



Foreign and Commonwealth Office

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London SW1A 2AH

17 November 1989

Dear Charles,

Paris Summit: 18 November 1989

The Foreign Secretary has sent the Prime Minister a minute on our approach to the Paris Summit. We wrote separately, in connection with the message to President Bush, about handling of the meeting. I enclose copies of relevant telegrams from our Embassy in Paris.

Prospects in the GDR. Developments so far will not satisfy the people. The Party is in crisis. Almost all the old regional Secretaries have now been voted out by the grass-roots. Four recently-appointed Politburo members have resigned. Membership rolls are falling. A Party Congress is to take place on 15-17 December. Sweeping changes of the Central Committee and Politburo are possible, even of Krenz. In the meantime we must press for genuine elections based on a sound electoral law.

Poland. The Polish economy is in a near-catastrophic state. But the IMF is impressed with the leadership's resolve and measures taken so far. The Poles are considering either a rapid, high-risk option or a more cautious approach to economic reform. The IMF could live with either and is ready for an early agreement. Government and national unity are holding up well, but this winter will be a severe test. The momentum of change must be kept up. On the basis of a firm but tolerable IMF programme, the UK is ready to participate in a far-reaching Paris Club debt rescheduling, and meet our share of any collective financing effort to support economic reform and stabilisation. No decisions have yet been taken on resumption of export credits. Our "Know-how" Fund is well under way.

In Hungary, pending elections, the Government is unwilling to take unpopular measures. A non-Communist government is likely in the spring. If Pozsgay fails to secure the Presidency, a wholly new and inexperienced administration would take over. Reform is not in doubt; but there may be a messy coalition. External support will remain essential. The Hungarians are determined to avoid debt rescheduling and to retain a good international credit rating. We want to help them. This might involve participation in a bridging loan until drawings can be made under a new IMF programme (currently under negotiation).

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In Bulgaria Mladenov is more flexible than Zhivkov, and conscious of the country's external image. Better treatment of the Turkish minority is likely, and tolerance of dissidents has already improved. The old guard are being dismissed in short order. The omens for political reform are good.

In Czechoslovakia changes so far are barely perceptible. The latest changes in travel laws were minor. The leadership are coming under increasing pressure and Prime Minister Adamec could lead a reform group against the post-1968 generation of Party leaders. Change when it comes could be very swift - and relatively successful given the country's industrial base and low debt.

In Romania, the clearing of foreign debt has brought no relief for the people. The EC has suspended negotiations for a trade agreement; avoids Ministerial visits; and exerts pressure including through the CSCE.

In Yugoslavia, Prime Minister Markovic's economic reform programme is impressive but inter-republic rivalries prevent full implementation. Ethnic tensions remain high. Political reform is advanced in Slovenia but much less so elsewhere. The Yugoslavs are seeking massive financial assistance - oddly, since their external balance is strong and they have stopped paying principal on their official debts. This would be premature until there is more internal reform.

NATO: The US Ambassador approached Michael Alexander on 15 November expressing the hope that the Paris Summit would recognise the importance of NATO in similar terms to those used by the Prime Minister in her Guildhall speech.

EC/Eastern Europe

The Community's policy is based on establishing trade or trade and economic cooperation agreements which vary according to the extent of reform achieved in each East European country. Simple trade agreements limited to industrial products have been reached with Romania (1980), and Czechoslovakia (1988). Hungary (1988) and Poland (1989) have Economic Cooperation Agreements providing for greater trade access, and broader cooperation. Separately the Community is working to build up relations with EFTA going beyond the present free trade, to study how the internal market might be extended to them. With most Mediterranean countries, the Community has Association Agreements, eg Turkey (1963) or Cooperation Agreements, eg Yugoslavia (1980) which include substantial trade concessions, and some financial aid. The Prime Minister might argue:

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- must deepen our association with the emerging democracies, taking account of their particular circumstances, the reform achieved, their prosperity, and the nature of their economies;
- must tailor the present models to suit individual circumstances;
- look to the Commission to use imagination to produce proposals. Must then study them quickly.

NO
The Foreign Secretary's minute covers the French proposal for a "European Bank to promote Eastern countries' economies". The majority of donors would be the Community and individual member states; and the recipients - Poland, Hungary, Yugoslavia, and later other Eastern European countries. All members of the Bank would subscribe total callable capital up to 10 becu. The rate of contribution is not specified. The French proposal would offer a particular advantage if it secured extra US and Japanese financing for Eastern Europe.

The third round of negotiations on an EC/USSR Trade and Cooperation Agreement will take place on 22-24 November. The Commission and the Presidency are pushing for conclusion of negotiations then. We share that aim.

The Commission, following discussions with the GDR, has prepared a draft mandate for negotiation of an EC/GDR Trade Agreement. The Foreign Affairs Council on 6 November decided that it was premature for the Commission to table a draft. Events have moved on and we and others now believe that the Commission should make its proposal. The prospects for reform in the GDR may in due course justify an agreement going beyond trade to economic cooperation covering, eg environment and technology.

