



Foreign and Commonwealth Office

London SW1A 2AH

6 January 1982

Dear John

Poland

I understand that the Prime Minister is to hold a meeting at 1700 hrs tomorrow. You will wish to know where matters now stand on Poland, and in particular what response we and our partners in the Ten might be able to make to the US request for support for the measures against Poland and the Soviet Union announced by President Reagan on 23 and 29 December. There is quite a lot of ground to be covered and I apologise for the length of what follows.

The regime in Poland following the imposition of martial law on 13 December is now entering its fourth week. The repressive nature of the regime has become clear although it would be premature to reach any final judgements about General Jaruzelski's long-term intentions or his room for manoeuvre. Meanwhile our public stance has, as you know, been adjusted to reflect sharp condemnation of what has happened in Poland as well as the Soviet Union's role.

At the meeting of the Ten Foreign Ministers on 4 January there was no fundamental disagreement over the Soviet Union's complicity in and responsibility for the imposition of martial law in Poland. This is an encouraging step forward, as is the fact that most Ministers present spoke firmly of the need to preserve Western unity and particularly not to undermine the US measures. We are at one with the United States on our immediate objectives to press for the lifting of martial law, the release of the detainees and the resumption of a dialogue between the Polish authorities, the Church and Solidarity.

A very intense period of consultation both within the Alliance and the Community lies ahead. The NATO Ministerial meeting on 11 January could prove difficult, given the existing differences of interest and opinion among the Ten. Nevertheless attention must remain focussed on the real crisis in Poland and not on divisions among the Alliance partners. We need therefore to join with them in measures which, while not identical with those the US have announced, do show our clear support.

It will not be possible to take final decisions on all these questions on 11 January. A number of them fall to be taken in the Community, through preparation in COREPER leading to decisions at the Foreign Affairs Council on 25-26 January.

/There



There may be some discussion at the EC Foreign Ministers' meeting on 14 January, but that is of course intended to deal with the mandate.

This is the background against which, bilaterally and in the Ten, we have made our views clear about developments in Poland. The scope for political action against the Soviet Union is not great. Following Afghanistan we have already reduced our contacts to the essential minimum. One obvious opening is to use the Madrid Review Conference. At the meeting of Foreign Ministers of the Ten on 4 January we agreed to press for the early reconvening of the Review Conference at Ministerial level to discuss the grave violations of the Helsinki Final Act and, if this takes place, it will give a further early opportunity to put the Soviet Union and Poland in the dock.

The following are specific points which now arise for decision in connection with Poland and the Soviet Union (against whom the Americans are pressing us to take economic measures).

POLAND

/ [REDACTED] I attach a note by officials making recommendations on a number of economic aspects of our relations with Poland. Lord Carrington hopes that these can be agreed. He would like to draw attention to two points in particular.

/ The URSUS project We need to think further about the balance of advantage, political, economic and industrial in the continuation or otherwise of this project. I understand that officials of the Department of Trade are examining these issues in consultation with Massey-Ferguson. We should await their report before taking decisions. Meanwhile, a summary of the present position is contained in an annex to the officials' paper.

EC Food Supplies Lord Carrington thinks that it would be wrong for the Community to offer further subsidised food to Poland. Although there will be opposition to this view within the Community from those who have a national interest in continuing to export Community surpluses to Poland, he asks his colleagues to agree that any consideration of further supplies of subsidised food to Poland must be made dependent on significant movement towards lifting martial law and resuming the reform process. As there will be strong public and Parliamentary pressure on governments to respond urgently to the serious shortages of food in Poland, he would like to ask the EC to agree that further community funds be made available for humanitarian supplies to be distributed by voluntary and church agencies in Poland. This would be a humanitarian gesture most likely to serve the interests of the Polish people.

/Two other



Two other questions should be mentioned. Poland has applied for readmission to the IMF. The application is now under consideration by the Fund's authorities but will move very slowly. We need not take specific blocking action for the time being. But we should look again at this later in the year when substantive decisions are more imminent.

