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ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
142622	MEMO	RICHARD ALLEN TO VICE PRESIDENT RE. POLISH DEBT NEGOTIATIONS *R 7/8/2015 M434/3*	2	ND	B1
142623	PAPER	RE. POLISH DEBT NEGOTIATIONS *R 7/8/2015 M434/3*	3	ND	B1
142624	PAPER	RE. POLISH DEBT SITUATION *R 7/8/2015 M434/3*	3	ND	B1
142625	PAPER	RE. MEETING ON POLAND'S FINANCING NEEDS *R 7/8/2015 M434/3*	4	ND	B1
142626	PAPER	RE. POLISH FINANCIAL ASSISTANCE *R 7/8/2015 M434/3*	6	ND	B1
142627	PAPER	RE. POLAND: CAN IT SURVIVE UNTIL 1984 *R 7/8/2015 M434/3*	8	ND	B1
142628	MEMO	NORMAN BAILEY TO RICHARD ALLEN RE. NSC MEETING AGENDA *R 7/8/2015 M434/3*	1	7/6/1981	B1
142629	MEMO	BRIEFING MEMO RE. ECONOMIC AID TO POLAND *R 3/2/2018 M434/3*	4	ND	B1

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142630	PAPER	RE. POLAND: CAN IT SURVIVE UNTIL 1984 [COPY OF DOC. 142627] *R 7/8/2015 M434/3*	8	ND	B1
142631	MEMO	BRIEFING MEMO RE. ECONOMIC AID TO POLAND *R 3/2/2018 M434/3*	4	ND	B1
142632	PAPER	RE. POLAND: CAN IT SURVIVE UNTIL 1984 [COPY OF DOC. 142627] *R 7/8/2015 M434/3*	8	ND	B1
142633	REPORT	RE. SOVIET AND EAST EUROPEAN ASSISTANCE TO POLAND *R 1/9/2017 M1743/1*	10	8/21/1981	B1

MEMORANDUM

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DEBT RESCHEDULING

NATIONAL SECURITY COUNCIL

~~SECRET~~ ATTACHMENT

ACTION

April 17, 1981

MEMORANDUM FOR RICHARD V. ALLEN

FROM: TIM DEAL

SUBJECT: Polish Debt Negotiations

The Vice President's office requested a briefing paper on the Polish debt negotiations. State's response is at Tab A. The transmittal memorandum for your signature at Tab I addresses several points which the State paper either omits or treats superficially.

RECOMMENDATION:

That you sign the memorandum to the Vice President at Tab I.

Concur:
Allen Lenz
Richard Pipes

~~SECRET~~ ATTACHMENT

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DECLASSIFIED
Sec.3.4(b), E.O. 12958, as amended
White House Guidelines, Sept. 11, 2006
BY NARA RW, DATE 8/31/12

MEMORANDUM

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THE WHITE HOUSE

WASHINGTON

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MEMORANDUM FOR THE VICE PRESIDENT

FROM: RICHARD V. ALLEN

SUBJECT: Polish Debt Negotiations (U)

State's briefing memorandum (Tab A) regarding the Polish debt negotiations indicates that the Western creditors have made substantial progress in their talks, although several key issues remain unsettled. They hope to resolve these at the next negotiating session on April 27-28 and then initial an agreed "minute" (a multilateral agreement setting forth the terms and conditions for rescheduling). (S)

The following supplements information in State's memorandum:

1. Conditionality: Under pressure from the creditors, the Poles have developed a medium-term economic stabilization program designed to restore balance to their external accounts. As part of the agreed "minute," the creditors will establish a commission, which will meet semi-annually, to monitor Polish progress in meeting balance of payments targets. (S)

2. Amount Rescheduled: We have argued for a high proportion of debt to be rescheduled (98% in the first year) because a smaller proportion will result in a larger financial gap which will, in turn, require new credits to maintain equilibrium in Poland's balance of payments. By pushing for a high percentage we hope to reduce pressure for new US credits to Poland. The Europeans, especially the French and Germans, want a smaller rescheduling package: (a) to create market opportunities for domestic producers through tied export credits, and (b) to force us to provide additional financing to Poland. (S)

3. Financial Gap: Even with 100% of its debt rescheduled, Poland will still need an additional $2 billion or more annually in hard currency to stay afloat financially until the balance of payments can begin to show some improvement around 1985 or so. The prospective financial gap increases as the proportion of debt rescheduled decreases. (S)

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Review on
April 17, 1987

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NLRR M434/3 #142622
BY RW NARA DATE 7/8/15

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4. Soviet Role: We have taken the position that the Soviets and West Europeans should share jointly (without specifying proportions) the burden of providing the new credits that Poland will need to cover the $2-$3 billion financial gap which will remain after rescheduling. The Soviets can contribute to this effort directly through hard currency loans or grants to Poland or indirectly through resource transfers (i.e., allowing Poland to run a substantial trade deficit with the USSR and other Eastern European countries). (S)

DEPARTMENT OF STATE

Washington, D.C. 20520

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Polish Debt Negotiations

Poland is almost out of foreign exchange. It is no longer making all payments due to official and private Western creditors (except for interest payments to commercial banks). This state of "technical default" is not unusual in debt rescheduling cases. Both official and private creditors are reacting calmly. They are eschewing formal default procedures, while pressing on to wrap up a rescheduling of Polish debt due in 1981.

The Poles owe Western creditors over $25 billion -- about $14 billion is to commercial banks and $11 billion to governments. USG exposure in Poland is $1.4 billion. The European Governments are much more heavily exposed (FRG $4.2 billion, U.K.: $2.3 billion, figures not available for France and Austria, but they are large creditors). U.S. banks have lent Poland about $1.5 billion. European banks have lent much larger amounts, but these figures are not available. Most of the official and private debt falls due between 1981 and 1984, about $7.5 billion this year, and over $10 billion next.

Rescheduling Negotiations

Our negotiating objectives are set out in the attached paper (prepared for the Cabinet Council on Economic Affairs). The major issues still not fully resolved are:

-- Conditionality. Progress has been slow, but real. The Europeans have gradually come around to accepting the need for economic stabilization. The Poles have produced successively better programs at each meeting. The only open issue is their current balance with other Communist countries during 1983-84. They have persisted in planning surpluses (which in effect would mean repayment in real goods to the East); we insist on deficits. They promised revised plans at the next negotiating session (April 27-28).

-- Amounts to be Rescheduled. We want to reschedule up to 98% of Poland's 1981 debt in order to minimize the risk of default and reduce the pressure for new credits. The French and Germans resist a generous rescheduling.

5

They prefer to provide larger amounts of new tied export credits to meet Polish financial needs. An 80% rescheduling -- which the Europeans now propose -- means a gap of $3 billion; a 98% rescheduling means a gap of $2.3 billion.

-- Which Credits Should Be Rescheduled We have sought to include in a rescheduling all credits granted before January 1, 1981. The Europeans want to exclude bridging credits that were given in the first part of this year.

The creditors have achieved a consensus on the other important questions: 1) the need for a significant Soviet contribution; 2) private banks must reschedule on comparable terms; 3) rescheduling should be confined to payments falling due in successive six-month periods; and 4) that there should be a termination clause in case of Soviet intervention or domestic crackdown.

Outline of the Agreement

While issues remain open, the general shape of the agreement is clear. The 15 major official creditors will reschedule 80% or more of Polish debt falling due between May 1 and December 31, 1981. (We agreed to include May and June -- plus arrearages -- since the Poles aren't paying anyway, and the bilateral implementing agreements won't be signed until June.) There will be a grace period of 4 or 5 years and a repayment period of 4 or 5 years. A commission of the major creditors and the Poles will be formed to monitor progress of the Polish stabilization program. Barring a Soviet invasion, or Polish repression of the Unions, the commission will begin in September to look at rescheduling the first half of 1982.

Implications

Rescheduling serves our political and economic interests by:

-- reducing the risk of default and the financial/economic chaos that would follow and lead almost certainly to more labor unrest in Poland;

6

-- giving us leverage, along with our other economic assistance, to defer a Soviet intervention or a domestic crackdown;

-- increasing, if only marginally, the chance we and our banks will be repaid.

The private banks will follow our lead and reschedule the bulk of Poland's commercial debt. But even after both an official and a private rescheduling, Poland will still need new credits to finance needed imports (especially of food) and to pay remaining interest charges. If the U.S. position to reschedule 98% is accepted, the additional financing needed could amount to as much as $2.3 billion. A less generous rescheduling increases that figure. While we have told the other creditors that the U.S. cannot provide additional new credit, the pressures on us to do so are growing and will be intense.

We have also made it clear that the U.S. cannot accept a Western approach to assisting Poland that would "bail out" the Soviets or let them off the hook on meeting Poland's additional financial needs. Our position on rescheduling and on new credits would require for a sizeable Soviet contribution, as well as new West European export credits. We are considering how to ensure an adequate Soviet contribution.

The budget implications are little different under any scenario. Rescheduling reduces USG revenues and increases outlays -- the same as default. One possible option for new credits would be additional CCC guarantees. These credits would have no immediate budgetary impact, but they are subject to future rescheduling which would have a budgetary impact. Another option is to seek a separate appropriation.

We have consulted with the Hill and discussed the issue with private interest groups.

7
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Issues Paper On The Polish Debt Situation
For Wednesday Meeting Of The Cabinet
Council On Economic Affairs

Issues

Should the U.S. enter into negotiations with a view to joining the European-led effort to reschedule Polish debt if acceptable terms and conditions can be worked out? If so, what is the general outline of the terms and conditions we should seek?

Background

A background paper has been circulated to the Council. A copy is attached. This paper covers issues on which we need immediate decisions.

We have participated in the European-led discussions on the Polish debt problem, while keeping open the question of our participation in a rescheduling. In these discussions we have insisted that we could not enter negotiations to reschedule Polish debt absent four major criteria. These are not yet assured, but the discussions have been sufficiently satisfactory so that we can no longer delay the negotiation phase. Moreover, the Polish financial situation grows more critical every day; delay only increases the chances of default. The four tenets of our position are:

-- rescheduling must be accompanied by a Polish medium-term program to restore external financial balance so that the Western creditors will be repaid. This implies reform and stabilization of the domestic economy. The other Western creditors now agree that such a condition is necessary, and the Poles appear to accept this. They will submit a fleshed-out reform and stabilization program to the creditors on March 26. Whether they can ultimately perform remains questionable, but they recognize Western rescheduling is unlikely unless they commit themselves to try.

-- rescheduling must take place in a way which minimizes pressure on the U.S. for new credits, a function that should be left to the Soviets and West Europeans. Our ability to provide new credits (which the Poles will need) is constrained both by the Administration's budget policies and by existing law.

