



Poland

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FOREIGN AND COMMONWEALTH SECRETARY

Prime Minister

You may wish to defer comment pending Lord Carrington's views.

Yes not

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f-a. 1. 3

1982 POLISH DEBT RESCHEDULING

.... I enclose a paper on this subject which has been prepared by Treasury officials in consultation with the FCO and other Departments concerned.

2. The main message of the paper is that the continued refusal of Western Creditor Governments to resume rescheduling talks with the Poles is doing more damage to the West than to the Poles, and increasingly so as time goes on.

3. I recognise the difficulty of a UK initiative on this matter at the present delicate stage of our negotiations with the Americans about non-undermining of their economic measures against the Soviet Union. But I think we ought at least to be ready to respond to any moves by other Creditors.

4. I should be interested to have your comments on the analysis and the tactics.

5. I am copying this minute and enclosure to the Prime Minister and other members of OD; also to Sir Robert Armstrong.

(G.H.)

26 February 1982

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1982 RESCHEDULING OF POLISH DEBTS

Note by the Treasury

1. This paper examines the options for policy with regard to Polish debt rescheduling in 1982.
2. In November 1981 Creditor Governments provisionally agreed with the Poles that negotiations about 1982 rescheduling would be continued in January this year. However, following the declaration of martial law in December, the NATO Declaration of 11 January said that NATO Governments had decided to postpone further rescheduling talks for the time being. This approach was confirmed by a meeting of the sixteen main Creditor Governments in Paris on 14 January.
3. In agreeing last November to resume negotiations in January, Governments had stipulated that Poland must first conclude an agreement with the banks about rescheduling unguaranteed 1981 debt payments. Unlike the Governments, the banks have been insisting on the Poles keeping up to date with interest payments (about \$500 million had been outstanding at one point in 1981). Until recently it has been unclear whether Poland would be able to reach agreement with the banks on this basis. However latest reports suggest that Poland may now be in a position to find the money required for the interest payments and intends to sign a rescheduling agreement with the banks by the end of February.
4. Poland's total foreign currency debts to Western banks and Governments are estimated at some \$28.5 billion. Assuming that the banks conclude their agreement with the Poles for 1981 rescheduling, the total payments rescheduled from 1981 (comprising 90% of the interest and principal due to Governments, and 95% of the principal due to the banks) will be \$4.5 billion

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approx. Poland seems to have made strenuous and on the whole successful efforts to keep up to date with payments of the 10% of non-rescheduled 1981 official debt. In the case of the UK arrears are not high and the first interest payment due on 1 January 1982 on the 1981 rescheduled debt has been paid.

5. The comparable total at issue in 1982 rescheduling discussions would be \$5 billion. There is no prospect of Poland meeting all her payments (plus the bank interest and interest on the 1981 Government rescheduled debt) without some form of rescheduling arrangement.

6. If Poland shows evidence of meeting the EC and NATO political desiderata (lifting of martial law, release of those detained, and resumption of a genuine dialogue between Government, Church and Solidarity) and concludes a rescheduling agreement with the banks there is unlikely to be any disagreement among Western Creditor Governments about the desirability of resuming negotiations about 1982 rescheduling.

7. But while we now expect Poland to reach an agreement with the banks about 1981 rescheduling, there is little prospect of early relaxation of the internal regime in Poland. Western Governments could soon be confronted with something of a dilemma in deciding whether to resume negotiations about 1982 rescheduling in those circumstances. The issue could come to a head quite soon if the Poles, or some of the neutral Creditors, were to propose a resumption of negotiations if and when a 1981 agreement is reached with the banks.

8. There is a substantial UK financial interest in achieving an orderly debt rescheduling programme rather than simply allowing the Poles to default completely on their debts. The Annex shows the different effects on the PSBR of a situation in which we rescheduled debt due in 1982 and later years and received payment from the Poles accordingly; and one in which the Poles simply defaulted from now on. The difference in 1982 is £50 million on the PSBR. Over the 4 years 1982-85 it is some £300 million. In

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addition default would add to losses for British Shipbuilders and the British Steel Corporation which make their own arrangements with the Poles.

9. However, political reasons against resuming rescheduling talks look equally strong. EC and NATO Ministers have set clear conditions for the resumption of normal economic relations with Poland. There is a risk that a resumption of rescheduling negotiations at the present time would be seen as a signal that Western Governments consider that the Polish authorities have moved to meet Western requirements and are ready to resume business as usual with the military regime. Such a step would undermine the West's strong policies towards the Soviet Union and Poland at the present time.