The Americans have announced that they will be proposing a tightening of the restrictions on high technology exports to Poland under the COCOM rules. Given the very small percentage of our trade that would be affected by such a move we would see no reason to oppose this if our other Allies were also willing to go along with the Americans.

Then there is the question of Polish refugees. The question is sensitive and has already aroused a considerable amount of Parliamentary interest. The Home Secretary has agreed not to return any Pole to Poland against his will. Lord Carrington welcomes this, and hopes that we can also play a helpful part in response to the request from Chancellor Kreisky (now supported by the UN High Commissioner for Refugees) for assistance in the re-settlement of the large number of Polish refugees in Austria. He will be pursuing this question separately with the Home Secretary.

There is also the question of what we should say to the Poles, Parliament and press about these decisions. As far as the Poles are concerned, until we are in a position to make a collective announcement with our other allies, we should continue to take the line that while we are willing when circumstances permit to return our relations, including economic relations, to their former level, present circumstances make this impossible. We will need to see how far we have got in taking decisions before deciding whether to make a formal announcement of these measures in Parliament when it reconvenes on 14 January. The press line should continue to be that reflected in the communique following the 4 January meeting, which was that measures including those concerning credit and economic assistance to Poland would be considered as the situation in Poland developed.

/ SOVIET UNION



SOVIET UNION

I attach the text of President Reagan's statement of 29 December setting out US measures against the Soviet Union. It is not entirely clear what the impact of these measures will be on Europe's trade with the Soviet Union, especially as regards the gas pipeline and high technology exports. I understand that officials are looking further into these aspects.

The Americans have pressed the allies to take complementary action. While they are not necessarily looking for measures identical to their own, they have made it clear that they want a convincing display of unity and support through concerted action. Lord Carrington thinks it important that we should make a positive response and that our approach should be guided by the following two considerations: first, any action which we take should be closely coordinated with our Community partners and with the other main Western industrialised countries; and, second, existing contracts should not be affected.

Our broad objectives should be to secure agreement on means to ensure that the United States' measures are not undermined. How we give effect to the commitment not to undermine the US measures gives rise to a number of important and complex questions which will need to be carefully studied by officials and worked out with our EC and other partners to ensure that we are in line. We should also seek agreement to measures which would generally support those taken by the US but would not be identical.

Restrictions on Imports of Soviet Manufactures At the meeting on 4 January the Commission raised the possibility of increasing restrictions on imports of Soviet manufactured goods into the Community. A reference was made to this in the communique. We should encourage the Commission to produce proposals. These are likely to be either increases in quantitative restrictions or in tariffs. Lord Carrington hopes that on examination we shall be able to agree to some form of restrictions on these lines. This is a field where he believes that, provided we act collectively, we could achieve a significant political gesture at very limited economic cost.

COCOM The Americans have asked for our support in placing further limitations on exports of high technology goods to the Soviet Union. This is something we shall need to look at carefully at the high-level meeting of officials planned for 16/18 January where the Americans will no doubt make their views clearer.

/Maritime Agreement



✓ Maritime Agreement The Americans have suspended negotiations on a new maritime agreement with the Soviet Union. Our own Maritime Agreement has not worked in our favour. Lord Carrington hopes that it can be agreed that he should be able to say that we were prepared to give notice of termination of the Agreement. We shall of course have to consider the position of those of our partners who have similar agreements and who could usefully be encouraged to take similar action.

Factory Fishing Lord Carrington has circulated to colleagues a minute he sent to the Minister of Agriculture on the possibility of using the proposed new licensing system for the transfer of fish caught by UK fishermen, to discriminate against Soviet factory ships. Flag A. While the introduction of licensing is a measure we may be taking for conservation reasons, he thinks it would be wrong to miss the opportunity of presenting this as part of a package of measures we might be prepared to take against the Soviet Union.