-- the Soviets must bear a significant share of the burden, rescheduling their own credits to Poland, and contributing a large part of new financing, both through direct cash transfers, and maintaining a sizeable export surplus in their trade with Poland. We cannot allow Western rescheduling to bail the Soviets out. (The USSR has provided about $1.1 billion in credits this year, and declared a moratorium on Polish debt obligations.)

-- The private banks must follow their governments with a rescheduling on similar terms. This is traditional in our debt policy to avoid "bailing out" the banks.

Joining the Negotiations

There is no possibility that Poland can avoid default without rescheduling. Thus, the alternative to joining is to accept default now. But if we join, we must recognize that it will be difficult to get the terms and conditions we think necessary to minimize pressure for new credits.

For the U.S. the economic and political costs of default are high; for the Europeans they are monumental. Aside from the heavy impact on budgets and the potential danger to some European banks and the banking system, a default would almost surely end the "Polish experiment," the success of which is in our political interests. Import disruption would lead to further economic dislocation, and the chances of domestic repression and/or Soviet intervention would be increased. The Europeans have warned us that U.S. failure to participate in rescheduling will reduce their ability to cooperate on post-intervention sanctions, should they be necessary.

Rescheduling by itself would cost no more than default to our 1981/82 budget, and it would increase the chances of repayment in later years. Moreover, rescheduling the second half of 1981 (at the start) would reduce the pressure for new US short-term credits during the maximum danger period for Soviet intervention. If the Poles get through the next few months, however, we can expect at least a "normal" request for further CCC credits in FY 82 - a decision we can face at that time.

Terms and Conditions

If we join the rescheduling negotiations, we will need to have a clear view of where we want them to come out. Staff level interagency discussions have produced certain guidelines.

-- rescheduling should be confined to payments falling due in successive six month periods, allowing us to pull back if the Soviets invade, and to keep the pressure on the Poles by making each half-year rescheduling contingent on Polish economic progress; we would not retreat from this.

-- rescheduling should be on terms which minimize the risk of default and allay pressures for new credits. The terms of any rescheduling should not, however, breach traditional standards, as we have refused to do this for allies such as Turkey.

-- The terms of any rescheduling should provide for adequate burdensharing among the Western creditor governments, the banks, and CEMA, including the USSR.

Detailed preparation of the U.S. negotiating position is being done by an interagency group chaired by Bob Hormats.

→ POLISH DEBT Rescheduling

10

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

April 24, 1981
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Haig, Lewis, Block, Brock, Stockman, Weidenbaum, Anderson, Wright, Porter, Kudlow, Garrett, Leland, Droitsch, Denoon, Hopkins, Gribbin, Cribb, Deal, Johnston, Ms. Dyke, and Ms. Small.

1. Polish Debt Situation

The Council reviewed a paper on the Polish debt rescheduling negotiations and situation. The discussion focused on the U.S. and other creditor governments' positions on debt rescheduling, the likely actions of private bank creditors, the likely levels of pressure for further additional credits, and the budgetary impact of various rescheduling and additional credit alternatives.

Decision

The Council approved the U.S. negotiating team pressing for a higher level of rescheduling thereby reducing the requirements for new credits to balance Poland's external accounts.

The negotiating team will report back to the Council following the creditor countries meeting April 27-28.

2. Update on the FY 1981 Budget

The Council considered a report on the status of the FY 1981 budget and recent changes in revenue and outlay estimates. The OMB report also included changes in estimates for off-budget outlays. The discussion focused on the reasons for major changes in FY 1981 outlay estimates since March 10, comparisons between total Treasury financing requirements for FY 1981 and financing requirements in FY 1979 and FY 1980, and the impact on financial markets of changes in the administration's budget and revenue estimates for FY 1981.

The Council reviewed how changes in Treasury financing requirements would affect estimates of the total federal debt and the date on which the debt ceiling would be reached and the alternatives for considering further actions relating to the FY 1981 budget.

Decision

The Council agreed that OMB would work with individual departments and agencies in reviewing the major changes in outlay estimates for FY 1981 and possible areas for additional savings.

The Council will consider the issue again within the next two weeks.

3. Business Tax Cuts

The Council briefly discussed the President's tax program and congressional reaction to it concentrating on the structure of the proposed changes in accelerated depreciation for business assets.

Decision

Secretary Regan indicated that the Treasury would prepare materials for the Council's consideration relating to the cost of various components of the administration's 10-5-3 accelerated depreciation proposals and an analysis of the Bentsen proposals.

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POLAND - DEBT RESCHEDULING 142625

12

Meeting on Poland's Financing Needs (June 1-2):

U.S. Strategy and Tactics

Poland's principal Western trading partners (the 15 nations which participated in debt rescheduling negotiations) will meet under a French chair June 1-2 to discuss Poland's credit needs through the remainder of 1981. The U.S. delegation to the debt negotiations succeeded in getting the meetings labeled as "informational", but we have to realize the Europeans will press to use this as a forum to put together a multilateral export credit package for Poland.

The European strategy will undoubtedly be to apply whatever pressure is available to maximize the U.S. contribution in 1981. They may try to ignore the U.S. credits granted thus far this year and start from scratch on credits needed to fill the financing gap following official and private Western reschedulings. In terms of sharing the burden, the Europeans are likely to fall back on more traditional formulas, such as the OECD package for Turkey, which allocate shares loosely based on the country's position in the Atlantic alliance and on relative economic size.

Our strategy should be to defend the U.S. position of no new credits this year. The U.S. delegation should insist on full accounting of credits provided during 1981 and attempt to get agreement on a burdensharing formula that will substantiate our claim that we have already done our part.

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The pushing and shoving among Western creditors, however, should not obscure the principal substantive questions. Stabilization of the Polish economy is essential to prevent even greater demands on Western resources. To the extent practical, disbursements of new export credits should be tied to reviews of Polish economic performance by the Commission. The Polish experiment in greater pluralism and democratic reforms in the party can be a thorn in the Soviets' side for years to come. Chronic food shortages and a continued economic decline due in part to the lack of imported intermediate goods, however, may threaten the political stability necessary to carry out political and economic reform. It is in the West's interest to avoid an economic collapse that could bring the Polish renewal to an abrupt halt, and reduce our chances of eventual repayment. The delegation should get agreement with other Western creditors on measures to encourage the Soviets to extend further credits. It should press hard for an additional European contribution comparable, in terms of relative trade and financial ties, to the U.S. credits extended this year.

The Delegation should take the following line on issues that are likely to be raised:

-- Size of Poland's financing gap: Although better information may be available prior to the meeting, we estimate Poland's remaining financing needs at \$2.5 - 3.0 billion. We should have a better estimate of this

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14

gap after evaluating the information provided at the meeting.

-- <u>Burdensharing</u>: In our view, burdensharing should be based on each country's economic and financial ties with Poland.

-- <u>Quality of Credits</u>: The Europeans are likely to include in their totals a number of credits which the Poles will be unable to draw down because of insufficient guarantee covrage or restrictions on use. Assuming we find a way of freeing our $113 million in still outstanding CCC guarantees, the delegation should prompt a general discussion of the magnitude of the problem and how it can be resolved.

-- <u>Soviet Contribution</u>: We should press to leave a sizeable gap (on the order of $1.5 - 2.0 billion) to be filled by CEMA nations.

-- <u>Kinds of Credits</u>: Overinvestment in economically unviable projects has been an important factor in Poland's financial difficulties. Further export credits for turnkey plants or new investment projects may do more harm than good in

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15

future years. The delegation should stress that further export credits must be concentrated in areas that fit Poland's priority import needs: food, raw materials, semi-processed goods, and spare parts. Credits for new projects or machinery and equipment should be in areas of export interest (such as coal or minerals), agriculture (fertilizer and farm machinery), of domestic bottlenecks (such as electric power or transportation).

Drafted:EB/IFD/OMA:FParker:pmw:5/7/81:x21116

POLISH DEBT

16

NATIONAL SECURITY COUNCIL

July 1, 1981

MEMO FOR HENRY NAU
ALLEN LENZ
RICHARD PIPES
PAULA DOBRIANSKY
BILL STEARMAN
RUD POATS

FROM: NORMAN BAILEY

The attached papers are for discussion at the 11 a.m. meeting today on Polish debt.

~~SECRET~~ attachment
RW 8/31/12

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DEPARTMENT OF STATE

Washington, D.C. 20520

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POLISH FINANCIAL ASSISTANCE

THE PROBLEM

Poland's year-long march toward pluralism has now reached the point that, absent Soviet intervention, the possibility exists for the institutionalization of a new model of communism that could hasten the loosening of the Soviet grip on Eastern Europe. It is strongly in our interest to take actions which will, without causing a direct challenge to Moscow, facilitate this loosening. Soviet intentions are unclear; there is no reason to believe they have decided definitely what to do; the Soviet threat will continue to loom over Poland for years. However, even if the Soviets hold back from intervention, a further deterioration of Poland's economy, leading to chaos and violence, could provoke Soviet intervention--which would bring about bloodshed, a tightened Soviet grip on Eastern Europe, the shutting down of our successful policy of differentiation toward Eastern Europe, and possibly dangerous destabilization in Central Europe. In such an event, we might legitimately be asked whether we had done all in our power to avert it by contributing to the decrease of tensions within Poland, and by assisting the Polish people to consolidate their very real gains over the past year.

In the months ahead and over the next few years, a major source of tensions within Poland will be dissatisfaction over food shortages and other austerity measures brought about by ongoing deterioration of the economy coupled with Polish Government efforts to get its economic house in order. Assuming that the Polish Government continues its commitment to socio-political "renewal" and that it institutes necessary economic reform measures, it will be to the West's political advantage to assist it through new credits and new food supplies. Based on mid-June discussions with key Allies on the Ottawa Summit, it appears that the Europeans have come to the same conclusion. They expressed skepticism as to whether we could influence the Soviets to do more, noting that the Soviets must have come to the conclusion that it is in the West's interests to keep the liberalization process in Poland going. They suggest that we are faced with the choice of providing more aid or losing everything. Turning political concern into concrete action, however, is a more difficult task.

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RDS-3 6/30/91

We need to decide how to respond to the ongoing deterioration of the Polish economy. Our current position is that we have done our share in providing credits to Poland and the remaining gap should be filled by the Soviets and Europeans. We can stick to this position, or alternatively take a more active role in organizing a collective Western assistance package.

STRATEGIES FOR 1981 AND BEYOND

Even if the Poles meet their ambitious balance of payments targets, they will need large infusions of hard currency credits to prevent a disastrous decline in Western imports and default. At a minimum, they must: (1) convince the Europeans to change the terms of $1.4 billion in available credits to allow the Poles to draw them down; and (2) arrange another $2.4 billion in hard currency financing.