10. The political difficulty described in paragraph 9 above arises from the link which Western Governments have made between rescheduling and economic measures against Poland. That was a natural link to make as part of the immediate response to martial law, since the 1981 rescheduling had been in part a gesture of Western support for the Polish economy, and had been buttressed by offers of new credit from some Western Governments. The decision of Western Governments to hold 1982 rescheduling in abeyance was a signal that the Poles could not expect to resume negotiations where they had left off. It also carried an implied threat to drive the Poles into default, either by invoking the so-called "tank clause" of the 1981 agreement or by refusing to reschedule for 1982.

11. That threat was never very credible and has become less so now that the US has publicly disowned the default option at any rate for the time being. This reflects a general acknowledgement of the possible serious consequences of deliberately bringing about a default. The effect therefore of continued reluctance on the part of the Creditor Governments to negotiate about 1982 rescheduling is to condone 100% interest-free debt relief for an indefinite period, thus taking some financial and economic pressure off the Poles (and indirectly the Russians). What was originally seen as a political move against the Poles is now working to their advantage, and increasingly so as time goes on and 1982 payments fall due.

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12. If Western Governments now agreed to resume talks about 1982 rescheduling, there could be no question in circumstances where the Poles had not met Western political conditions of the UK making any new credit available to help the Poles meet their rescheduling commitments. The Poles would be unlikely to get more generous treatment from other Western Governments. It must also be on the cards that few Creditor Governments would now be willing to agree without argument to terms as generous as those conceded last April (90% of interest and principal payments).

13. Even though in the present political climate it would be easier to get agreement among the Western Creditors to seek to impose tougher repayment terms on the Poles than for 1981, there is some doubt about the ability of the Polish economy to bear this extra burden. If the Poles maintain they cannot meet Western demands, the official Western Creditors will be faced with a difficult choice. The Creditors could:

- (a) settle for softer terms than those originally envisaged (90% for capital and interest) which would be undesirable both presentationally and because of the precedent for other Third World Creditors;
- (b) declare the Poles in default;
- (c) suspend the talks (and thus return to 100% relief);
- (d) reconsider the question of credits.

A decision does not have to be made now, and it is clearly right that an attempt should be made to press the Poles to repay their debts. Their economy has in the past proved more resilient than had been thought likely. The effect of such pressure should be to transfer more of the burden of Poland's economy on to the shoulders of the Soviet Union and its CMEA allies who support the imposition of martial law.

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Conclusions

14. Given the West's self interest in rescheduling and in averting a disorderly default we would not want it to be thought that we have lost interest in rescheduling altogether. One possible option would be to maintain for the time being the present position where talks are suspended and payment is in effect rolled over pending an improvement in the Polish situation. Politically this would be consistent with Western signals to date. But financially the continued lack of a rescheduling agreement is increasingly to the Poles' advantage, for the reasons explained above. Moreover, we cannot afford to maintain a "wait and see" posture indefinitely. A belated, reluctant agreement by the West to resume rescheduling talks could give us the worst of all worlds if by then there was still no evidence of political improvement in Poland.

15. It would therefore be in the UK's interest to resume rescheduling negotiations for 1982 with the Poles once they have signed their 1981 rescheduling agreement with the Banks. The resumption of such negotiations will, however, need careful handling. It is possible that the neutrals may take the initiative and ask the French as Chairman, to reconvene the Western Creditors Group. Alternatively the French may act on their own initiative. Either course would be preferable from the point of view of our relations with the Americans to any initiative by the UK. Initially consultations might take place among an inner group of Western Creditors; France, FRG, UK, Italy, US, Austria and possibly Sweden. Thereafter careful co-ordination would be needed to ensure that the wrong conclusions are not drawn by the Poles, our Allies, or public and Parliamentary opinion in the UK. We would present a move to resume negotiations not as a concession to the present Polish authorities but as requiring the military regime to honour Poland's massive debts on terms which would not be as favourable as those envisaged before the imposition of martial law.

HM Treasury
17 February 1982

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ANNEX

RESCHEDULING OF POLISH DEBTS - NOTE BY ECGD

The following table shows the effect on PSBR which would be caused by ECGD claims payments in the two cases where:

A Poland reached agreement with its creditors on debt rescheduling in each year on the same basis as in 1981; or

B No such agreement is reached and no further payments arising from the 1981 refinancing or rescheduling agreements are made.

	<u>Increase in PSBR - £ million</u>			
	1982	1983	1984	1985
A	150	90	45	40
B	200	150	120	190

Thus, over the period 1982-85, PSBR is increased by a total of £325 million in case A and £620 million in case B.

The outcome could lie somewhere between cases A and B. For example, under case A the Poles might not be able to meet all their rescheduled commitments. Alternatively, in the absence of any formal agreement on rescheduling (case B) it is conceivable that the Poles might make some payments of unrescheduled debt.

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26 FEB 1982

