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INFO PRIORITY EUROPEAN COMMUNITY POSTS, WASHINGTON, UKDEL IMF/IBRD
INFO PRIORITY WARSAW, BUDAPEST
INFO ROUTINE UKDEL OECD, UKMIS NEW YORK, UKMIS GENEVA, UKDEL NATO
INFO ROUTINE ANKARA, BELGRADE, BERNE, CANBERRA, HELSINKI, OSLO
INFO ROUTINE OTTAWA, REYKJAVIK, STOCKHOLM, TOKYO, VIENNA, WELLINGTON
INFO SAVING BUCHAREST, EAST BERLIN, MOSCOW, PRAGUE, SOFIA

FRAME EXTERNAL
FRAME AGRICULTURE

MIPT: ASSISTANCE TO POLAND AND HUNGARY: DONERS MEETING: 1 AUGUST:
TRADE AND ECONOMIC COOPERATION:

1. COSTA (DIRECTOR GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS) GAVE A TRENCHANT ACCOUNT OF THE SITUATION IN POLAND AND HUNGARY. POLAND WAS BANKRUPT, WITH HEAVY DEBTS, HIGH INFLATION AND A 'BLACK AFRICAN EXCHANGE RATE SYSTEM'. HUNGARY HAD SLOW GROWTH, LARGELY ATTRIBUTABLE TO ITS IMF-BASED ADJUSTMENT POLICY OF THE PAST TWO YEARS. BUT INFLATION WAS LESS SEVERE THAN IN POLAND. THE FOREIGN TRADE PICTURE WAS BETTER, THOUGH STILL WITH A CURRENT ACCOUNT DEFICIT. HUNGARY WAS STILL CREDIT WORTHY, ALTHOUGH WITH DEBT/GDP AND DEBT/EXPORT RATIOS CLOSE TO THE WORSE CASES IN LATIN AMERICA. POLAND BADLY NEEDED RELATIVE PRICE CHANGES TO MAKE CONSUMER PRODUCTS MORE EXPENSIVE. THE HUNGARIAN RELATIVE PRICE STRUCTURE WAS ALREADY MUCH CLOSER TO REALISM. HUNGARY'S PREPARATIONS FOR FULL CONVERTIBILITY OF ITS CURRENCY WAS A REALISTIC MEDIUM TERM OBJECTIVE.

2. AGAINST THIS BACKGROUND, THE COMMISSION'S ASSESSMENT WAS THAT OECD COUNTRIES SHOULD AIM TO PROMOTE STRUCTURAL CHANGE AND TO REDUCE THE COST OF TRANSITION IN BOTH COUNTRIES. POLAND BADLY NEEDED AN IMF STABILISATION PROGRAMME. THE CONTAINMENT OF REAL WAGES WAS THE KEY, HOWEVER POLITICALLY DIFFICULT IT MIGHT APPEAR IN THE SHORT TERM. EMERGENCY FOOD AID WOULD MAKE A CONTRIBUTION, THOUGH ONLY A SMALL ONE, TO THE CONTAINMENT OF INFLATION. GOVERNMENT DEFICITS HAD TO BE REDUCED: AT PRESENT THEY WERE TOO LARGE EVEN FOR THE IMF TO GET A HANDLE ON THEM.

3. COSTA CONCLUDED WITH THREE KEY THEMES: CONDITIONALITY, POLICY DIALOGUE AND ADDITIONALITY. HE ADDED A WARNING: IF, AS SOME

INDICATIONS SUGGESTED, THE SOVIET GOVERNMENT DECIDED ON FINANCIAL AND ECONOMIC DISENGAGEMENT FROM THE REST OF EASTERN EUROPE, AND ONE CONSEQUENCE WAS THE CHARGING OF HARD CURRENCY PRICES FOR SOVIET EXPORTS OF RAW MATERIALS, THEN THE WEST WOULD NEED TO LOOK AT OTHER COUNTRIES BEYOND POLAND AND HUNGARY.