Time Frame: 1981 - ($2.4 billion)

The U.S. is the largest single contributor of credits to Poland this year , and we have insisted that it is now the responsibility of the Europeans and Soviets to fill the remaining gap. This position is defensible internationally and avoids straining U.S. resources to find additional credits for Poland. The question of where Poland will find sufficient financing to avoid even more severe economic dislocation, however, still remains.

The Soviets are a logical candidate for covering a good portion of the gap. They have provided somewhat more hard currency financing than we previously supposed -- a total of at least $700 million this year. They have also increased their shipment of oil and raw materials, and intelligence reports indicate that Soviet-owned banks in the West may put together a new hard-currency loan for Poland in the $200-300 million range.

The Soviets, however, are not a source of assistance upon which the Poles can rely at present. At any point, they may decide it is in their interest to promote further chaos in Poland. They will find it tempting to use economic leverage, particularly if it appears that Poland is unable to count on the West as an alternative source. If the West holds back to prompt a further Soviet contribution, Western assistance becomes a hostage to Soviet policy and magnifies Soviet leverage.

? extent of their leverage

Unfortunately, given Europe's poor performance thus far this year, we may not be able to count on our allies in the absence of a stronger U.S. lead. On the political side at least, there are indications that the Europeans would be responsive to stronger U.S. leadership. Most recently, the Poles have approached European governments with a request for $500 million in additional short-term financing. The EC Commission will discuss this request this week. The French tried to convert the Polish request into a package of short-term credits from central banks including the U.S., but we cannot participate.

The only way we can be reasonably sure that Poland will have sufficient financing in 1981 is to press for further multilateral Western assistance. Western efforts should be carefully coordinated. We can point out that the major European financial powers "owe" further credits but realistically we would have to be prepared to make some kind of contribution ourselves if we plan to adopt this approach. Europe would have to make up the bulk of the assistance effort while the U.S. would try to get away with a token gesture. Depending on the size of the entire package and how well we bargain, we might have to provide $60 - $200 million in additional credits. We might fulfill Poland's outstanding request for 400,000 tons of corn as our contribution or a part of our contribution to a multilateral effort.

LONG-TERM ASSISTANCE STRATEGY

Our active participation in aid to Poland in 1981 (and previous years) puts us some way down the road for 1982. If Poland sticks to a stabilization program, their balance of payments should show significnt improvement and the requirement for assistance should be much lower than this year. We estimate a U.S. contribution, following debt rescheduling, would be in the range of $200-400 million -- less than half the level of U.S. credits required this year.

Without U.S. participation, it is doubtful whether any Western assistance effort can succeed. We should consider a strategy which would encourage, to the maximum extent feasible, European countries' assistance to Poland by making additional U.S. assistance contingent on adequate European efforts. In addition, future U.S. assistance could be made contingent upon Polish implementation of a credible and workable economic recovery program. We may also want to encourage Poland to work more closely with the IMF with a view towards eventual membership. This type of multilateral burden-sharing would be necessary for the Europeans to garner sufficient political support for further large-scale credits.

To implement this policy, we need to have ready an agreed U.S. government policy position on long-term assistance for Poland. Additional short-term CCC financing could be made available but would have several drawbacks: The relatively short repayment period only aggravates the debt problem over the longer term; the banks are not anxious to acquire additional CCC exposure; and Poland already accounts for a disproportionate share of CCC exposure.

The alternatives for replacement of all or part of CCC credit allocations to Poland include:

CCC INTERMEDIATE CREDITS. (GSM 301) This program authorizes extension of direct credits for up to ten years for the purchase of livestock and agricultural commodities. The principal advantage is the longer repayment term which would lessen the burden of repayment. The legislative mandate gives us another lever, in addition to the debt rescheduling, to pressure the Poles for economic reform. The program is not currently funded, however, so budgetary legislation would be required.

PL-480. The amounts available under this program would be small and therefore it would have to be used in connection with other sources of funds. This program is the principal means of support for concessionary food sales to developing countries. Use of PL-480 would require Congressional approval for a budget supplement, and the size of the program would be limited by the requirement that 75 percent of PL-480 allocations must go to the poorest nations. We would aso have to seek a Presidential waiver of the Congressional prohibition on aid to communist countries.

EXIMBANK. EXIM could fulfill a preliminary commitment made to Poland on a $25 million credit line and continue to evaluate individual projects on a case-by-case basis.

LOCAL CURRENCY SALES OF SURPLUS AGRICULTURAL PRODUCTS. State and Agriculture lawyers, and some members of Congress, are unhappy with the legal justification used for previous dairy sales. To be effective, we would have to expand the program to include corn held by the CCC.

A SPECIAL LEGISLATIVE PACKAGE. We could approach Congress to seek a special legislative package on assistance for Poland. The package could include a combination of the measures above which would have the considerable advantage of

Not placing all the burden on any one program or agency.
But this approach would have the major disadvantage of raising the legislative and administrative complexity of assembling the package, perhaps to an unacceptable degree.

22

Polish Financial Assistance

Drafted: EB/OMA:FParker:mjw FP
6/30/81, X21116

Clearance: EUR/EE:PSBridges PSB
EB/OMA:WMilam WM
EUR:JDScanlan JDS

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Poland: Can It Survive Until 1984?

There will be two key elements in Poland's future economic and political stability: (1) an austerity and reform program which stabilizes and then revives the Polish economy; and (2) continued foriegn financing with an additional $2.1 billion in financing in 1981. Both of these elements will have to be present and reinforce each other for the Polish renewal to continue. Western financing without stabilization is only throwing good money after bad. Without a turn-around in the economy, Poland's financing needs will quickly outstrip the ability of the West to provide further assistance -- even with a substantial CEMA contribution -- and there would be no way for Poland ever to repay. On the other hand, a Polish stabilization plan has little chance of success without the availability of sufficient resources to purchase needed Western imports. Polish industry already suffers from chronic shortages of imported Western intermediate goods and spare parts. The production shortfalls due to these shortages form a vicious circle -- the fall in production of exportable goods reduces Poland's ability to earn foreign currency to make purchases of needed inputs. Poland's difficulty in financing Western foodstuffs could also threaten internal cohesion, as it may lead to further disruptive work stoppages and greater internal strife over the implementation of economic reforms.

Assuming Poland can find sufficient financing in 1981 to avoid a disastrous decline in imports and meets its ambitious balance of payments targets, next year should be more easily managed. Following an official and private rescheduling in 1982, Poland would require approximately $3.8 billion in financial or export credits. With Poland on track on its stabilization program for 1981 and 1982, sufficient progress should be made by 1983 to allow replacement of the bulk of official financial assistance by commercially motivated private and official credits.

Prospects for Stabilization

Although the Poles have implemented some important measures, such as the 50 percent increase in prices paid to farmers for agricultural products, Polish authorities have been unable to put together a comprehensive stabilization program. It is clear that any stabilization package would have to be negotiated with solidarity. Thus far, solidarity has blocked piecemeal measures to improve the economy and tied measures which would have an adverse impact on worker living standards to a more comprehensive reform effort. The Polish party leadership, occupied with political turmoil, the internal

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24

power struggle and the threat of Warsaw Pact intervention, has not been able to overcome the practical and idealogical obstacles to a comprehensive reform program. In addition, it is not clear how much effective central control can be exercised over the actions of the local bureaucracies that have to implement stabilization measures.

On the brighter side, Walesa has clearly stated that Polish workers are prepared to make "sacrifices" for an economic recovery. Soviet threats of intervention may actually increase Polish workers' willingness to accept lower standards of living. The upcoming party Congress, should it be held, promises to settle the internal dispute in favor of the "reformist" elements. This offers the possibility of sweeping changes in economic policies and removal of local bureaucratic opposition to reform.

In any event, Poland is rapidly approaching the point where the balance of payments will be "stabilized" by the lack of sufficient hard currency financing to cover Poland's import needs. Unless Western imports are more efficiently allocated, the downward spiral of industrial production will accelerate and the chronic food shortages will be exacerbated. In short, Poland will have only a fixed amount of foreign financing in 1981, so they will be unable to run a large trade deficit. If the Poles are lucky, they may receive sufficient financing to run a trade deficit of $700 million, or the targets on their balance of payments. Stabilization, or how efficiently these credits are used, will determine how far GDP will have to decline this year. The ability of Polish authorities to maintain social cohesions and keep the economy going during this period will be crucial for an eventual economic recovery.

The Situation in 1981

The Polish economic situation continues to deteriorate rapidly. Even if Polish authorities succeed in implementing stabilization measures, GNP will fall between 10-15 percent this year. The precipitus fall is due to shortages of imported raw materials, absenteeism, and shorter hours. Shortages of intermediate goods and the lack of work incentives due to increased wages without goods to purchase, need to be corrected if the situation is to be stabilized. This decline may be even greater if Poland does not meet its ambitious balance of payments targets and line up further financing for the second half of the year.

As shown in Table I, after rescheduling by its three major Western creditor groups (the Paris Group governments, other Western governments, and the private banks) and CEMA,

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Poland will have covered over one-half of its financing needs, leaving about $5.1 billion in hard currency credits to meet minimum import needs and stave off default. We estimate that if Western governments take steps to change the terms of their credits, Poland has already arranged usable financing of $2.7 billion. About $1.4 billion of this total is in European credits which have not been drawn due to requirements for large cash down payments which the Poles cannot afford. As shown below, the U.S. is the single largest contributor to this total thus far this year.

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Italy	100	30
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Belgium	77	7
Austria	60	-
Netherlands	49	-
Sweden	42	30
Japan	30	8
Other	321	-
TOTAL	2479	1200

* includes $113 million as usable credits.

The remaining financing gap is in the range of $2.4 billion. Given the already sizable U.S. contribution this year, particularly in view of our relatively smaller financial and economic ties with Poland, the U.S. position is that the remaining gap should be filled by the Europeans and Soviets.

Neither the Europeans nor the Soviets have shown any enthusiasm for further credits. European performance on credits this year has been particularly disappointing. The major European participants in Polish creditor meetings have pledged slightly less than $1.2 billion. Only some $300 million of this total has actually been drawn this year. At the last creditor meeting on Poland June 1-2, France was the only country to offer further credits -- and this offer only amounted to $60 million. CEMA has reportedly provided $450 million in the first quarter of 1981, but hard figures are not available. The Poles claim that CEMA has decided against

providing further hard currency assistance in 1981. Both of these hard line positions may crumble, however, as the Poles run into a financial crunch in the fall.

