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PRIME MINISTER

ASSISTANCE TO POLAND

I attach the latest version of George Soros' plan for economic assistance to Poland, which you may find of interest. It is the so-called 'big bang' approach advocated by the American economist called Sachs and applied with considerable success - but in very different circumstances - to Bolivia. To the layman, quite a lot in it looks unrealistic but it is certainly bold.

Soros is going to Poland at the end of next week and has asked whether he could see you on the way through London. I have said that this simply will not be practicable with all your other commitments, and am trying to arrange for a Foreign Office or Treasury Minister to meet him. I shall also be seeing him myself.

CDP

Charles Powell

8 September 1989

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MJ/AFD

File PC

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

8 September 1989

Dear Stephen,

POLAND: GEORGE SOROS

George Soros has sent me the latest version of his plan for economic reform in Poland. It is the 'big bang' approach about which the Economist (I think it was) wrote last week. Soros tells me that he is full of admiration fo the lead given by the Prime Minister on Poland and would very much like to see her to discuss his latest plan, when he is en route to Poland in the middle of next week.

I shall be showing the Prime Minister the paper (she has seen earlier ones), but I don't think its going to be possible for her to see him. It would be helpful to know whether Mr Waldegrave or another Minister would be willing to do so on 13 September. I have undertaken to get back to Mr Soros by this evening.

I am copying this letter and enclosure to John Gieve (HM Treasury) and to Neil Thornton (Department of Trade and Industry).

Yours sincerely,

Charles Powell

Charles Powell

J.S. Wall, Esq.,
Foreign and Commonwealth Office.

TELECOPIER COVER SHEET

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PLEASE DELIVER THE FOLLOWING PAGES TO:

NAME: Mr. Charles Powell

COMPANY: Prime Minister's Personal Office

FAX NO.: (44-1) 222-8141

FROM: George Soros

IF YOU DO NOT RECEIVE ALL PAGES CLEARLY, PLEASE CONTACT US AS SOON AS POSSIBLE.

NUMBER OF PAGES (INCLUDING COVER SHEET): 6

FAX MACHINE OPERATOR: K. Valen DATE: Sept. 7, 1989

SENDER'S INSTRUCTIONS/MESSAGE:

A PLAN FOR POLAND

There is no precedent for the successful conversion of a centrally planned economy to a market-oriented one. The present situation in Poland offers a unique opportunity to accomplish such a transformation. If successful, it would have an impact that goes far beyond the borders of Poland. It is not too much to say that it would change the course of history.

A radical, comprehensive program is more likely to succeed than the gradual, step-by-step approach usually favored by the IMF. Painful measures that would be accepted today may run into greater resistance in the future; and the more far-reaching the plan, the more likely it is to engender enthusiasm both in Poland and abroad, the Soviet Union included.

The main argument against a radical approach is the lack of preparation and the lack of qualified personnel. I believe that both shortcomings could be overcome with assistance from the West. A "big bang" could be prepared before the end of this year. Emergency help, especially food, could be obtained for the transition period.

A comprehensive reform program would have three major components:

A) monetary stabilization;
B) internal economic reorganization;
C) external assistance.

A) Monetary Stabilization

This would be arranged with the assistance of the IMF but it would resemble the German currency reform of 1948 rather than a typical IMF program. Most price controls would be removed at once and a new, fully convertible currency introduced. Certain key commodities (bread, fuel) may remain controlled to provide an anchor for the price structure but the subsidies would be removed. Domestic prices of tradeable goods would adjust to international levels, prices of non-tradeable goods would be governed by the level of in-

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comes. Wages and social benefits would have to be fixed for an initial twelve-month period. Thereafter, wages would be subject to collective bargaining and social benefits would be indexed to the cost of living. The Polish National Bank would be given greater autonomy to assure proper control of the money supply and the budget deficit would be eliminated as part of internal reform.

As a result, the cost of living should remain stable after the initial adjustment period and may even fall if improved efficiency is translated into a rising currency rather than rising wages. Real wages can be kept at their current level to start with but living standards would suffer from high unemployment. Internal reforms coupled with external assistance should encourage new investment so that both employment and living standards would start to rise rapidly from the initial low point. Special measures would be needed to attract investment to areas of high unemployment and to improve labor mobility. To this end, rents must be raised to realistic levels and housing privatized over a relatively short period of time. The introduction of realistic rents, the removal of subsidies, the reduction in international debt service, and the elimination of operating losses in State-owned enterprises should swing the State budget into surplus, allowing a reduction in taxation.