POLAND

4. KRENZLER REPORTED THAT THE COMMISSION'S FACT-FINDING MISSION HAD BEEN RECEIVED IN WARSAW BY THE FOREIGN MINISTER AND VICE MINISTER FOR AGRICULTURE. THERE HAD ALSO BEEN MEETINGS WITH THE OPPOSITION. WITH NO CLEAR GOVERNMENT STRUCTURE, DETAILED POLICIES FOR THE FUTURE REMAINED UNCLEAR. BUT ALL HAD EMPHASISED THEIR COMMITMENT TO ECONOMIC AND POLITICAL REFORM, AND HAD LAID EMPHASIS ON THREE PRIORITIES FOR ACTION: MANAGEMENT TRAINING, INVESTMENT AND ENVIRONMENTAL PROTECTION. BENAVIDES DESCRIBED THE EC/POLAND TRADE AND COOPERATION AGREEMENT CONCLUDED LAST MONTH, EMPHASISING THAT THE COOPERATION VOLET, WHILE DYNAMIC AND WIDE-RANGING, WAS NOT INTENDED AS A SUBSTITUTE FOR THE CONSIDERABLE RANGE OF CURRENT AND FUTURE ACTIVITIES CARRIED OUT ON THIS FRONT BY MEMBER STATES OF THE COMMUNITY.

5. THERE FOLLOWED A LENGTHY TOUR DE TABLE, IN WHICH MOST PARTICIPANTS PROVIDED A BROAD DESCRIPTION OF THEIR CURRENT TRADE AND ECONOMIC RELATIONS WITH POLAND. ALL AGREED THAT TRAINING WAS A PRIORITY: BAYNE RECALLED THAT A KNOW HOW FUND THE FIRST OF ITS KIND, HAD BEEN CREATED BACK IN JUNE TO THIS END. ALL AGREED TOO THAT INVESTMENT WAS IMPORTANT: AUSTRIA, CANADA AND FRG ALREADY HAD A SIGNIFICANT NUMBER OF JOINT VENTURES, WHILE MOST EUROPEANS WHO SPOKE REPORTED THAT JOINT VENTURE PROJECTS WERE ACTIVELY UNDER DISCUSSION. BILATERAL INVESTMENT PROTECTION AGREEMENTS WERE ALSO BEING PREPARED BY A NUMBER OF COUNTRIES. THE UK AND US EMPHASISED THE NEED TO INVOLVE THE PRIVATE SECTOR IN THESE ACTIVITIES: THIS IMPLIED A LARGE MEASURE OF RESPONSIBILITY ON THE POLISH AUTHORITIES TO ENSURE A CLIMATE CONDUCIVE TO WESTERN PRIVATE INVESTMENT. ALL AGREED THAT ENVIRONMENTAL PROTECTION WAS IMPORTANT.

MARKET ACCESS

6. FINLAND AND NEW ZEALAND CALLED ON OTHERS TO REMOVE REMAINING EXCEPTIONS TO MFN TREATMENT TO POLAND. ITALY NOTED THAT FURTHER MARKET OPENING WAS A PRIORITY. BELGIUM ADDED THAT MORE RAPID LIBERALISATION OF BENELUX QRS WAS UNDER CONSIDERATION. AUSTRALIA, US AND JAPAN REPORTED THAT THE EXTENSION OF GSP TO POLAND WAS UNDER ACTIVE CONSIDERATION. NEW ZEALAND ALREADY GAVE GSP TREATMENT TO POLAND. SWITZERLAND, NORWAY AND UK THOUGHT GSP FOR POLAND A

DIFFICULT PROPOSITION, LIKELY TO UNDERMINE THE AIM OF INTEGRATING MIDDLE INCOME COUNTRIES INTO THE FULL RANGE OF GATT OBLIGATIONS IN THE COURSE OF THE URUGUAY ROUND.