If the gap is not filled, Polish authorities will face one of two unpalatible choices: (1) to cut back sharply on Western imports; or (2) default on unrescheduled debt service to Western creditors. A sharp cutback on Western imports would in the short run prove the most disruptive. Recurrent food shortages could again bring the political situation to a boil and the shortage of Western intermediate goods would accelerate the economic decline. The alternative would be to default on $700 million in unrescheduled interest due the private banks in the second half of 1981 and $400 million in unrescheduled debt service due official creditors.

There are three sources of funds which Poland may be able to tap to cover their $2.4 billion gap this year: the private banks, CEMA and the Europeans.

The banks are working on their own rescheduling and it appears that principal payments due this year will be deferred. Rather than reschedule, the U.S. banks have decided to roll-over principal repayment through the end of the year. The European banks will meet next week.

At present, it is clear that the private banks are not prepared to accept further exposure in Poland. As a default on interest payments in the second half of the year approaches, however, the pressure to provide additional funds will mount. While banks are loath to reschedule interest, they may be willing to provide sufficient funds to allow the Poles to keep current on a portion of interest payments due in the second quarter. We should not, however, expect any quick agreement to this procedure, particularly from the American banking community. Polish loans are rated as non-performing by U.S. bank regulators, which means Polish exposure must be met in part by a special reserve against bank capital. Any private loans to enable Poland to keep current on interest would probably be handled quietly in negotiations between the Poles and individual banks.

The Soviets have a vital stake in Poland's stability, and an additional CEMA contribution will be a critical element in Poland's ability to close the $2.4 billion gap. Economic chaos in Poland will involve significant costs to the Soviet Union. Poland's financial problems and the Soviet Union's reluctance to open the CEMA "umbrella" has already made the private banks more cautious about lending to Eastern Europe. A Polish economic collapse would erode bank confidence further, although we do not expect a complete credit cut-off. Perhaps

27

more important, Poland's economic difficulties have deprived the Warsaw Pact countries of vital Polish exports, in particular coal deliveries. Finally, further chaos within Poland might force a military intervention, which could impose substantial political and economic costs.

Given the costs of military intervention, the Soviets may find it tempting to use economic leverage to reverse the course of events in Poland, particularly if it appears that Poland is unable to count on the West as an alternative source of credits. The West will have a tricky hand to play here. Poland's financial needs exceed the West's ability to provide assistance. Some gap will have to be left for the Soviets. On the other hand, if the West holds back to prompt a Soviet contribution, Western assistance becomes a hostage to Soviet policy and magnifies Soviet economic leverage.

The Europeans have played a confused role in the Polish financial problem; it would be easy to suspect bad faith, but perhaps they simply have not done their homework. They have been cool towards our attempts to devise strategy towards pressing for a large Soviet contribution and actively resisted our proposal to maximize debt relief this year. At the same time that they have pressed for further U.S. credits, they have done little on their own.

Outlook for 1982

Assuming Poland can get through 1981 without a disastrous decline in Western imports and can regain control of the economy, the situation next year should be more manageable. The levels of Western assistance required to meet the financial gap may prove uncomfortable but should fall well short of assistance levels for 1981.

Assuming the terms of a rescheduling stay the same in 1982, the combined value of a private and official rescheduling would be approximately $5.3 billion, leaving a financing gap of $3.8 billion. Poland's gross financing needs next year should be in the range of $9.0 billion. A good portion of this total can be met with debt relief. Under the same debt relief terms granted in this year's rescheduling (90 percent of principal and interest on credits granted prior to January 1, 1981) an official rescheduling should be worth approximately $3.0 billion. Changes in these terms, however, could increase the value of a rescheduling by $400-500 million. The most significant changes in terms might include:

-- changes in the cut-off date of the rescheduling to include credits granted in 1981;

-- changes in the percentage of debt covered by rescheduling.

While it was in U.S. financial interest to maximize the amount of debt relief granted in 1981, the same strategy may not hold in 1982, particularly in regard to changes in the cut-off date. Our delegation in Paris managed to exclude $500 million in CCC credits signed in 1981 from the rescheduling. A change in the cut-off date would include them in 1982. Maintenance of January 1, 1981 as the cut-off date would be defensible as standard international practice.

Drafted:EB/IFD/OMA:FParker:pmw:6/22/81:x21116

Clearances:EB/IFD/OMA:WBMilam
EUR/EE:DGrabenstetter

Financing Gap 1981
(billions of dollars)

Current Account Deficit		$ 3.0
Amortization		7.5
Credits Extended		.2
Short-term Capital Flight		.6
Gross Financing Requirement		11.3
Financing Items		8.9
of which		
Already Arranged		
Official Rescheduling (Paris Group)	$2.9	
Western Export Credits	.7	
Socialist Assistance (First Quarter)	.7	
Western Financial Credits	.2	
Private Rescheduling	2.4	
Expected		
Undrawn European Export Credits	1.4	
Official Roll-Over (Other Western Governments)	.6	
Financing Gap After Already Arranged and Expected Financing		$ 2.4
Financing Gap Including Only Financing Already Firmly Arranged		$ 4.4

Table II

Financing Gap 1981-1983
(billions of dollars)

	1981	1982	1983
Current Account	$ 3.0	$ 2.5	$ 2.0
Capital Outflows	7.7	6.6	5.8
Short-Term Capital Flight	.6	-	-
Gross Financing Needs	$11.3	$ 9.1	$ 7.8
Financing Item of which			
Official Rescheduling	$ 3.8	$ 3.1	$ 2.2
Private Rescheduling	2.4	2.2	.7
Gap Following Rescheduling	$ 5.1	$ 3.8	$ 4.9
Additional Financing Available			
Export Credits	$ 2.1	-	-
Other Credits	.2	-	-
CEMA AID	.4	-	-
Remaining Gap	$ 2.4	-	-

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MEMORANDUM

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NATIONAL SECURITY COUNCIL

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ACTION

July 6, 1981

MEMORANDUM FOR RICHARD V. ALLEN

FROM: NORMAN BAILEY NB

SUBJECT: NSC Meeting Agenda, July 9: Economic Aid to Poland (S)

Attached at Tab I is a proposed NSC briefing paper taking a preliminary look at the high stakes decisions on economic aid to Poland that President Reagan and our allies may need to take this summer. I suggest that you register this topic as a briefing item on the agenda of the July 9 meeting, even though time constraints may require holding it over for discussion at the next meeting. At that time, Secretary Regan and Dave Stockman should be included. (S)

Whether and how to respond to Poland's request for large-scale economic aid is not a question ripe for decision, but it is timely to prepare for consultations on Poland during the political portions of the Ottawa Summit. (S)

This tightly condensed 3½-page paper consolidates information and views developed during a set of inter-agency staff discussions which I arranged. The European and Economic bureaus of State and Dick Pipes have approved the paper. (S)

RECOMMENDATION

That you enter this topic as a briefing item on the July 9 NSC agenda and circulate the paper to members of the NSC and, separately, to Secretary Regan and Dave Stockman. (S)

Approve ________ Disapprove ________

Attachment

Tab I Proposed NSC Brief Paper

~~SECRET~~
Review on
July 6, 1987

~~SECRET~~

DECLASSIFIED
NLRR M434/3 #142628
BY RW NARA DATE 7/8/15

NSC BRIEFING MEMORANDUM

ECONOMIC AID TO POLAND

The Stakes

The fate of Poland's challenge to Soviet hegemony and communist orthodoxy -- a still embryonic development of potentially great strategic value to the West -- may depend largely on economic forces:

-- Before the Polish people have time to savor the new era of greater freedom, the new ruling triumvirate of reformist communists, independent unions, and the Catholic church must decide to impose economic measures aimed at arresting the country's economic deterioration and qualifying Poland to receive additional Western debt relief and new credits; this bitter medicine will be politically hazardous for the new leadership either to prescribe or to avoid. (S)

-- Within weeks of these critical Polish economic policy decisions, Western governments and banks must make a high-stakes decision of their own -- either to risk, by inaction, the economic undermining of Poland's challenge to Moscow or to undertake a prolonged, costly, and inherently speculative multilateral aid program to shore up Poland's capacity to preserve its independence. The strategic and political rewards for success could be the neutralization of the second largest military force in the Warsaw Pact and the loosening of Soviet control of all of Eastern Europe. Success cannot, however, be assured. (S)

-- The Soviet Union, without risking military intervention, may decide to impose severe economic sanctions, so as to nullify Polish recovery efforts supported by Western economic aid, thereby either inducing popular rejection of the new Polish political leadership or heightening anti-Soviet Polish nationalism, and in either case greatly increasing the cost of any rescue effort on the part of the Western powers. Trade sanctions would be awkward and costly to Moscow. (S)

-- Alternative projections also are strewn with perils. If the Soviets refrain from both military intervention and economic reprisals, and the Polish leadership refrains from profound economic measures, the West is unlikely to contribute substantially to the relief of Poland's critical shortages; very quickly the resulting economic distress could explode in ways that create opportunities for successful Soviet suppression of Poland's flirtation with deviationism. On the other hand, if the new Polish leadership adopts austerity without fundamental reforms and persuades the West to respond with large-scale economic aid, Poland will escape immediate food riots but will remain indigent and vulnerable to Soviet economic pressure at times of Moscow's choosing. (S)

Economic Factors in Brief

Poland's chronic economic illness, made critical by a year of strikes and governmental change, is evidenced by a projected 10-15% decline in GSP and shortfall of $11 billion in foreign exchange needed to service its $26 billion foreign debt and close its growing external trade gap this year. A generous rescheduling of payments due on official Western credits and the prospective rescheduling of debts to Western commercial banks will reduce the shortfall by nearly $6 billion. New Western offers of credit -- including $585 million scheduled to be provided by US banks under US Department of Agriculture guarantees to finance Polish imports of US grain -- total about $2.5 billion, but about 60% of the European credits are effectively frozen by financial terms which Poland appears to be unable to meet. If the Soviet Union and other Eastern European countries provide no more credits in the second half of 1981, Poland will need to borrow from the West an additional $2-$2.5 billion to finance food and other essential imports in the next six months. It will need credits with maturities averaging more than three years. (S)

The need for official Western credits -- about $5 billion this year -- should decline somewhat next year if generous rescheduling of official and private debts continues and Poland is able to restore exports of coal and other goods. If all went well, Poland would be able to attract and service a rising proportion of commercial credits and reduce its need for official aid in 1983 and 1984. (S)

Poland's need for Western aid would be increased significantly if preferential Soviet and other CEMA export pricing and payment terms on intra-bloc trading were withheld from Poland. Such economic sanctions could raise Poland's requests for Western aid by as much as $2 billion per year. (S)

If Poland joins the IMF this fall, it could become eligible as early as mid-1982 for credit drawings up to 4.5 times its quota, or as much as $4.5 billion over three years. (S)

