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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

5 February 1990

Rt Hon Nicholas Ridley MP
Secretary of State for Trade
and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

C 2072.

Dear Secretary of State,

EC - EAST EUROPE

Mar (13/12)

Thank you for copying me your letter of ~~15~~ 15 December to Douglas Hurd and the paper attached to it. I have also seen your letter of ~~11~~ 11 January to Douglas Hurd, and John Gummer's letter of ~~8~~ 8 January to you and your reply of ~~12~~ 12 January.

The paper provides a useful analysis of the implications for the Community and the UK of the opening up of the East European economies. I agree with most of the conclusions, particularly the need to ensure that the main focus of Western aid is to help these countries help themselves. I agree also that the situation on Inner German Trade should be kept under surveillance for the present.

There are two points though which I disagree with. First, while there is much political force in the argument that trade concessions should not be granted until countries have begun the reform process, once the time has come to give concessions we should be ready immediately to support rapid and extensive liberalisation along the lines agreed for Poland and Hungary. I am not persuaded that the pace of liberalisation should be phased as an incentive to progressive internal political and economic reforms. Slowing the process reduces export opportunities for these countries and indeed delays the potential benefits to our



own consumers of access to cheaper imports. We should not forget that EC consumers, as well as producers, have a stake in this process. I should therefore like to see the UK arguing for the approach taken in the case of Poland and Hungary to be followed when negotiations on trade with other Eastern European countries are in prospect.

Second, I do not think that our primary objective for the know-how fund should be to secure a high degree of penetration for UK service suppliers in the Polish market. While that is desirable the main aim is to ensure that the fund does promote the development of a market economy in the most cost effective manner. To that end, the overall aim should be to direct business to the most efficient suppliers, and so obtain the best value for money. But of course I agree that UK firms should be encouraged to bid for a sizeable share of the various Community Funds now available.

I note that ECGD is reviewing its cover both for investment in Eastern Europe and for exports.

In the case of investment insurance, ECGD will need to be particularly careful not to unbalance its relatively narrow portfolio. Officials are already in touch about ECGD's new proposals in this area, which no doubt will be submitted to Ministers in due course.

In the case of export guarantees, I share your view about Poland's lack of credit worthiness. The Polish Letter of Intent to the IMF sets a ceiling of \$700 million for total borrowing of this kind, which is roughly equivalent to the French and German offers already on the table. So there is unlikely to be pressure from the Poles in the near future. Nor is there much, I understand, from British exporters. So your caution seems entirely appropriate. I think we shall also have to be very careful about Hungary (where cover has temporarily been withdrawn) and in Bulgaria, where the new government is for the first time talking of rescheduling its debts. I am sure that direct UK help to these countries should take other forms than export credit.

By way of a general comment, I wonder whether we should be doing more (and encouraging the Commission to do more) to publicise the trade liberalisation measures recently implemented - which complement the package of financial and other aid for Poland and Hungary. The speed at which this was agreed was remarkable and provides a valuable signal of the virtues of free trade. As you rightly say in your letter of 12 January, this message will be reinforced by further concessions in the agricultural sector, which could be examined on a case by case basis as John Gummer suggests.

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I am copying this letter to the Prime Minister, members of OD(E), Sir Robin Butler, Sir David Hannay and Sir Christopher Mallaby.

Tancred Tankowski

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JOHN MAJOR

[Approved by the Chancellor of the Exchequer & signed on his behalf]

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The Rt. Hon. Nicholas Ridley MP
Secretary of State for Trade and Industry

The Rt Hon John Major MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Enquiries
01-215 5000

Telex 8811074/5 DTHQ G
Fax 01-222 2629

CDR
20/2

Direct line 01 215 5622
Our ref PB4AJM
Your ref
Date 20 February 1990

Dear John

EC-EAST EUROPE

Thank you for your letter of 5 February. I do not think there is much, if anything, between us in the points you raise.

Trade Liberalisation

I would certainly agree that trade liberalisation is something we should pursue on its own merits and not only as a reward for good behaviour in the abstract. But I do see one economic justification for some differentiation. The main reason why we have maintained restrictions on East European exports in the past is because those exports have had little relationship with economic rationality. Their pricing has borne no relation to costs, because those costs have been unknown; and export surges have been common, not so much because of demand here, as of a sudden surplus of supply there. In those East European countries where economic reform is lagging behind, we can expect such arbitrary behaviour in exports to continue, and, in these circumstances, there is some justification for caution and/or, at least, insisting on tough safeguard mechanisms. But I agree that we need to balance this with an assessment of the effect on consumers of continuing restrictions: our own work here suggests this would be small.



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Know-How Fund

I also agree that the main aim of the Know-How Fund must be to promote the development of an effective market economy. As we have considerable expertise here, the interests of our service suppliers should coincide neatly with the broader objective. We can also, as you have agreed, use the Fund for preinvestment feasibility studies, to which I attach considerable importance.

ECGD

You mentioned the proposal in my letter of 15 January on ECGD investment insurance for Eastern Europe. I am grateful for the support from Douglas Hurd and John Gummer in their letters of 26 January and 7 February respectively. Detailed proposals are now being discussed between our Departments and it is my intention to circulate these to colleagues once officials have completed their work. The existing and potential portfolio for Investment Insurance will obviously be one, but only one, factor to be taken into account. It is important that we should respond positively to these new areas of interest for UK investors and in the light of ECGD's assessments of the changed risks set review points on initial exposure levels for each market which give our investors the proper degree of encouragement to look at opportunities in these markets.

Whilst matters seem to be moving in the right direction on Poland with the signature of a Letter of Intent with the IMF, I continue to think that the Poles do not have the capacity under present conditions to service new debt. I would not agree, however, nor do I think the export community here would readily accept that we should not provide support for new export credits simply because others, such as the French and Germans, are offering enough such support to Poland to meet the provisions in the IMF programme.

In his letter, John Gummer suggests that a distinction needs to be drawn between the debts accumulated by the old regimes in Eastern Europe, and the need for new credit cover. We shall, of course examine constructively requests for new credit cover, but we shall need to consider the economic Position and prospects as a whole, including that which then applies on existing debt, in deciding the capacity of a particular market to absorb and service new debt obligations if these are to be guaranteed by ECGD.



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On your final point about publicity for the EC's trade liberalisation efforts, I have two words of caution. We do need to minimise the backlash from domestic producers, which could only make it harder politically to push through liberalisation programmes for the other East Europeans; and I doubt whether we will get very much credit as many of the restrictions liberalised were arguably illegal in the GATT anyway! But I agree we should do what we can to draw attention to the speed and effectiveness of the EC's response and to the wider lessons on the virtues of free trade.

I am copying this letter to the Prime Minister, Geoffrey Howe, Tom King, Chris Patten, John Wakeham, members of OD(E) and to Sir Robin Butler, Sir David Hannay and Sir Christopher Mallaby.

John Major
Answer

For Pol: East/West
Relations - All