DEBT AND FINANCE:

7. ALL AGREED THAT THE EARLY CONCLUSION OF IMF NEGOTIATIONS WAS IMPORTANT. THE US CALLED FOR AN EXPEDITIOUS RESCHEDULING OF POLISH DEBT. THE PARIS CLUB SHOULD PROCEED PARTICULARLY FAST AND WITHOUT AWAITING AN IMF PROGRAMME. THE UK COMMENTED THAT THIS WAS PRESUMABLY ONLY POSSIBLE IN RELATION TO 1989 MATURITIES (A POINT ON WHICH THE US DELEGATION REMAINED OBSTINATELY VAGUE IN THE MARGINS).

8. SWITZERLAND COMMENTED THAT CONTINUED FINANCIAL ASSISTANCE TO POLAND WOULD BE ESSENTIAL. EXPORT CREDIT (WHICH BELGIUM, CANADA AND FINLAND WERE CONSIDERING RESTARTING) WAS RISKY IN SWISS EYES, AND COULD LEAD TO A DETERIORATION OF THE POLISH DEBT PROFILE. THE IMF AND WORLD BANK WOULD BE THE MAJOR SOURCES OF FUNDING. BUT LONG-TERM LOANS FROM OTHER SOURCES WOULD ALSO BE ESSENTIAL, IF DIFFICULT. THEY WOULD NEED TO BE CLOSELY LINKED TO IMF AND WORLD BANK FUNDING. SWITZERLAND WAS PREPARED TO EXAMINE THIS. SWITZERLAND ARGUED, WITH UK SUPPORT, FOR POLISH ENTRY INTO MIGA.

9. JAPAN AND NORWAY STRESSED THAT NO NEW FINANCIAL ASSISTANCE COULD BE CONSIDERED BEFORE POLAND HAD REACHED AGREEMENT WITH THE IMF: ALL DECISIONS SHOULD BE TAKEN IN CLOSE CONSULTATION THROUGH THE PARIS CLUB.

CONCLUSIONS

10. KRENZLER CONCLUDED THAT ALL AGREED ON THE NEED TO ENCOURAGE THE ECONOMIC REFORM PROCESS IN POLAND, ESPECIALLY BY ASSISTANCE TO THE PRIVATE SECTOR. A STRONG PROGRAMME OF STRUCTURAL REFORM WAS ESSENTIAL. ALL ASSISTANCE SHOULD BE COORDINATED: THERE SHOULD BE NO COMPETITION AMONG DONORS. THE MAIN PRIORITY AREAS FOR ACTION WERE:

- THE BETTER INTEGRATION OF POLAND INTO THE MULTILATERAL TRADING SYSTEM, IN ORDER TO INCREASE MARKET ACCESS FOR POLISH EXPORTS. THERE WAS A DIFFERENCE OF OPINION ON THE ROLE OF GSP IN THIS CONTEXT.
- MANAGEMENT TRAINING, PARTICULARLY IN THE FINANCIAL SERVICES AREA.
- THE ENCOURAGEMENT OF WESTERN INVESTMENT AND ITS PROTECTION, FOR EXAMPLE BY THE RESTORATION OF INVESTMENT INSURANCE BY POLISH MEMBERSHIP OF MIGA.

- ENVIRONMENTAL PROTECTION.

HUNGARY

11. THE COMMISSION CIRCULATED A DETAILED HUNGARIAN MEMORANDUM ON THEIR PERCEIVED NEEDS. KRENZLER NOTED THAT THIS WAS THE PRODUCT OF A RAPID HUNGARIAN RESPONSE TO THE SUMMIT INITIATIVE. HUNGARY WAS NOT SEEKING FOOD AID OR DEBT RESCHEDULING BUT DID WANT PUBLIC ENCOURAGEMENT (AND UNDERWRITING) OF PRIVATE SECTOR WESTERN INVESTMENT. THE HUNGARIANS ACKNOWLEDGED THEIR RESPONSIBILITY TO CREATE THE RIGHT CONDITIONS FOR SUCH INVESTMENT. HUNGARY'S PRIORITIES WERE: INCREASED MARKET ACCESS, BETTER ACCESS TO WESTERN CAPITAL MARKETS, MANAGEMENT TRAINING, TECHNOLOGY TRANSFER, CAPITAL INVESTMENT TO HELP INDUSTRIAL RESTRUCTURING AND CONTINUED DEVELOPMENT OF AGRICULTURE AS A MAJOR HUNGARIAN ASSET. HUNGARY MADE A POINT OF DENYING ITS STATUS AS A STATE TRADING COUNTRY, AND SET ITSELF A TEN-YEAR TARGET FOR FREE TRADE ARRANGEMENTS WITH THE EC AND EFTA.