Further details are contained in the attached State Department Staff Paper, "Poland: Can It Survive Until 1984?" (U)

Western Aid Means

Interagency staff discussions have found no basis for confident prediction of the will and capacity of the Polish political and union leadership to adopt and maintain an effective economic reform program. The outlook may be somewhat clearer after the Party Congress, but Solidarity's August convention may be more revealing. Moscow's response also should become clearer during and immediately after these pivotal Polish conventions. (S)

Western European governments have been taking a wait-and-see attitude toward Poland's appeals for economic aid. The new French government expressed readiness to help in raising $500 million in short-term credit from central banks (which the Federal Reserve has no legal authority to provide), but no European initiative commensurate with the economic need and political stakes has emerged. US representatives have been instructed to reject suggestions of a US lead in raising new credits, inasmuch as we already have done more than our share this year in purely economic terms as measured against historic trade and financial ties with Poland. We currently are considering how to respond to Poland's request for $80 million in longer than three-year credits to finance imports of US corn. (S)

If the Western allies decide to make either a gesture of support or a major and prolonged effort to support Polish independence, they will need to collaborate in order to achieve maximum political effect and assure equitable burden-sharing. IMF participation would greatly facilitate negotiation of economic policy conditions of aid and would reduce the fiscal burden on Western governments. (S)

Informal staff discussions have agreed that neither the regular instruments of bilateral economic aid (AID development assistance, PL480 credits and emergency grants, or security-related Economic Support Fund credits or grants) nor existing official export credit programs (ExIm Bank and CCC credit guaranties) are ideally suited to US participation in a possible multilateral aid consortium for Poland. A specially designed and legislated Polish aid instrument providing for financing of US grain exports to Poland, on repayment terms longer than existing CCC export credits and consistent with a possible IMF-Polish stabilization-recovery plan, is the preferred US instrument. The US loans might be conditioned on and associated with Polish adoption of a comprehensive agricultural rationalization and development program. In acting on a large-scale aid package for Poland, the Congress might legislate its own policy stipulations. (S)

If the Western allies were to launch a major program of economic support for Polish independence, their primary aim would be to serve allied military security objectives. While budgeted as foreign economic assistance, the US share might appropriately be funded by an offset against NATO theater or other defense programs. (S)

Decision Process

The Ottawa Summit, occurring immediately after the Polish Party Congress, offers the opportunity for private consultation on Poland at the highest political and economic levels among the major industrial nations. At that time, however, key facts required to make a firm assessment or decision will not be available. (S)

This matter should be kept on the NSC agenda for further consideration after the Ottawa Summit. Only after the critical political decisions have been made should the issue be entrusted to international economic decision processes. (S)

The 15 Western creditor governments participating in Polish debt rescheduling have formed with Poland a standing group, or "commission" at variable senior economic official levels which can meet to concert views in response to an expected Polish request for aid immediately after the Party Congress. If Poland joins the IMF this fall, this group could meet jointly with the IMF management and Polish government negotiators to review and respond to the initial Polish-IMF stabilization/reform program. (S)

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36

Poland: Can It Survive Until 1984?

There will be two key elements in Poland's future economic and political stability: (1) an austerity and reform program which stabilizes and then revives the Polish economy; and (2) continued foriegn financing with an additional $2.1 billion in financing in 1981. Both of these elements will have to be present and reinforce each other for the Polish renewal to continue. Western financing without stabilization is only throwing good money after bad. Without a turn-around in the economy, Poland's financing needs will quickly outstrip the ability of the West to provide further assistance -- even with a substantial CEMA contribution -- and there would be no way for Poland ever to repay. On the other hand, a Polish stabilization plan has little chance of success without the availability of sufficient resources to purchase needed Western imports. Polish industry already suffers from chronic shortages of imported Western intermediate goods and spare parts. The production shortfalls due to these shortages form a vicious circle -- the fall in production of exportable goods reduces Poland's ability to earn foreign currency to make purchases of needed inputs. Poland's difficulty in financing Western foodstuffs could also threaten internal cohesion, as it may lead to further disruptive work stoppages and greater internal strife over the implementation of economic reforms.

Assuming Poland can find sufficient financing in 1981 to avoid a disastrous decline in imports and meets its ambitious balance of payments targets, next year should be more easily managed. Following an official and private rescheduling in 1982, Poland would require approximately $3.8 billion in financial or export credits. With Poland on track on its stabilization program for 1981 and 1982, sufficient progress should be made by 1983 to allow replacement of the bulk of official financial assistance by commercially motivated private and official credits.

Prospects for Stabilization

Although the Poles have implemented some important measures, such as the 50 percent increase in prices paid to farmers for agricultural products, Polish authorities have been unable to put together a comprehensive stabilization program. It is clear that any stabilization package would have to be negotiated with solidarity. Thus far, solidarity has blocked piecemeal measures to improve the economy and tied measures which would have an adverse impact on worker living standards to a more comprehensive reform effort. The Polish party leadership, occupied with political turmoil, the internal

37

power struggle and the threat of Warsaw Pact intervention, has not been able to overcome the practical and idealogical obstacles to a comprehensive reform program. In addition, it is not clear how much effective central control can be exercised over the actions of the local bureaucracies that have to implement stabilization measures.

On the brighter side, Walesa has clearly stated that Polish workers are prepared to make "sacrifices" for an economic recovery. Soviet threats of intervention may actually increase Polish workers' willingness to accept lower standards of living. The upcoming party Congress, should it be held, promises to settle the internal dispute in favor of the "reformist" elements. This offers the possibility of sweeping changes in economic policies and removal of local bureaucratic opposition to reform.

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Assuming Poland can get through 1981 without a disastrous decline in Western imports and can regain control of the economy, the situation next year should be more manageable. The levels of Western assistance required to meet the financial gap may prove uncomfortable but should fall well short of assistance levels for 1981.

Assuming the terms of a rescheduling stay the same in 1982, the combined value of a private and official rescheduling would be approximately $5.3 billion, leaving a financing gap of $3.8 billion. Poland's gross financing needs next year should be in the range of $9.0 billion. A good portion of this total can be met with debt relief. Under the same debt relief terms granted in this year's rescheduling (90 percent of principal and interest on credits granted prior to January 1, 1981) an official rescheduling should be worth approximately $3.0 billion. Changes in these terms, however, could increase the value of a rescheduling by $400-500 million. The most significant changes in terms might include:

-- changes in the cut-off date of the rescheduling to include credits granted in 1981;

-- changes in the percentage of debt covered by rescheduling.

41

While it was in U.S. financial interest to maximize the amount of debt relief granted in 1981, the same strategy may not hold in 1982, particularly in regard to changes in the cut-off date. Our delegation in Paris managed to exclude $500 million in CCC credits signed in 1981 from the rescheduling. A change in the cut-off date would include them in 1982. Maintenance of January 1, 1981 as the cut-off date would be defensible as standard international practice.

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Export Credits	$ 2.1	-	-
Other Credits	.2	-	-
CEMA AID	.4	-	-
Remaining Gap	$ 2.4	-	-

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POLAND

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NSC BRIEFING MEMORANDUM

ECONOMIC AID TO POLAND

The Stakes

The fate of Poland's challenge to Soviet hegemony and communist orthodoxy -- a still embryonic development of potentially great strategic value to the West -- may depend largely on economic forces:

-- Before the Polish people have time to savor the new era of greater freedom, the new ruling triumvirate of reformist communists, independent unions, and the Catholic church must decide to impose economic measures aimed at arresting the country's economic deterioration and qualifying Poland to receive additional western debt relief and new credits; this bitter medicine will be politically hazardous for the new leadership either to prescribe or to avoid.

-- Within weeks of these critical Polish economic policy decisions, western governments and banks must make a high-stakes decision of their own -- either to risk, by inaction, the economic undermining of Poland's challenge to Moscow or to undertake a prolonged, costly, and inherently speculative multilateral aid program to shore up Poland's capacity to preserve its independence. The strategic and political rewards for success could be the neutralization of the second largest military force in the Warsaw Pact and the loosening of Soviet control of all of Eastern Europe. Success cannot, however, be assured.

-- The Soviet Union, without risking military intervention, may decide to impose severe economic sanctions, nullifying Polish recovery efforts supported by Western economic aid, thereby either inducing popular rejection of the new Polish political leadership or heightening anti-Soviet Polish nationalism, and in either case greatly increasing the cost of any rescue effort on the part of the Western powers.

-- Alternative projections also are strewn with perils. If the Soviets refrain from both military intervention and economic reprisals, and the Polish leadership refrains from profound economic measures, the West is unlikely to contribute substantially to the relief of Poland's critical

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shortages; very quickly the resulting economic distress could explode in ways that create opportunities for successful Soviet suppression of Poland's flirtation with deviationism. On the other hand, if the new Polish leadership adopts austerity without fundamental reforms and persuades the West to respond with large-scale economic aid, Poland will escape immediate food riots but will remain indigent and vulnerable to Soviet economic pressure at times of Moscow's choosing.

Economic Factors in Brief

Poland's chronic economic illness, made critical by a year of strikes and governmental change, is evidenced by a projected 10-15% decline in GNP and shortfall of \$11 billion in foreign exchange needed to service its \$ _____ billion foreign debt and close its growing external trade gap this year. A generous rescheduling of payments due on official western credits and the prospective rescheduling of debts to western commercial banks will reduce the shortfall by nearly \$6 billion. New Western offers of credit -- including \$585 million scheduled to be provided by US banks under US Department of Agriculture guarantees to finance Polish imports of US grain -- total about \$2.5 billion, but over half of this amount is effectively frozen by financial terms which Poland appears to be unable to meet. If the Soviet Union and other Eastern European countries provide no more credits in the second half of 1981, Poland will need to borrow from the West an additional \$2-\$2.5 billion to finance food and other essential imports in the next six months.

The need for official Western credits -- about \$5 billion this year -- should decline somewhat next year if generous rescheduling of official and private debts continues and Poland is able to restore exports of coal and other goods. At least two further years (1983 and 1984) of substantial Western aid (financial and export credits with maturities averaging more than three years) probably would be required before Poland could carry on with conventional financing.

These needs would be increased significantly if preferential Soviet and other CEMA export pricing and payment terms on intra-bloc trading were withheld from Poland. Such economic sanctions could raise Poland's requests for Western aid by as much as \$_____ billion per year.

If Poland joins the IMF this fall, it could become eliglble as early as mid-1982 for credit drawings up to six times its quota, or as much as \$_____ billion over three years.

Further details are contained in the attached State Department Staff Ppaer, "Poland: Can It Survive Until 1984?"