Following the Prime Minister's initiative, the Community and member states have responded well to aid for Hungary and Poland. In the Community, 100 mecu of free food has been disbursed in Poland; a 300 mecu package agreed in principle for 1990 covering agricultural reform, environmental protection and manpower vocational training; the principle of the extension of Generalised Scheme of Preferences to these countries; European Investment Bank lending; the abolition of all discriminatory quantitative restrictions from 1 January 1990. Detailed consideration of the agricultural coverage within GSP continues, and the Commission should propose abolition of certain non-discriminatory agricultural QRs. The 27 November Foreign Affairs Council should take final decisions. The Prime Minister might say:

- Community and member states have responded positively. Commission has coordinated G24 exercise effectively. Look to the Foreign Affairs Council on 27 November to finalise

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the measures.

- UK "Know-How Fund" for Poland under way. 40 projects already agreed. Looking to do more. Similar fund for Hungary to start next year.

President Mitterrand may suggest that the Community support observer status in GATT for the USSR. This would be welcome but we would need to maintain the distinction between observer status and full membership. An early Soviet application for membership would be premature. They could not apply the necessary open market principles.

I am copying this letter to John Gieve (HMT), Brian Hawtin (MOD) and Trevor Woolley (Cabinet Office).

Yours,
Stephen Wall
(J S Wall)
Private Secretary

C D Powell Esq
10 Downing Street

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PM/89/53

PRIME MINISTER

Eastern Europe

1. I had talks with Genscher in Bonn on 15 November and visited Berlin yesterday. The German analysis of developments in the GDR is very close to our own. They want to encourage free elections, avoid talk of reunification and reassure the Soviet Union. Only the right-wing of the CDU are making much of reunification. The reformers in the GDR are deliberately avoiding the topic. Genscher thought the new government in the GDR would want free elections. These might well come a month or two before the elections in West Germany and the FRG political parties are already thinking about what role they might play. Whatever happens, it is clear that developments in the GDR will be a major election issue in the FRG over the next year. So far the government parties are benefiting but the SPD claim that what is happening was started by Willy Brandt, and that the credit belongs to them.

2. The Germans think the time has come for the Commission to open negotiations on a Community trade agreement with the GDR. If democracy takes hold, we shall need to look at other forms of cooperation. Genscher agreed with me that we should look at all the models, including EFTA and the Council of Europe. But he doubted if EFTA would turn out to be the right model and thought that different agreements would be needed with each emerging Eastern European democracy, tailored

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to their requirements. The Association Agreement which we have with Turkey looks forward to eventual membership of the EC, which may not be realistic for the East Europeans for a long time to come. As agreed at our talk this week, we are working on a paper on all this for Strasbourg.

3. We agree with the Germans that the Community has been a pole of attraction to the countries of Eastern Europe. *? Has it-* The Germans think we will give the wrong signal if we do not now proceed apace with further integration. I suspect the French may try and point up differences with us on this in Paris at the weekend. I said to Genscher that we too wanted to see progress in Europe. The best signal we could give to Eastern Europe was to show that the Community was implementing its existing undertakings, notably completion of the single market. The argument about EMU was less about the pace than about whether we should have a liberal free market approach or a more bureaucratic centralist one.

4. The French have proposed in the Monetary Committee the establishment of an investment bank for Eastern Europe. It would have a capital of 10 billion ecu, 20% up front. It would be financed primarily by EC countries but participation by other OECD members is envisaged. Mitterrand will mention this on Saturday. We shall want to look in detail, but I think we should welcome it as an interesting idea.

5. Genscher agreed that the kind of message which should emerge from Paris would be:

- an enthusiastic welcome for developments in Eastern Europe;

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- reaffirmation of NATO and EC policies which have helped to make these developments possible;
- recognition both of Gorbachev's role and his concerns.

Mitterrand will obviously want to talk to Bush after the weekend meeting. I see no point in trying to prevent him from conveying the sort of message outlined above.

6. There are a number of other issues which you will want to discuss with President Bush and which we can talk about with Tom King next Wednesday. I shall send you a note on these before our meeting but some of them may come up on Saturday night, notably what kind of initiative Gorbachev may produce at Malta. It would be surprising if he does not produce a trump card. This might be:

- some dramatic proposal on nuclear weapons so as to get SNF talks underway straight away;
- a proposal to give Berlin back to the Germans: East Berlin to the GDR and West Berlin to the FRG;
- a proposed peace treaty to end the Second World War.

I hope Bush would resist being bounced. But he should be prepared.

7. The press were suggesting a few days ago that NATO was now redundant. People have sobered up since then. It was very obvious to me that the role of the Allies continues to give a tremendous sense of stability to West Berlin and is one reason why they have been able to react

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with such controlled enthusiasm to developments in the East: they know they still have the underpinning of Allied support. The British garrison in Berlin has responded to recent developments with everything from accommodation to soup kitchens. We shall have to adapt to changing circumstances and the Commandant and his team are giving thought to this. But our presence remains a necessary insurance policy for the democratic reforms that are now taking place.

8. I am copying this minute to the Chancellor of the Exchequer, the Defence Secretary and the Cabinet Secretary.

DH.

(DOUGLAS HURD)

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