

*I gather that the Treasury
are replying to the effort,
honestly, but they agree.*

A.T.C. 14/11.

N.B.P.R.

FC5/83/7

CHANCELLOR OF THE EXCHEQUER

Yugoslavia: Economic Crisis

1. You will have seen the outcome of the Creditors' meeting in Berne (Berne telegram numbers 7 and 8 enclosed). We have now to consider urgently what our position should be before the final Creditors' meeting, on 18/19 January.
2. On 6/7 January our offer of \$250 million looked increasingly thin the more it was examined by our partners. This is because we sought to count in our 1983 offer \$120 million of medium term credits which stem from contracts signed in 1982 and before. And the terms of the Memorandum of Understanding circulated by the Swiss will not allow us to count our \$120 million without a major amendment which will be resisted by the Americans and others. The Italians said specifically that they would not seek to count their \$250 million credits already in the pipeline, with the \$110 million which they were offering additionally for 1983.
3. If, however, \$120 million (and the short-term credit) is subtracted from our medium term contribution we will be offering only \$65 million of refinancing credit which puts us well below our major partners. The situation is made more difficult by the fact that our offer has been passed (not by us) to the Yugoslavs who have told our Ambassador in Belgrade that they hope we will be able to increase our offer of medium term commercial credit in line with provisional commitments by a number of other countries.
4. At the next meeting therefore we face the difficult position of putting our names to a document with our partners and the Yugoslavs in which our contribution will be seen by all not to measure up to the political importance of a problem which we have consistently acknowledged. What then should we do? There are several possibilities:



- (a) We could sit tight on our present offer and try to face our criticism from the Yugoslavs and our partners. I do not think this will do.
- (b) We could consider increasing our provisions of commercial credit from ECGD. While I would hope that Arthur Cockfield will agree to put Yugoslavia back on medium term cover (in line with most of our partners) for certain limited and specific projects, once the IMF programme and the current international assistance package are in place, I do not think that an extra offer of medium term commercial credit unless it were for commodities, is the best sort of help for Yugoslavia.
- (c) We could look at increasing our present offer, of \$65 million for refinancing credits, to \$81 million which would cover the whole of the sum due to be repaid to us by the Yugoslavs for officially guaranteed debts maturing in 1983. But this would only be a very small increase to off-set against the \$120 million. And our refinancing offer has in any case, been looked at slightly askance by our partners, as rescheduling by another route.

5. I do not think these options are the answer. What the Yugoslavs need are financial credits. To convert our full offer into the form of a financial credit might attract criticism from the Public Accounts Committee, given that only a few of our partners have so far offered aid in this form (Switzerland, Austria and Holland) while other creditors are proposing to give their help in the form of commercial and commodity credits. I would therefore like to make a claim in respect of the FCO vote on the contingency reserve for 1982/83 for the equivalent of \$100 million of assistance to Yugoslavia to be tied in the following way:-



- (a) \$35 million to be released to the Yugoslavs on repayment by them of the Bank of England's possible share (at present estimated at \$30 million) of the BIS short term bridging operation of (probably) \$500 million; the \$35 million would thus function in the first place as collateral for the participation of the Bank of England in the BIS operation and only thereafter to be disbursed as an untied financial credit;
- (b) \$65 million to be made available as a loan to the Yugoslav government. The loan should be tied explicitly to purchases of British goods and commodities in 1983. It should carry market rate of interest and be repayable between 3 to 5 years. The precise terms and conditions to be stipulated to the Yugoslavs should be discussed urgently between our officials. Exceptionally, the \$65 million would be paid over to the Yugoslavs in advance of the conclusion of the contracts to which it would be tied: this would have to be made clear to Parliament. This arrangement, although unusual, seems to me more realistic than the alternative of telling the Yugoslavs that the \$65 million must all be spent on British goods and commodities by 31 March 1983; and less open to objection here than the other option of making the loan untied.

6. In practical terms, at this stage of the financial year it would be unrealistic to offer the prospect of any compensating savings within the Public Expenditure programmes for which I am responsible, to off-set the proposal in paragraph 5 above. I realise that a claim on the Contingency Reserve will be unwelcome but I believe we have to accept that a financial crisis of this importance is likely to involve some increase in Public Expenditure and would be an appropriate use of the Contingency Reserve.



7. If you and the others concerned can agree that on 18/19 January we should improve our present contribution in the way I have suggested, then I do not think it would be necessary to avail ourselves of the Prime Minister's offer to chair a meeting (her Private Secretary's letter of 4 January).

8. To sum up. I do not claim that this operation is certain to succeed. I am, however, sure that we should play our full part and be seen, both by our Allies and also the Yugoslavs, to be doing so. The question at issue is of the highest political and strategic importance. Yugoslavia lies on the fault line between East and West. Ever since she broke with Stalin 35 years ago, her survival and well-being have been seen by East and West alike as an acid test of Western willingness to contain the Soviet empire in Europe. The present Yugoslav government believes it would not itself survive a major economic collapse, with the consequent increase in tension between the various republics of the fragile Yugoslav Federation. If the West is not seen to be actively helping during the coming months, the consequences will be a rejection of the structural reforms contained in the IMF's latest programme and a further increase in Yugoslavia's dependence on its East European neighbours, above all on the Soviet Union under its new and more active leadership.

9. I am sending copies of this minute to the Prime Minister, the Secretary of State for Trade, the Governor of the Bank of England and Sir Robert Armstrong.

(FRANCIS PYM)