Western Aid Means

Interagency staff discussions have found no basis for confident prediction of the will and capacity of the Polish political and union leadership to adopt and maintain an effective economic reform program. The outlook may be somewhat clearer after the Party Congress, but Solidarity's August convention may be more revealing. Moscow's response also should become clearer during and immediately after these pivotal Polish conventions.

Western European governments have been taking a wait-and-see attitude toward Poland's appeals for economic aid. The new French government expressed readiness to help in raising $500 million in short-term credit from central banks (which the Federal Reserve has no legal authority to provide), but no European initiative commensurate with the economic need and political stakes has emerged. US representatives have been instructed to reject suggestions of a US lead in raising new credits, inasmuch as we already have done more than our share this year in purely economic terms as measured against historic trade and financial ties with Poland.

If the Western allies decide to make either a gesture of support or a major and prolonged effort to support Polish independence, they will need to collaborate in order to achieve maximum political effect and assure equitable burden-sharing. IMF participation would greatly facilitate negotiation of economic policy conditions of aid and would reduce the fiscal burden on Western governments.

Informal staff discussions have agreed that neither the regular instruments of bilateral economic aid (AID development assistance, PL480 credits and emergency grants, or security-related Economic Support Fund credits or grants) nor existing official export credit programs (ExIm Bank and CCC credit guaranties) are ideally suited to US participation in a possible multilateral aid consortium for Poland. A specially designed and legislated Polish aid instrument providing for financing of US grain exports to Poland, on repayment terms matching Western Europe's and consistent with a possible IMF-Polish stabilization-recovery plan, is the preferred US instrument. The US loans might be conditioned on and associated with Polish adoption of a comprehensive agricultural rationalization and development program.

47

If the Western allies were to launch a major program of economic support for Polish independence, their primary aim would be to serve allied military security objectives. While budgeted as foreign economic assistance, the US share might appropriately be funded by an offset against NATO theater or other defense programs.

good

Decision Process

The Ottawa Summit, occurring during the period of the Polish Party Congress, offers the opportunity for private consultation on Poland at the highest political and economic levels among the major industrial nations. At that time, however, key facts required to make a firm assessment or decision will not be available.

Only after the critical political decisions have been made should the issue be entrusted to international economic decision processes.

The 15 Western creditor governments participating in Polish debt rescheduling have formed with Poland a standing group, or "commission" at variable senior economic official levels which can meet to concert views in response to an expected Polish request for aid immediately after the Party Congress. If Poland joins the IMF this fall, this group could meet jointly with the IMF management and Polish government negotiators to review and respond to the initial Polish-IMF stabilization/reform program.

R. Poats, NSC, 7/6/81

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48

Poland: Can It Survive Until 1984?

There will be two key elements in Poland's future economic and political stability: (1) an austerity and reform program which stabilizes and then revives the Polish economy; and (2) continued foriegn financing with an additional $2.1 billion in financing in 1981. Both of these elements will have to be present and reinforce each other for the Polish renewal to continue. Western financing without stabilization is only throwing good money after bad. Without a turn-around in the economy, Poland's financing needs will quickly outstrip the ability of the West to provide further assistance -- even with a substantial CEMA contribution -- and there would be no way for Poland ever to repay. On the other hand, a Polish stabilization plan has little chance of success without the availability of sufficient resources to purchase needed Western imports. Polish industry already suffers from chronic shortages of imported Western intermediate goods and spare parts. The production shortfalls due to these shortages form a vicious circle -- the fall in production of exportable goods reduces Poland's ability to earn foreign currency to make purchases of needed inputs. Poland's difficulty in financing Western foodstuffs could also threaten internal cohesion, as it may lead to further disruptive work stoppages and greater internal strife over the implementation of economic reforms.

Assuming Poland can find sufficient financing in 1981 to avoid a disastrous decline in imports and meets its ambitious balance of payments targets, next year should be more easily managed. Following an official and private rescheduling in 1982, Poland would require approximately $3.8 billion in financial or export credits. With Poland on track on its stabilization program for 1981 and 1982, sufficient progress should be made by 1983 to allow replacement of the bulk of official financial assistance by commercially motivated private and official credits.

Prospects for Stabilization

Although the Poles have implemented some important measures, such as the 50 percent increase in prices paid to farmers for agricultural products, Polish authorities have been unable to put together a comprehensive stabilization program. It is clear that any stabilization package would have to be negotiated with solidarity. Thus far, solidarity has blocked piecemeal measures to improve the economy and tied measures which would have an adverse impact on worker living standards to a more comprehensive reform effort. The Polish party leadership, occupied with political turmoil, the internal caps

49

power struggle and the threat of Warsaw Pact intervention, has not been able to overcome the practical and idealogical obstacles to a comprehensive reform program. In addition, it is not clear how much effective central control can be exercised over the actions of the local bureaucracies that have to implement stabilization measures.

On the brighter side, Walesa has clearly stated that Polish workers are prepared to make "sacrifices" for an economic recovery. Soviet threats of intervention may actually increase Polish workers' willingness to accept lower standards of living. The upcoming party Congress, should it be held, promises to settle the internal dispute in favor of the "reformist" elements. This offers the possibility of sweeping changes in economic policies and removal of local bureaucratic opposition to reform.

In any event, Poland is rapidly approaching the point where the balance of payments will be "stabilized" by the lack of sufficient hard currency financing to cover Poland's import needs. Unless Western imports are more efficiently allocated, the downward spiral of industrial production will accelerate and the chronic food shortages will be exacerbated. In short, Poland will have only a fixed amount of foreign financing in 1981, so they will be unable to run a large trade deficit. If the Poles are lucky, they may receive sufficient financing to run a trade deficit of $700 million, or the targets on their balance of payments. Stabilization, or how efficiently these credits are used, will determine how far GDP will have to decline this year. The ability of Polish authorities to maintain social cohesions and keep the economy going during this period will be crucial for an eventual economic recovery.

The Situation in 1981

The Polish economic situation continues to deteriorate rapidly. Even if Polish authorities succeed in implementing stabilization measures, GNP will fall between 10-15 percent this year. The precipitus fall is due to shortages of imported raw materials, absenteeism, and shorter hours. Shortages of intermediate goods and the lack of work incentives due to increased wages without goods to purchase, need to be corrected if the situation is to be stabilized. This decline may be even greater if Poland does not meet its ambitious balance of payments targets and line up further financing for the second half of the year.

As shown in Table I, after rescheduling by its three major Western creditor groups (the Paris Group governments, other Western governments, and the private banks) and CEMA,

58

Poland will have covered over one-half of its financing needs, leaving about $5.1 billion in hard currency credits to meet minimum import needs and stave off default. We estimate that if Western governments take steps to change the terms of their credits, Poland has already arranged usable financing of $2.7 billion. About $1.4 billion of this total is in European credits which have not been drawn due to requirements for large cash down payments which the Poles cannot afford. As shown below, the U.S. is the single largest contributor to this total thus far this year.

	Usable Credits	Drawn
U.S. *	585	413
CEMA	450	450
FRG	336	0
Canada	235	32
France	180	61
U.K.	146	116
Denmark	110	19
Italy	100	30
Norway	79	34
Belgium	77	7
Austria	60	-
Netherlands	49	-
Sweden	42	30
Japan	30	8
Other	321	-
TOTAL	2479	1200

* includes $113 million as usable credits.

The remaining financing gap is in the range of $2.4 billion. Given the already sizable U.S. contribution this year, particularly in view of our relatively smaller financial and economic ties with Poland, the U.S. position is that the remaining gap should be filled by the Europeans and Soviets.

Neither the Europeans nor the Soviets have shown any enthusiasm for further credits. European performance on credits this year has been particularly disappointing. The major European participants in Polish creditor meetings have pledged slightly less than $1.2 billion. Only some $300 million of this total has actually been drawn this year. At the last creditor meeting on Poland June 1-2, France was the only country to offer further credits -- and this offer only amounted to $60 million. CEMA has reportedly provided $450 million in the first quarter of 1981, but hard figures are not available. The Poles claim that CEMA has decided against

providing further hard currency assistance in 1981. Both of these hard line positions may crumble, however, as the Poles run into a financial crunch in the fall.

If the gap is not filled, Polish authorities will face one of two unpalatible choices: (1) to cut back sharply on Western imports; or (2) default on unrescheduled debt service to Western creditors. A sharp cutback on Western imports would in the short run prove the most disruptive. Recurrent food shortages could again bring the political situation to a boil and the shortage of Western intermediate goods would accelerate the economic decline. The alternative would be to default on $700 million in unrescheduled interest due the private banks in the second half of 1981 and $400 million in unrescheduled debt service due official creditors.

There are three sources of funds which Poland may be able to tap to cover their $2.4 billion gap this year: the private banks, CEMA and the Europeans.

The banks are working on their own rescheduling and it appears that principal payments due this year will be deferred. Rather than reschedule, the U.S. banks have decided to roll-over principal repayment through the end of the year. The European banks will meet next week.

At present, it is clear that the private banks are not prepared to accept further exposure in Poland. As a default on interest payments in the second half of the year approaches, however, the pressure to provide additional funds will mount. While banks are loath to reschedule interest, they may be willing to provide sufficient funds to allow the Poles to keep current on a portion of interest payments due in the second quarter. We should not, however, expect any quick agreement to this procedure, particularly from the American banking community. Polish loans are rated as non-performing by U.S. bank regulators, which means Polish exposure must be met in part by a special reserve against bank capital. Any private loans to enable Poland to keep current on interest would probably be handled quietly in negotiations between the Poles and individual banks.

The Soviets have a vital stake in Poland's stability, and an additional CEMA contribution will be a critical element in Poland's ability to close the $2.4 billion gap. Economic chaos in Poland will involve significant costs to the Soviet Union. Poland's financial problems and the Soviet Union's reluctance to open the CEMA "umbrella" has already made the private banks more cautious about lending to Eastern Europe. A Polish economic collapse would erode bank confidence further, although we do not expect a complete credit cut-off. Perhaps

more important, Poland's economic difficulties have deprived the Warsaw Pact countries of vital Polish exports, in particular coal deliveries. Finally, further chaos within Poland might force a military intervention, which could impose substantial political and economic costs.

Given the costs of military intervention, the Soviets may find it tempting to use economic leverage to reverse the course of events in Poland, particularly if it appears that Poland is unable to count on the West as an alternative source of credits. The West will have a tricky hand to play here. Poland's financial needs exceed the West's ability to provide assistance. Some gap will have to be left for the Soviets. On the other hand, if the West holds back to prompt a Soviet contribution, Western assistance becomes a hostage to Soviet policy and magnifies Soviet economic leverage.