12. KRENZLER NOTED THAT THE HUNGARIAN MEMORANDUM REFERRED TO A POSSIBLE FOLLOW-UP MEETING WITH DONOR COUNTRIES IN BUDAPEST. THIS HAD NOT BEEN RAISED WITH THE COMMISSION'S FACT-FINDING MISSION AND DID NOT AT PRESENT SEEM A LIVE PROPOSAL.

13. THERE FOLLOWED A RATHER SHORTER TOUR DE TABLE. THE UK, US AND CANADA STRESSED THAT HUNGARY WAS DOING WELL AND REQUIRED RECOGNITION. BAYNE NOTED THAT AMONG EAST EUROPEAN COUNTRIES HUNGARY WAS THE FURTHEST DOWN THE ROAD TO ECONOMIC AND POLITICAL REFORM, THAT HUNGARY HAD ALREADY ACCEPTED IMF DISCIPLINE FOR TWO YEARS AND WAS PREPARING TO DO MORE, AND THAT WHILE DEBT REMAINED HIGH, HUNGARY HAD CONSISTENTLY SERVICED ITS OBLIGATIONS AND NOT SOUGHT RESCHEDULING. THE HUNGARIAN PAPER LAID PROPER STRESS ON THEIR ATTEMPTS TO ATTRACT FOREIGN INVESTMENT ON SIMPLER TERMS. A UK COMPANY HAD IN FACT BECOME THE FIRST TO TAKE A MAJORITY SHAREHOLDING IN A JOINT VENTURE. THE LONDON STOCK EXCHANGE WAS PARTICIPATING WITH ITS BUDAPEST COUNTERPART ON A MAJOR MANAGEMENT TRAINING PROJECT.

14. AUSTRIA, JAPAN AND NEW ZEALAND ALREADY OFFERED GSP BENEFITS TO HUNGARY. AUSTRALIA AND THE US WERE ACTIVELY CONSIDERING THIS.

15. SPAIN DREW ATTENTION TO HUNGARY'S OFFER TO SHIP FOOD AID TO POLAND IF IT WAS PAID FOR FROM EC FUNDS: KRENZLER RESPONDED THAT THIS WAS A TRICKY ISSUE, NOT RAISED BY THE HUNGARIANS DURING THE COMMISSION'S VISIT TO BUDAPEST.

16. KRENZLER CONCLUDED THAT ALL WERE IMPRESSED BY THE SPEED AND QUALITY OF HUNGARY'S REACTION TO THE SUMMIT REMIT. ALL AGREED THAT THE HUNGARIAN REFORM PROCESS WAS MORE ADVANCED THAN THAT IN OTHER EAST EUROPEAN COUNTRIES. FURTHER STEPS MUST BE ENCOURAGED. PRIORITY AREAS WERE NOT VERY DIFFERENT FROM THOSE IDENTIFIED FOR POLAND. ADDITIONAL MARKET ACCESS, PARTICULARLY FOR AGRICULTURAL PRODUCTS, WAS IMPORTANT. SO TOO WAS FURTHER PROGRESS IN STIMULATING FOREIGN INVESTMENT AND JOINT VENTURE CAPITAL. MANAGEMENT TRAINING AND ENVIRONMENTAL COOPERATION ALSO REQUIRED URGENT ATTENTION.

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ADDITIONAL 1

FRAME

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