



FCS/90/005

CHIEF SECRETARY TO THE TREASURY

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Prime Minister

You may like to
tell our thinking
on expansion of the

Know-How Fund for Eastern Europe

Know-How
Funds to
Other
East
European
countries.

1. The Know-how Fund for Poland is going well. It is innovative, eye-catching and practical, and has been well received by the Poles. The Hungarians have welcomed the prospect of their Fund, and we have had useful discussions about getting it off the ground.
2. Changes in the rest of Eastern Europe in recent weeks have been momentous. Free elections are to be held in Czechoslovakia, Bulgaria, Romania and the GDR in the next 6 months. Though some Communist Parties are clinging to a share of power, they are all in retreat. Opposition movements are now involved in government, either directly or through Round Table talks. All are intent on opening up their societies and economies. All need Western help.
3. We have said that we will help once political and economic reforms are in place. At the Strasbourg European Council in December the Prime Minister and other heads of government agreed that the Community should, as East European countries espoused democracy, "encourage the necessary economic reforms by all the means at its disposal". In the House on 9 January the Prime Minister said "we shall do all we can to assist" those seeking a freer market economy and genuine democracy. There is public and parliamentary interest.

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4. Recently we have committed substantial resources to Poland and Hungary for the Know How Funds, the Polish stabilisation loan, and EC programmes, and we face contributions to the proposed European Bank and an adjustment loan to Hungary. We should begin to look more strategically at the likely scale and nature of our assistance to Eastern Europe. I propose that our officials work on this in the coming months in advance of the Survey.

5. However, the extension of our technical assistance efforts in Eastern Europe is urgent. We are planning a series of high-level contacts with East European leaders in the next 3 months. I shall be going to the GDR on 22-24 January, and meeting the Czechoslovak Foreign Minister in February. William Waldegrave will be going to Romania on 15-16 January, and the Czechoslovak President may visit London fairly soon. We shall want to show our support for the reforms undertaken and to encourage further progress.

6. I suggest that we agree in principle to establish a single Know How Fund for Eastern Europe, embracing our existing commitments to Poland and Hungary. New countries would become eligible for such assistance when we judged that the progress of reform so justified.

7. Economic assistance to the Soviet Union would be a major decision requiring separate ministerial consideration, but I hope we could also use the fund to pay for occasional modest technical assistance activity for the Soviet Union to help reform at a time when Gorbachev is facing growing domestic pressures. This is something the Prime Minister may well wish to consider before she goes to the USSR in June.



8. In terms of public impact, I would have liked to name a concrete figure, and our officials have discussed a total over several years of £150m, ie £75m more than the existing allocations to Hungary and Poland. This sum would be large enough to be publicly defensible, though well short of the figure which would emerge from a comparison of the combined GNP of Poland and Hungary with that of the other four main countries concerned. It is modest in comparison with the sums which other Western countries may be willing to spend.

9. I understand that making a specific new commitment now may cause you difficulties. I would be content therefore that we make an early announcement as follows:

- we will extend the Know-how Fund to other East European countries once they are firmly committed to reform.
- we will make substantial new funds available for this purpose.

10. I do not propose that within a global Fund for Eastern Europe we announce specific items for individual countries, though we shall need figures for internal planning purposes. The indicative figures we have in mind at this stage would be £25m for Czechoslovakia and £10 m each for Bulgaria, Romania and the GDR (where there is a particular need for non-German activity). The Fund should also be available to cover modest expenditure on equipment and supplies (eg for the health sector in Romania) and on encouragement to British private investment in Eastern Europe. An unallocated fund will help to avoid invidious comparisons and allow us to switch resources as circumstances change. I suggest we also drop the current 5-year time limit in the interest of flexibility and effective use of our money. If we agree commitments on the scale I have indicated, we could



get by with some £15 million for the next financial year (including our existing commitments in Poland and Hungary), increasing to about £25 million by 1992/93.

11. The PES sub programme for Economic Assistance to Eastern Europe, which we have recently established, amounts to only £5 million for each of the three years 1990/91-1992/93 to cover the initial £25 million Polish Know How Fund, though it is agreed that this will be increased to cover the further commitments to Poland and Hungary which we announced at the end of last year. It is important that we agree now provision for any new commitments. I therefore seek your agreement to an allocation from the Reserve for next year of £10 million to cover all Know How Fund expenditure, and that additional new resources will be made available in the Survey for subsequent years in the light of progress in the coming months.

12. I could not find resources for this purpose from within existing FCO provisions. The Overseas Aid budget for developing countries remains under considerable pressure as we continue to pursue our foreign policy objectives in other parts of the world. There is already a growing concern here, and in developing countries, that the West's response to events in Eastern Europe may diminish its support for the needs of the third world. It would be a mistake both in domestic political terms and internationally if we were seen to assist Eastern Europe at the expense of the poorer developing countries.

13. So far we have, with difficulty, managed to cope with the extra running costs of administering the Know-how Funds at present levels of activity. This will would no longer be possible with a larger Fund. We would normally expect that in order to run an effective technical assistance programme,



the requirement would be for running costs equivalent to about 3 per cent of programme expenditure over time: this suggests additional running cost requirements of about £½ million, taking account particularly of the costs of increasing overseas representation. I would be grateful if you would agree in principle an addition to running costs ceilings of the Diplomatic Wing and ODA of such an amount subject to more detailed consideration by our officials of the exact requirement.

14. In sum, there is an urgent need to commit ourselves to concrete support for the emerging democracies in Eastern Europe once they show themselves to be on the right path. An enlarged Know-how Fund would be the most practical and cost-effective way of responding to East European needs and helping them with the essential free market reforms. It would respond to public and parliamentary expectation that the UK will play an active and relevant part in shaping the future in Eastern Europe.

15. I hope an announcement along the lines suggested can be made before the high-level meetings with East Europeans beginning at the end of this month. The Presidency of the European Community has convened a meeting of Foreign Ministers for 20 January to consider the Twelve's policy towards Eastern Europe in the light of recent events. The announcement could be made at that meeting.

16. I am copying this minute to the Prime Minister, and to the Lord President, the Chancellor of the Exchequer, the Secretaries of State for Trade and Industry, Defence and the Environment, and the Cabinet Secretary.

DH.

(DOUGLAS HURD)

Foreign and Commonwealth Office
12 January 1990