Bilateral Exchange Agreements Lord Carrington thinks we ought to be prepared to follow the US lead and, in conjunction with our partners, state that we will not renew any scientific, technical or similar exchange agreements with the Soviet Union that fall due for renewal and will confine the implementation of existing agreements in these fields to routine exchanges. If a package along these lines is to be agreed, we will need to think carefully about ministerial and other contacts with the Soviet Union. These have already been reduced to a routine level and confined to essential business, mainly in the trade field. He believes that such contacts should continue. At present these include a CBI Economic Round Table visit to the Soviet Union in February, the Anglo/Soviet Joint Commission meeting in May and indeed Mr Rees' speech at the British-Soviet Chamber of Commerce lunch on 21 January.

I am copying this letter to John Kerr (HM Treasury), Kate Timms (MAFF), John Rhodes (Department of Trade), Ian Ellison (Department of Industry) and David Wright (Cabinet Office).

9 Mrs Carr,

(B J P Fall)
Private Secretary

A J Coles
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ECONOMIC POLICY TOWARDS POLAND

Note by Officials

INTRODUCTION

1. At their meeting on 12 November (OD(81) 17th Meeting, Minute 2), the Defence and Oversea Policy Committee considered various aspects of economic assistance towards Poland, prior to the imposition of martial law in that country. They took decisions on the rescheduling of outstanding debts and on the provision of credit. This note reviews the position and sets out official advice, interdepartmentally agreed on the handling of outstanding issues. Since earlier decisions on Poland have distinguished between action relating to the calendar year 1981 and 1982, this division is retained in this note for the sake of clarity.

RESCHEJULING: 1981

Government Guaranteed Credit

2. In 1981 Poland reached agreement with 15 major creditor governments for the rescheduling of government guaranteed debt due for repayment between May and December 1981 (together with arrears up to 1 May). Ninety percent of the principal and interest was rescheduled over four years with a four year grace period.

3. The texts of the bilateral and multilateral agreements both permit suspension without notice "if exceptional circumstances are observed" - a provision which has become known as the "tank clause". The effect of such a suspension would be to render the debts due on their original dates. As the Poles could not find the \$2 billion or so involved, they would be virtually obliged to declare a moratorium for which they would blame the West. In these circumstances, it is our view and that of our main allies that, although present conditions in Poland would justify invoking the tank clause, it is not in our interests to do so, at least for the time being. Departments therefore recommend that no action should be taken as regards the 1981 rescheduling agreement.

Unguaranteed Commercial Debt

4. The Poles were due to sign an agreement with representatives of 460 commercial banks and other commercial creditors on 10 December. This would have provided for

rescheduling of 95 per cent of principal, but not interest. A prior condition was the repayment of arrears of interest thought to amount to about \$500 million. The Poles have asked a number of banks to contribute to bridging finance of \$350 million for six months to meet these arrears. They have also asked several Western governments either to contribute or encourage their banks to do so. The banks have told the Poles they are not willing to provide bridging finance; nor is any Western government expected to do so. In these circumstances, Departments see no reason for HMG to consider a contribution.

RESCHEDULING: 1982

Guaranteed Debt

5. In November 1981, the major creditor governments agreed in principle to reschedule Poland's debt repayments for 1982 on broadly the same terms as for 1981 provided that the Poles signed the 1981 rescheduling agreement with the banks. At the United States' insistence, the rescheduling was to be in two six month stages, the second depending on Poland's economic progress in the first six months. The creditors were to meet the Poles again on 14/15 January to finalise and sign the agreement.

6. There would be little advantage to Western creditors in refusing to reschedule for 1982. The only effect would be to make it impossible for the Poles to meet their financial obligations. It is in our interest that the debts be handled in an orderly manner; rescheduling would contribute to this. But there would be political disadvantages in reopening negotiations with the Poles at present, particularly since rescheduling is widely (if mistakenly) regarded as an instrument of Western generosity. It would be possible to postpone the next meeting with the Poles for a month or two as a gesture of disapproval. This would also suit the creditors since it would enable them to pause until the situation in Poland ^{and} the outcome of negotiations with commercial banks was clearer. The French, as hosts to the Joint Commission, will soon consult other creditor governments; they have already indicated to the Poles that an invitation to them is in doubt. Officials recommend that we should favour a meeting in January confined to creditor governments, with the Poles being put off for an indefinite period; and that we should review this issue at the end of January.

