twyford (ECGD), John Footman (Bank) and Trevor Woolley (Cabinet Office).

Yours sincerely
J M G Taylor

J M G TAYLOR
Private Secretary

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Prime Minister

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Prime Minister

Foreign and Commonwealth Office

London SW1A 2AH

22 September 1988

This says that you will not be able to offer the Poles any economic or financial help. It will make the visit more difficult, but must be right. Accept the advice?

We will discuss this

Dear Charles,

Prime Minister's visit to Poland:
UK Economic and Financial Policy

CDP 23/9.

When the Prime Minister is in Poland next month, we can expect the Polish Government to try to elicit her support for long-term debt rescheduling and for fresh infusions of Western lending for export-oriented projects. We have considered her possible response carefully, bearing in mind the Prime Minister's view, (recorded on page 3 of the Record of 18 May of her meeting with the Swedish Prime Minister) that Western European countries "ought to be ready on occasion to sacrifice their economic and trade interests for the larger political interests of encouraging greater freedom and reform in Eastern Europe". We have, however, to conclude that the present situation in Poland does not justify substantial politically motivated gestures of economic or financial support, and we recommend accordingly that the Prime Minister eschew any offer of substantial economic support at this stage.

The current Polish economic and financial situation remains thoroughly discouraging. The second stage of economic reform introduced last autumn has clearly run into trouble. Economic policy lacks coherence and the recent wave of industrial unrest underlines the fact that the authorities have yet to come to grips with the fundamental socio-economic problems. Inflation has accelerated, largely because the authorities made a practice of buying off industrial unrest with excessive wage increases. Investment continues to be subject to political manipulation, and to favour traditional heavy industry, which represents a powerful lobby. Poland has been unable to service its large external convertible currency debt. On the political side, the Poles have made some very cautious moves towards liberalization. Their recent agreement to talk to Solidarity is encouraging, but their real intentions remain obscure.

If Poland is ever to achieve a lasting economic recovery, and to repay its debts to Western creditors, large scale Western assistance in the form of longer term debt relief and new credits will undoubtedly be necessary. But now is not the time to provide it. Such assistance must depend on agreement to an IMF programme and on the Poles showing that they can keep to it. But an IMF agreement has yet to be negotiated. Moreover, the US attitude remains problematical. There is no

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prospect of the US agreeing to a Fund programme before the Presidential Election; and it is by no means certain that a new Administration would lift US opposition. Without US support, there is little chance of IMF support for a Polish adjustment programme, nor of a long-term debt relief agreement.

Nor is there, at present, any justification for proposing the resumption of ECGD support for medium-term project related finance (ECGD resumed a restrictive form of short-term cover late last year). Our existing exposure is high, with ECGD owed some £900m, and Poland has so far failed to conclude bilateral debt rescheduling agreements to implement the Paris Club Agreement of last December. There is one major project with a potential UK interest. This is a new terminal at Warsaw Airport (estimated value £65 million) for which MOWLEM are bidding. The Poles have emphasised the priority they attach this project and have assured us of their readiness to finance it by diverting airport dues and taxes into an account outside Poland. This would not however remove the need for some form of ECGD guarantee - a course of action to which ECGD are strongly opposed. Apart from the commercial risks involved, any official financial support would be inconsistent with our position (outlined above) on the Polish economy, IMF agreement and new credit, and would send the wrong signals to the Poles. We do not believe there is at present any convincing political case to outweigh these arguments.

Our recent exchanges with the Polish authorities do not suggest they will have exaggerated expectations of substantial new offers, but they may be expecting some gesture. The best way of finessing the issue would be to link the prospect of future economic assistance to progress in the political field. The Prime Minister could say that economic reform and reconstruction in Poland must run hand in hand with political dialogue and liberalization. Only when economic reform becomes a reality and large sections of Polish society cease to doubt the capacity of their leaders and industrial managers to deliver will Western confidence begin to be restored. Economic and political reform could thus open the way for a whole new era in Poland's economic relations with the West. It will of course be important to avoid any commitment on the UK's part to debt rescheduling and new credits, but the Prime Minister could indicate that if, in the weeks and months ahead, Poland was at last seen to be on the right track, she would not hesitate to urge other Western leaders (particularly, by implication, the new US Administration) to draw the appropriate policy conclusions.

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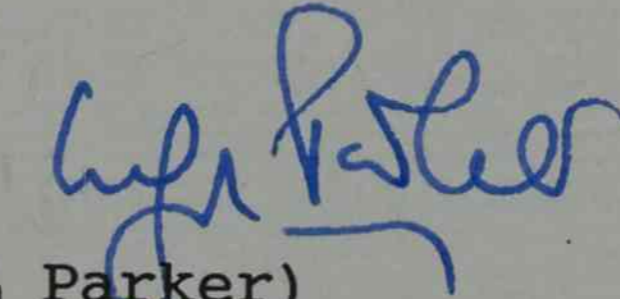


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There is one area of limited assistance the Prime Minister may wish to float in front of the Poles, if she judges it appropriate at some stage in the discussions. This is the idea of providing some help in management training. Such assistance, which we are actively considering in the case of Hungary, would chime with our general message that Eastern Europeans should begin to understand and accept market forces. We would need first to establish Polish needs in this area, possibly through a consultancy report and/or some preliminary visits to Britain by interested Poles. Until we know what the Poles want, it will be impossible to quantify the value of the assistance we might offer (the DTI can, however make £50,000 available this financial year to support management training for Eastern Europe as a whole, provided British industry make a matching contribution in cash or kind). If she judged that it would accord with their general message the Prime Minister could say that we are willing in principle to help in this area.

I understand that Lord Jellicoe wrote to the Prime Minister on 8 September in his capacity as Chairman of the EETC about our commercial relations with Poland. We shall shortly be sending a suggested draft reply, based on the line set out above.

I am sending copies of this letter to Alex Allan (HM Treasury), Neil Thornton (DTI), D Twyford (ECGD), J Footman (Bank of England) and Trevor Woolley (Cabinet Office).

Yours ever, 
(L Parker)
Private Secretary

C D Powell Esq
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POLAND: Pm's visit May 88