B) Internal Reform

The entire public sector would be converted into corporations guided by the profit motive. The major part of the equity capital would perforce remain in public hands since there is not enough private capital available, but both foreign and domestic private investment would be encouraged. Public shareholdings would be distributed into a large enough number of institutional hands to allow stock and bond markets to be established. Institutions would include profit sharing and pension funds, as well as newly created investment banks and trust funds for servicing the foreign debt.

To attract much needed foreign participation, the government would select certain enterprises and/or ministries and specify the percentage of foreign ownership allowed. Investment banks from abroad, as well as newly formed investment banks at home, would then be invited to take charge of these enterprises and/or ministries and arrange for their transfer into private hands. Insofar as they realize a

price above a guaranteed minimum established by a bidding process, they would participate in the profit. This would maximize the price received by Poland.

The conversion of the entire Polish industry to the profit motive could be accomplished over a period of, say, 3-5 years. The process would be guided by the National Property Trust envisaged by the Roundtable Agreement, relying on the assistance of foreign experts. Since most of the enterprises would be left in the hands of present management to start with, foreign experts could be helpful to Parliament in exercising control. It would be desirable to establish an expiration date for the National Property Trust.

C) External Debt Reorganization and Assistance

i) Commercial Bank Debt

Trade debt will be serviced in full. Medium term debt will continue to receive interest, but commercial banks will be asked to give a 3-5 year option to Poland to repurchase the loans at 40% of par; in addition, they will be asked to re-lend to Poland 100% of the interest they receive in the first year, 66% in the second year, and 33% in the third year, subject to the same conditions. Poland will have an incentive to exercise the option starting in the second year because the effective interest rate, calculated on the repurchase price, is very high. It will use any funds raised from the sale of assets for this purpose and, if it makes progress in attracting a capital inflow by maintaining high domestic interest rates, it should be able to refinance the entire amount quite soon. The bankers will have to be persuaded to accept these terms by the Paris Club governments.

ii) Paris Club Debt

There would be a three-year moratorium on payments. Ideally, interest would be forgiven during the moratorium period but, if this is not acceptable to the Paris Club because it would establish a precedent, interest could be capitalized. In that case, a commitment must be obtained now which would limit future obligations. Otherwise, the currency could not be stabilized because of the overhang of accumulated debt. The export credit agencies would re-open their windows

during the moratorium period and Poland would fully service all new obligations.

iii) New Money

Poland could receive, say, $700 million a year for the next three years from the IMF and World Bank under existing facilities. In addition several countries (Germany in particular) have indicated willingness to provide bilateral credits. Together with private investment from abroad and the mobilization of Polish savings, this should be sufficient to make the currency stabilization scheme possible and to impart an upward momentum to the economy.

iv) Trade

(a) The European Common Market would admit goods manufactured by EC subsidiaries in Poland free of duty. After the moratorium period, an excise duty may be charged which would be used to service the Paris Club debt. A similar concession may be made to all Polish enterprises, provided the Polish trade surplus is kept within certain bounds. The excise duty could be on a sliding scale, depending on the trade surplus. Some such arrangement is indispensable to create jobs for people displaced from loss-making enterprises.

(b) Similar agreements may be concluded with the U.S., Scandinavia, Austria, Switzerland.

(c) Trade with the USSR would have to be renegotiated. I know too little about it to formulate a concrete proposal, but the new arrangement should encourage Polish exports to the Soviet Union while allowing termination of uneconomic contracts.

v) Management Assistance

Management assistance from the West is required on a massive scale. Under the guidance and supervision of the National Property Trust, individual Polish enterprises may be matched up with individual Western enterprises. The Western enterprises would receive an incentive payment based on profit improvement. The Liquidating Agency itself would need an international staff -- Poles living abroad could be mobilized. The costs must be borne by Poland.

This plan is subject to modification in every detail as long as the guiding principle -- a radical transformation of the Polish economy -- prevails.

George Soros
September 6, 1989

cy BG

soros fund

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