PROVISION OF OFFICIALLY GUARANTEED CREDIT

7. The following paragraphs refer to credit cover under four different headings: short term cover; unspent credit on projects authorised before 1981; medium term credit authorised in 1981; and new credit for 1982. It does not make sense to set over-riding policy guidelines to determine the handling of each type of credit, given the variations in circumstances and in the balance of advantage to the United Kingdom. But officials consider that there are also common factors: in particular the need to demonstrate political disapproval of current Polish policies, to keep open the possibility of responding to improvements in the situation, and to allow time to see whether the Poles can bring their economy under control. They therefore recommend that certain issues should be reviewed by Ministers, and suggest that the end of January would be an appropriate time for this review to take place.

(a) Short term cover

8. Ministers decided (OD(81)8th Meeting) to permit Export Credits Guarantee Department (ECGD) to maintain short term cover facilities for Poland up to a liability limit of £10 million. Accordingly ECGD has been maintaining a limited facility for Comprehensive Guarantee policy-holders selling essential goods and commodities to Poland on payment terms of up to 180 days credit, secured by Irrevocable Letter of Credit (ILCs) issued by Bank Handlowy. ECGD's outstanding liability is at present estimated to be no higher than £6 million. In present circumstances normal commercial transactions with Poland are not possible. Moreover the prospects that the Poles will be able to keep up to date with their short-term repayment obligations appear poor. In addition, this type of cover does not lend itself to such effective control of the type of goods which may be supplied as is the case with terms of credit. Officials therefore recommend that the short term cover facility for Poland should now be withdrawn altogether.

(b) Unspent credit on projects authorised before 1981

9. Three main projects are involved -

i. URSUS TRACTOR FACTORY

When the Defence and Overseas Policy Committee decided on 12 November that ECGD should be directed to allow up to £30 million to be drawn during 1982 for this Massey Ferguson Perkins project, they had in mind that it would have represented the main British contribution to assisting Poland in 1982. Completion of the project would also, in the view of officials, help to secure improvements in

Polish agriculture which would reduce the strain on the Polish balance of payments and so facilitate the repayment of outstanding debts (a detailed account of the financing of this project and of ECGD's responsibilities in relation to it is appended to this note). The project is also of very great importance to Massey Ferguson who may however prove to depend on the continuing flow of officially guaranteed credit to keep the project alive.

Nevertheless officials do not think that, in Poland's immediate political and economic situation, further credit cover should be given. They therefore recommend that we should neither withdraw from the project nor authorise additional credit for it pending the review referred to in paragraph 7 above, unless the Secretary of State for Trade advises his colleagues that the circumstances of Massey Ferguson make an earlier review essential.

ii. LOT TERMINAL

The Lot Terminal project in Warsaw has been suspended as a result of the dispute between the contractual parties. Although the possibility cannot be entirely excluded that the Poles and the British firm involved, Cementation, will find a way of resolving their dispute, ^{the} only further drawing against the loan is likely to be an arbitration award in favour of Cementation on termination of the contract. This would increase Polish indebtedness by perhaps £10 million, but would be inescapable under the terms of ECGD's cover for Cementation. Officials invite Ministers to note the position.

iii. PVC FACTORY

About £10 million remains to be drawn to complete the PVC project. For the present ECGD are suspending further drawings on this line of credit; but a prolonged suspension might prejudice prospects of eventual repayment. Officials recommend that no further drawings should be allowed pending the outcome of the review referred to in paragraph 7 above.

(c) Medium term line of credit authorised in 1981

10. Altogether OD authorised ECGD to make available in 1981 £65 million of new Medium Term credit to Poland. Of this total £22 million has yet to be disbursed, but ECGD is committed in principle to support up to a further £10 million of orders in the pipeline and might face litigation if it withdrew from these commitments. These commitments include the cover necessary to implement the British contribution to the European Community food aid packages so far agreed (i.e. the first two tranches, and the first instalment of the third tranche). Of the remaining

£12 million, approximately £5.4 million has been provisionally earmarked by Ministers to support the sale of food exports and the remainder for industrial goods.