The Europeans have played a confused role in the Polish financial problem; it would be easy to suspect bad faith, but perhaps they simply have not done their homework. They have been cool towards our attempts to devise strategy towards pressing for a large Soviet contribution and actively resisted our proposal to maximize debt relief this year. At the same time that they have pressed for further U.S. credits, they have done little on their own.

Outlook for 1982

Assuming Poland can get through 1981 without a disastrous decline in Western imports and can regain control of the economy, the situation next year should be more manageable. The levels of Western assistance required to meet the financial gap may prove uncomfortable but should fall well short of assistance levels for 1981.

Assuming the terms of a rescheduling stay the same in 1982, the combined value of a private and official rescheduling would be approximately $5.3 billion, leaving a financing gap of $3.8 billion. Poland's gross financing needs next year should be in the range of $9.0 billion. A good portion of this total can be met with debt relief. Under the same debt relief terms granted in this year's rescheduling (90 percent of principal and interest on credits granted prior to January 1, 1981) an official rescheduling should be worth approximately $3.0 billion. Changes in these terms, however, could increase the value of a rescheduling by $400-500 million. The most significant changes in terms might include:

-- changes in the cut-off date of the rescheduling to include credits granted in 1981;

-- changes in the percentage of debt covered by rescheduling.

53

While it was in U.S. financial interest to maximize the amount of debt relief granted in 1981, the same strategy may not hold in 1982, particularly in regard to changes in the cut-off date. Our delegation in Paris managed to exclude $500 million in CCC credits signed in 1981 from the rescheduling. A change in the cut-off date would include them in 1982. Maintenance of January 1, 1981 as the cut-off date would be defensible as standard international practice.

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Financing Gap 1981
(billions of dollars)

Current Account Deficit		$ 3.0
Amortization		7.5
Credits Extended		.2
Short-term Capital Flight		.6
Gross Financing Requirement		11.3
Financing Items		8.9
of which		
Already Arranged		
Official Rescheduling (Paris Group)	$2.9	
Western Export Credits	.7	
Socialist Assistance (First Quarter)	.7	
Western Financial Credits	.2	
Private Rescheduling	2.4	
Expected		
Undrawn European Export Credits	1.4	
Official Roll-Over (Other Western Governments)	.6	
Financing Gap After Already Arranged and Expected Financing		$ 2.4
Financing Gap Including Only Financing Already Firmly Arranged		$ 4.4

Table II

Financing Gap 1981-1983
(billions of dollars)

	1981	1982	1983
Current Account	$ 3.0	$ 2.5	$ 2.0
Capital Outflows	7.7	6.6	5.8
Short-Term Capital Flight	.6	-	-
Gross Financing Needs	$11.3	$ 9.1	$ 7.8
Financing Item of which			
Official Rescheduling	$ 3.8	$ 3.1	$ 2.2
Private Rescheduling	2.4	2.2	.7
Gap Following Rescheduling	$ 5.1	$ 3.8	$ 4.9
Additional Financing Available			
Export Credits	$ 2.1	-	-
Other Credits	.2	-	-
CEMA AID	.4	-	-
Remaining Gap	$ 2.4	-	-

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POLAND - DEBT/ASSIST.

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56
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DEPARTMENT OF STATE · UNITED STATES OF AMERICA

BUREAU OF INTELLIGENCE AND RESEARCH

ASSESSMENTS AND RESEARCH

(U) SOVIET AND EAST EUROPEAN ASSISTANCE TO POLAND

Key Judgments

(C) Since the onset of the Polish crisis in July 1980, the Soviet Union and Poland's East European allies in the Council for Mutual Economic Assistance (CEMA) have provided Warsaw with a considerable amount of economic assistance. There is little evidence to substantiate early Polish assertions that large, new hard-currency loans have been made, but deferrals of payments on outstanding credits have been allowed. Close estimates of actual assistance are made difficult by contradictory Polish statements, apparent double-counting in announced assistance packages, and a scarcity of collateral information.

(S/NF/NC/OC) In 1980, the USSR and East European countries provided roughly $1 billion in assistance to Poland, including:

--about $950 million from the Soviet Union, one-third of which may have represented deferrals of payments on hard-currency debt or possibly new hard-currency lending; the remainder constituted ruble credits to cover the annual trade deficit and a specific package of above-plan Soviet export deliveries worth $130 million;

--about $90 million in above-plan and advance deliveries from East European CEMA trading partners; and

--an undetermined amount of hard-currency assistance from East Germany, reportedly in the $50-125 million range.

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Report 205-AR
August 21, 1981

57

(C) Assistance in 1981 will likely surpass $2 billion in new credits, almost entirely from the Soviet Union, comprising:

--more than $1.5 billion, possibly as much as $2 billion, in ruble financing by Moscow of an anticipated Polish trade deficit with the USSR for the year; declines in Polish exports to the East European countries have provoked East European efforts to cut exports to Poland this year (following more forthcoming policies in late 1980);

--up to $700 million in hard currency, provided principally through rollovers by Moscow, though the East Europeans may have made some contributions. The Poles have told Western creditors that $435 million was drawn on in the first quarter. Polish claims concerning the actual form and amount of this assistance remain largely unsubstantiated.

(S/NF/NC/OC) The Soviets have also allowed Poland to defer repayment on previously granted credits. Highly publicized announcements in February 1981 and more recently on August 15 indicate that Moscow is deferring Polish payments on at least the ruble debt coming due in 1981-85 until the 1986-90 period. This would include payments on more than $1.5 billion in ruble trade credits granted during 1976-80 (of which half may have been due before 1986) as well as payments on credits provided at least through mid-August 1981. In addition, part of Soviet short-term hard-currency exposure in Poland has been converted to medium-term loans with two-year maturities, according to other reports.

(S/NF/NC/OC) Perhaps the murkiest area of Soviet assistance to Poland involves the financial flows among the Soviet-owned banks in the West, Warsaw, and Moscow. Monies lent to Warsaw through this mechanism often represent relending through the Soviet Foreign Trade Bank of funds originally obtained from Western capital markets. It is difficult to construe such lending as Soviet financial assistance, particularly given the high commercial interest rates involved and the fact that the net exposure appears in the Polish accounts under the heading of indebtedness to the West.

* * * * * *

The Setting

(S) Fundamental Soviet concerns--particularly Moscow's political and strategic interests in maintaining Poland's key role in the Warsaw Pact--have been threatened by the Polish events since July 1980. In response, Moscow has resorted to a variety of measures, including economic assistance, to bolster its influence on the situation in Poland. However, the attendant economic costs have been substantial and may rise in the future, dwarfing any past assistance the Soviets may have given to the Poles.[1/] Poland's East European CEMA partners also have been called upon to render assistance.

(C) The seriousness of the Polish balance-of-payments crisis has created Western pressure on Warsaw to secure hard-currency aid from its Soviet and East European allies. Expectations by many in the West that the USSR should be the "guarantor" of CEMA members' debt have been key to lending to the East Europeans. Thus, the theory of the "Soviet umbrella" for CEMA financial obligations is being tested; Soviet actions are being closely watched by Poland's Western creditors, both official and commercial. For its part, Moscow has recognized the necessity of propping up the Polish economy.

(C) The actual amount of Soviet assistance, particularly its hard-currency element, has been obscured by misleading and often contradictory statements by the Poles. The assistance rendered so far has been relatively small when measured against

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1/ (S) The Polish crises in 1971 and 1976 brought similar commitments of assistance from Poland's CEMA partners. In particular, the Soviet Union extended large amounts of ruble trade credits in an attempt to improve the economic situation and thus ease political tensions. The reported 1-billion-ruble package provided in 1971, which may have included as much as $100 million in hard currency, apparently was not fully drawn down; stiff Soviet terms have been cited as a reason. The 1976 package, also for 1 billion rubles, though without a hard-currency element, again was used only in part by the Poles. The 1976 agreement may, however, have formed the basis for the financing of subsequent Polish trade deficits with the USSR. (At prevailing exchange rates, the 1971 and 1976 credit packages were worth $1.1 billion and $1.3 billion, respectively.)

the total value of Polish-Soviet trade;2/ nonetheless, it has eased Western pressure on both Warsaw and Moscow while strengthening Moscow's leverage over the Poles. But Moscow may accept the need to provide even more hard-currency assistance so that crucial imports are not denied to Polish industry, particularly to strategic production. And of course, Moscow would want to avoid an outright Polish default and any possible disruption in East-West trade that might ensue.

(U) At the same time, Moscow's stake in the Polish economy itself is substantial. Nine percent of the Soviet Union's total trade is with Poland, which ranks second only to East Germany among the USSR's trading partners. Soviet industry relies on Polish coal and minerals as well as equipment. Imports of manufactured consumer goods from Poland are substantial. Polish participation in bilateral and CEMA projects on Soviet territory (such as the Orenburg pipeline) has alleviated investment pressures in the USSR. Polish exports to the USSR have been falling, however. After a 4-percent decline in 1980, Polish exports have continued to drop off (down 20 percent in the first quarter of 1981), thereby taxing the ability of the USSR's rigidly planned economy to compensate for missed Polish shipments. For example, coal deliveries--about 10 percent of Polish exports to the USSR in 1978--fell in volume by about half in 1980, and could drop again by half in 1981.

(S/NF/NC/OC) To make better use of Polish facilities and to mitigate the impact of Polish economic deterioration on the USSR, the Soviets proposed coproduction agreements with the Poles during the December 1980 Warsaw Pact meeting. The coproduction concept gained acceptance by Warsaw only as Polish economic performance worsened in early 1981. Several such agreements3/ with the USSR, Hungary, and East Germany have apparently already been signed.

2/ (C) The same can be said about the level of East European assistance. Trade with the USSR alone amounted to almost $12 billion in 1980, or one-third of total Polish trade turnover. Adding Poland's trade with Eastern Europe raises this share to 52 percent. Except for Soviet ruble credits, mainly granted to help offset price increases in Soviet exports, the "clearing account" policy for intra-CEMA trade normally precludes the accumulation of any excessive trade or credit imbalances between partners.

3/ (C) The agreements call for Polish manufacture of ready-made clothing from Soviet cotton in exchange for a portion of the output, and Polish processing of Hungarian aluminum in return for additional deliveries of raw aluminum.

(U) For its part, Poland traditionally relies on the USSR for about a third of its total imports (including most of its oil imports). Through May, however, the Soviet share had jumped to 40 percent, reflecting programmed price increases for Soviet oil and a general decline in Polish imports from noncommunist countries.

(C) Poland's strategic location makes it vitally important to the Soviet Union. Its military significance is obvious: it links the USSR with East Germany, the Warsaw Pact's front line. Also significant is the large volume of Soviet trade with East Germany--the USSR's leading trading partner--transiting Poland. Indeed, it is the link to East Germany which is endangered most by the ongoing crisis and which plays an important role in Soviet strategic thinking.

