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Foreign and Commonwealth Office

London SW1A 2AH

10 January 1989

Dear Charles,

Attaded

Soviet Union: Soros and the Open Sector

Your letters of 4 and 5 January asked for early advice on our views of the Soros ideas and on whether it would be appropriate for you to see Mr Soros. I understand that you have now agreed to do so.

George Soros is a Hungarian exile who has turned himself from a more or less penniless waiter in London to a multi-millionaire. His financial skills are well-known and appreciated in the City. He is now particularly interested in the possibility of influencing the Soviet Union and Eastern Europe and has for example set up scholarships schemes for Hungarian, Polish and Soviet students to study in Britain. The FCO contribute to these and have a hand in the selection process. 9 Soviet Soros students started at Oxford last term.

Soros has very good contacts inside the Soviet Union, not least with Politburo member Yakovlev.

Last year these contacts led to an invitation to him to bring to Moscow a team of Western economists (including Dr Philip Hanson from Birmingham University) to discuss ways of reforming the Soviet economy and introducing market mechanisms and habits. The team visited Moscow last October and met many senior economic figures inside and outside the Soviet administration, including a 2½ hour meeting with the Soviet Prime Minister Ryzhkov. The fact of the visit was public but its origins and the ideas under discussion have remained confidential. We have been kept in touch with developments by Dr Hanson who has sent us copies of relevant papers.

The essence of Soros' idea is to establish a part of the Soviet economy, defined by both geographical and sectoral criteria, as an "open sector" operating on market lines and with direct links to the outside world. This sector would eventually expand to embrace the whole of the Soviet economy. The paper from Soros enclosed with his letter to you of 3 January is a summary of the latest version of this idea. He continues to make explicit that the ultimate object of the exercise is to create a market economy in the Soviet Union. It is not clear how far this aim is shared by the members of the Soviet leadership who have met Soros and his team, but they have not so far asked him to abandon it. Kamentsev is said to be particularly keen to see some form of Soros' ideas put into practice.

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The Soros proposals are indeed far-reaching but they have a lot of good economic sense in them. The latest paper is particularly clear for example about the pitfalls which have beset practical reforms of other communist economies (China, Hungary); that radical reform of the Soviet economy as a whole remains essential, including measures to bring the money supply under control and stop escalating inflation; and that reforms grafted on to the existing Soviet system simply will not work, so that in the short term the open sector can only work using imported foreign managers. However considerable question marks inevitably hang over the proposals:

- can the Soviet leadership really accept (and implement) the degree of market forces and dependence on foreign expertise envisaged?
- how would the interface with the rest of the Soviet economy work in practice, not least given the endless black market possibilities?
- would it be quite as easy as Soros suggests to enlist the help of Western companies, who may well doubt whether the Soviet Union can be a really large and profitable market for them, except in the long term?

What Soros seems to want from us at present is no more than general encouragement. He has been in touch with Sir Patrick Wright, in parallel with the letters you have received, via Mr David Walker, the Chairman of the Securities and Investments Board. Sir Patrick has discussed the Soros ideas with Mr Walker, and whom Soros might most appropriately see while in London. He is already due to call on Sir Peter Middleton at the Treasury and Mr Walker himself. Neither the Foreign Secretary nor Mr Waldegrave can fit in a call by Soros this week. Sir Patrick has therefore arranged a meeting himself at noon on 12 January. In these circumstances our view, with which Mr Walker agrees, is that there is no need to arrange further calls this time round, though we would see no objection if you particularly wish to see him yourself. We will keep you informed of further developments, not least in the context of briefing for the Prime Minister's talks with Mr Gorbachev, if and when his visit here is confirmed.

I attach a draft reply to Dr Pelczynski from you (Dr Pelczynski has also been in touch with us separately). It may need amendment in the light of your meeting tomorrow.

I am copying this letter to Alex Allan (Treasury).

Yours ever,
L Parker
(L Parker)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street

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DSR 11 (Revised Sept 85)

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TO:

Copies to:

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SUBJECT:

PRIVACY MARKING

..... In Confidence

Thank you for your letter of 4 January. I subsequently received a letter from Mr Soros' enclosing a paper setting out his ideas.

CAVEAT

~~As you are no doubt already aware, meetings have been arranged for Mr Soros with Sir Peter Middleton, Permanent Secretary at HM Treasury, and with Sir Patrick Wright, Permanent Under-Secretary at the Foreign Office. These will enable us to stay in close touch with Mr Soros's thinking as his ideas develop and his contacts with the Soviet authorities continue. You will know that we are following these developments with close and sympathetic interest.~~

I am asking the Treasury and Foreign Office to keep me informed about this fascinating initiative and we shall no doubt be in touch again in the future.

Enclosures flag(s)

and had a
 good talk
 with him
 yesterday
 evening.
 I advised
 that he is
 who seeing

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