11. Since the imposition of martial law in Poland ECGD has stopped processing new business with Poland pending a decision by Ministers on how to proceed with applying the limited amount of cover available. Apart from the scope available for physical and administrative delay it would also be possible to cancel the undisbursed £12 million credit on the technical grounds that the period during which contracts were to be placed expired on 31 December. However, cancellation of this credit would make it impossible, without fresh Ministerial decisions, for the United Kingdom to participate in the provision of any further tranches of European Community food aid that may be agreed. Officials consider, however, that the political justification for providing subsidised European Community food supplies (and the national credit to enable the Poles to purchase them) no longer exists and expect that enough European Community members will agree that this is the case to enable further tranches of Community food aid (other than humanitarian assistance) to be blocked. Officials recommend therefore that we should work to this end within the Community and that we should not in any case allow the outstanding 1981 credit to be used for food or industrial exports pending the outcome of the review referred to in paragraph 7 above.

(d) New credit for 1982

12. OD decided on 12 November not to make available any fresh credit in 1982, subject to reconsideration in the event of a request by the United States for contributions towards a major rescue operation. That contingency now appears less likely to arise. Officials see no reason therefore for proposing the provision of any new credit for Poland in present circumstances.

Recommendations

Officials therefore invite Ministers to agree that -

- i. We should not suspend the 1981 agreement for rescheduling Government guaranteed Polish debts (paragraph 3);

- ii. The Government should not contribute to the \$350 million bridging loan sought by the Poles (paragraph 4);
- iii. We should work for the postponement for the time being of negotiations for an official rescheduling agreement covering 1982 (paragraph 6);
- iv. Short term cover for exports to Poland should be withdrawn altogether (paragraph 8);
- v. Drawings on the outstanding lines of credit for the URSUS and PVC factory projects should be suspended for the time being (paragraph 9i and iii);
- vi. Any drawings on the line of credit for the LOT Terminal project necessary for contractual reasons should be made (paragraph 9ii);
- vii. The £12 million not yet committed from the lines of medium term credit authorised in 1981 should be suspended for the time being (paragraph 11);
- viii. The government should oppose for the time being any further exports of European Community food to Poland at subsidised prices (paragraph 11).
- ix. There is at present no case for the provision of fresh credits for Poland (paragraph 12);
- x. The matters covered by recommendations iii., v., vii., viii., and ix. above should be reviewed at the end of January.

Cabinet Office

6 January 1981

The Ursus project involves the construction of a facility for the production of Massey Ferguson Perkins type tractors and engines. Begun in 1974 and due for completion in 1980/81 the project has been partly financed by three ECGD guaranteed lines of credit, two in sterling and the third in US dollars with a total value of some £275m. To (to end of 1981) some £140m has been drawn of which £21m has been repaid.

The project is now three to four years behind schedule. On 12 November Ministers instructed that of the £135m as yet undrawn of the loans already in place a further £30m might be utilised in 1982.

Effect was to be given to the provision of this £30m tranche - and to the revision of the repayment terms of the previously drawn tranches as well as the remaining credit to be drawn outside the general rescheduling of Polish debts - by supplementary agreements due to be signed in the week beginning 14 December 1981. This intention was overtaken by the imposition of martial law on 13 December and although, technically, there is no obstruction to the signature by Barclays of the supplemental agreement relating to the sterling element of that tranche (£7m) ECGD has requested that the Bank do not sign. ECGD was to be a signatory to the US dollar element and is, therefore, able to control that situation.

ECGD believe in the present circumstances the arguments against releasing any further loan funds to Poland are strong from a financial point of view. They do not consider however that there is an immediate need to take any action and would accept that the matter ride pending clarification of the Polish situation. Massey Ferguson Perkins have indicated, however, that there is a risk that the continuing uncertainty over the further disbursement of credit and the costs which they are continuing to incur through paying their design team may force them to reconsider their involvement in this project.