<u>Soviet and East European Economic Assistance to Poland</u>

(S/NF/NC/OC) Soviet economic assistance to Poland during the current crisis has been largely in the form of ruble credits to cover current and projected Polish trade deficits with the USSR and the deferral of repayments by Poland on its roughly 1 billion rubles in past obligations.[4/] The Soviets also have provided some hard currency, though probably on a short-term basis at first. Some of the hard-currency support in fact may have originated from Soviet-owned banks in the West which normally impose strictly commercial terms.

(C) Assistance from Poland's East European partners so far has been limited to some hard currency from East Germany and commodity deliveries from others beyond the amounts and in advance of timetables called for by annual trade agreements. The above-plan

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4/ (LOU) Chronic Polish trade deficits with the USSR in the 1970s have required financing through ruble trade credits. During the 1976-80 period, these deficits totaled nearly 1 billion rubles (or the rough equivalent of $1.5 billion), largely reflecting the marked deterioration in Poland's terms of trade with the USSR as prices for Soviet oil and other raw materials shot up. For example, Soviet oil prices--although still roughly half the world level--tripled in 1976-80, and a 30-percent hike is in line for 1981. These price increases have necessitated special arrangements for Poland as well as other CEMA trading partners of the USSR. "Price credits" in fact may represent a significant element of the much ballyhooed Soviet assistance packages announced since the current Polish crisis began. Poland also benefits from the price subsidies for imports of Soviet and other raw materials. Such subsidies are not considered to be Soviet aid in the context of this report because they are also provided to other CEMA members.

deliveries in 1980 were worth about $90 million, according to Polish officials. According to Polish trade statistics, the only East European CEMA countries allowing Poland to run bilateral trade deficits in 1980 were East Germany, Hungary, and Bulgaria.

Details on Assistance in 1980

(S/NF/NC/OC) From the USSR. Statements by Polish officials have obscured the amount and nature of Soviet assistance by the apparent inclusion of "rollovers" of previous ruble and hard-currency obligations in the publicized credits packages of September and December 1980. Our estimate of actual Soviet assistance in 1980 is $950 million. Of this amount, less than one-third could be said to have been hard currency, whether in new credits or roll-overs of existing hard-currency debt. The Soviet credits may be broken down as follows:

- --Roughly $650 million in ruble trade credits, long-term and medium-term. The medium-term credits covered $130 million in above-plan shipments of wheat, cotton, and apatites, among other items. A Polish Deputy Minister of Foreign Trade has indicated that 40 percent of these credits were actually concluded in 1981 even though they covered deliveries recorded on the 1980 trade accounts.

- --About $300 million in hard currency, including a $45 million participation by Moscow Narodny Bank-London in the "jumbo" Western loan syndication arranged in August 1980. The Bank's participation was predicated on early repayment by Warsaw of an existing $40 million short-term loan. The balance of Soviet hard-currency assistance apparently came in the form of about $280 million in refinancing of outstanding Polish hard-currency obligations to Moscow. However, some reports have indicated that this money may represent a new short-term loan made in August 1980.

(S/NF/NC/OC) Some elements of the Soviet rollovers in 1980 of repayments on hard-currency debt appear in 1981 announcements as well, suggesting double-counting. This probably reflects the short-term nature of Soviet hard-currency lending to Poland. Such refinancing of short-term loans plays a significant role in transactions among Moscow (Vneshtorgbank), Moscow Narodny Bank in London, and Warsaw (Bank Handlowy).

(S/NF/NC/OC) From Eastern Europe. Of the East Europeans, East Germany apparently took the lead in assisting Poland. Berlin reportedly provided some $50-125 million in hard currency, though the actual form in which this aid was granted remains unclear. Berlin may be equating the delivery of hard goods--that is, goods marketable for hard currency--to actual hard-currency transfers (a view often shared by Moscow). Additional shipments of grain, butter, meat, and other items were made in response to Polish requests. Poland was also allowed to run a trade deficit for the year, although the amount ($50 million) came to less than half that recorded in 1979. All five East European countries boosted exports (the increase was worth about $90 million) to Poland in late 1980, though deliveries fell off in early 1981.

Details on Assistance in 1981

(C) Assistance from CEMA partners this year will come almost entirely from the USSR. Moscow's generosity with Warsaw on trade is not being matched by the East Europeans. Rather, the East Europeans are increasingly making their exports to Poland dependent on assured deliveries from Poland. Warsaw originally asserted that a "non-repayable" loan worth $465 million was made by the USSR in January, with some participation by the East Europeans, though subsequent statements suggest a lower amount. Neither the total nor the actual transfer has been confirmed, Polish claims aside.

(S/NF/NC/OC) Some Soviet and CEMA hard-currency lending--some for refinancing purposes--apparently has occurred. Part of this lending appears to have originated through the Soviet-owned banks in the West and likely carries stiff commercial terms. Since May, Soviet banks in the West have been pressed to raise new funds ($100 million, with an additional $120 million under consideration) for relending through Moscow's Foreign Trade Bank (Vneshtorgbank) to Poland, according to a reliable report.

(S/NF/NC/OC) From the USSR. New Soviet credits to Poland in 1981, according to our estimates, could surpass $2 billion, provided Moscow follows through on its planned 1½ billion ruble trade surplus with Poland. Our formulation borrows little from the much-publicized December 1980 Soviet aid package covering 1981, which we believe was more of a propaganda vehicle than a coherent group of aid measures.5/ However, the reported $465 million in hard-currency aid announced by Polish Party First Secretary Kania

5/ (LOU) The initial Soviet aid package for Poland in 1981, announced in December 1980, called for the equivalent of $1.3 billion in assistance. However, this package focused mainly on credits and little on trade. The apparent reformulation of the package through the large January hard-currency loan (albeit "non-repayable") and the subsequent signing of the annual trade agreement essentially pushed the December package to the sidelines.

in January, and reiterated in the 1981 creditor meetings, appears to have some substance. The Soviets had forcefully told the Poles that no aid in addition to what they promised in January would be forthcoming in 1981. Now, however, Moscow's position may be softening, given recent reports on Vneshtorgbank's activity. The key elements of new Soviet assistance are:

--The Soviet trade surplus with Poland, which could surpass $2 billion. The surplus through May had reached $788 million (587 million rubles). Some ruble financing has already been announced in the press, including more than $200 million in 10-year credits for above-plan deliveries of industrial goods (e.g., iron ore, fertilizers, apatites) and consumer items (including cars and TV sets). Presumably, the remainder will be covered by credit agreements still to be negotiated.

--Hard-currency assistance of as much as $700 million, composed partly of the "credit" facility announced in January. The vagueness of Kania's announcement and subsequent statements by Polish officials must be noted.[6/] Polish reexport of Soviet goods may prove to have been one means by which the USSR granted Warsaw hard-currency aid. Some US bankers believe that Poland would have defaulted in early 1981 had it not been for Soviet hard-currency help.

(C) In February, Moscow announced deferral until 1985 of Polish repayments--said to total 540 million rubles--due on ruble credits accumulated in the 1976-80 period. The total debt involved, according to Polish and Soviet trade statistics, is probably about 1 billion rubles (now equivalent to $1.4 billion). Subsequent Polish statements indicate that this rescheduling was for five years, a position consistent with the August 15 communique of the Brezhnev-Kania meeting in the Crimea. This communique highlighted Soviet assistance and specifically cited payment deferrals until 1986-90. Thus, while it may not have broken new ground on payment deferrals, the communique did serve to clarify that repayment of Polish debt (at least the ruble portion as of that date) would not have to begin until 1986.

6/ (C) Finance Minister Krzak said in April that this assistance actually came from several CEMA countries, but he asserted that the Soviet Union was the initiator and had arranged the "technical solution" for the aid package. In June, senior Polish officials declared the Soviet element of the "loan" to have been $345 million, while explaining that repayment terms had not yet been negotiated (implying this to be the basis for the characterization of the loan as "non-repayable").

(C) From Eastern Europe. There is little evidence to suggest that the East Europeans have provided assistance in the form of goods this year. The East Germans, concerned about trade imbalances related to declines in Polish exports, have taken steps to ensure that such imbalances do not worsen. In a recent development, however, the July-August food crisis in Poland may have prompted Berlin to agree to the shipment of 10,000 tons of meat in coming months. The overall level of Polish trade with Eastern Europe is down compared with 1980, with the drop in East European exports to Poland maintaining Poland's customary seasonal surplus in the first quarter. Reports that Hungary has reloaned hard currency to Poland have been vigorously denied by Budapest. There is the possibility that a Western loan syndication for East Germany in spring 1981 was in excess of Berlin's needs and that some of the money may have been used to help Warsaw.

(C) Assistance in the Post-1981 Period

The Soviet Union is publicly committed to helping Poland, but has avoided discussing particulars. Private acknowledgments by senior Polish officials indicate that Moscow is prepared to allow the Poles to run annual trade deficits of $1.6-2.0 billion through 1985, roughly equivalent to the anticipated deficit this year. Presumably, ruble credits would be arranged to cover the deficits, with some initial grace period allowed. The East Europeans may follow Moscow's lead to some extent, but they are not in a position to do much for Poland.

The Soviet attitude toward hard-currency lending to Poland, i.e., "the Soviet umbrella," is more difficult to gauge. The optimal strategy for Moscow is one that enables Warsaw to avoid default while forcing Western creditors to assume the burden of rescheduling Poland's hard-currency debt. Glimmers of this strategy can be noted in Moscow's efforts to date.

Moscow may be gambling that the economic crisis may force Warsaw into closer economic ties with the USSR. If so, and if the political role of the party can be maintained in the face of growing pressure for change, then Moscow's leverage in the post-1981 period will be strengthened. At present, Poland is getting the largest share of its industrial inputs from the USSR, and the Soviet share will likely grow as cutbacks in hard-currency imports increase. Similarly, the joint production and investment schemes currently under study argue for greater Soviet influence in Polish economic affairs. Even so, the course of political events in Poland should remain the Soviets' prime concern.

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(C) Effects on CEMA

Poland's economic decline and concomitant need for assistance from its CEMA trading partners have been disruptive to intra-CEMA economic relations. All CEMA countries have suffered shortfalls in imports from Poland. As a result, production sometimes has been interrupted, and some countries have been forced to make additional purchases from the West at a time when their own hard-currency balances of payments can ill afford the strain. East Germany appears to have been the most affected in this regard. In addition to economic costs, the East European governments of course fear the spread of Polish instability to their own countries.

Prepared by Michael C. Mozur
x29737

Approved by Terence E. Byrne
x22214