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NOTE OF A MEETING IN THE ECONOMIC SECRETARY'S ROOM, TREASURY CHAMBERS
AT 4.30pm ON THURSDAY 20 APRIL

Those present: Economic Secretary
 Mr Mountfield

 Mr Soros

MEETING WITH GEORGE SOROS

Mr Soros was grateful to the Economic Secretary for agreeing to meet him. He had just returned from Warsaw having previously visited Budapest and Moscow.

Poland

2. Mr Soros explained his ideas for international economic assistance for Poland. He believed a lasting political solution for the country could not be gained without first solving economic problems. Action was needed as in all Communist countries to tackle the problems of debt, monetary instability and the inefficient use of state capital. It was, Mr Soros believed, better to tackle these problems together rather than separately. His primary concern was the effective use of capital. He proposed that all state enterprises should be put in trust to be administered on behalf of shareholders by an independent Agency with representatives of foreign interests. There would also be a 3 year moratorium on Paris Club debt. After that, debt would be converted into preference shares in the Agency at a relatively low rate of return. The Agency could later use part of its income to repurchase its preference shares through an auction process.

3. Mr Soros claimed that as far as he could judge, Solidarity were enthusiastic about these proposals. They recognised Poland's problems and regarded Mr Soros' plans as a possible solution. The Polish Government had also proved more receptive than he had hoped. He was

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aware that he was likely to receive a much cooler reception from the UK and, he suspected, the US.

4. It would be important, Mr Soros explained, for the Government in Poland to relinquish its 'Nomenklatura' rights of nomination to the top management positions in the biggest companies. These would need to be forfeited for the Agency he proposed to operate. He recognised it would not be easy to achieve this, but it was essential to bring in new and properly trained management.

5. The Economic Secretary said that Mr Soros was no doubt correct in thinking people needed incentives to make capital work effectively. However he was doubtful as to how ready people in Poland would be to face up to the necessary solutions. Britain had faced problems of overmanning, for instance, in the 1970's. Once management of industries had improved, jobs had been shed. The same would happen in Poland.

6. Mr Mountfield added that Mr Soros' plan resembled a debt-equity swap, but by governments. It would be odd for Britain to pursue a policy of privatisation at home but to buy up nationalised industries in Poland. It would be easier for the banks to use their share of the debt for this purpose. The Economic Secretary said that if Poland could attract equity capital, this could be used to service debt. Mr Soros agreed that joint ventures with part foreign ownership would be helpful. He foresaw the Agency selling some of the more promising state industries to domestic buyers and holding the remainder as social capital. Administration of these remaining nationalised industries would need to be divided up otherwise he would just be creating another form of state ownership.

7. Mr Soros was under the misapprehension that the Paris Club had deliberately chosen to play a subordinate role compared with the commercial banks in rescheduling Polish debt. Mr Mountfield explained that this was accidental. The conventional Paris Club deal arranged in 1981 had been suspended on the imposition of martial law and the Paris Club had been forced to capitalise most of the interest accruing during the ensuing period. The banks by contrast had achieved an agreement with the Polish Government, and had continued to receive interest.

This had resulted in a switch in the relative shares of the stock of debt, as between banks and government, from 60:40 in 1981 to 40:60 now. The Paris Club wanted to increase the flow of funds to Government creditors and not, as Mr Soros proposed, agree to a further moratorium. It was for the banks (or other creditors, like USSR) to provide Poland with a breathing space if this could be negotiated.

8. Mr Soros said that concessions from the commercial banks alone would not be sufficient. Government creditors also needed to participate. Mr Mountfield noted that it would be difficult for the US to be seen to be more generous to Poland than, for example, to Mexico. They had not been prepared to contemplate write-down of Mexican debt to Paris Club governments.

9. Mr Soros asked whether there were any technical or constitutional obstacles to the Polish Club taking a stake in Polish industries. Mr Mountfield noted that the Paris Club collectively had never taken a loss. The individual agencies by statute had different rules. He knew of one which was debarred by statute from taking a loss; 5 or 6 others would have difficulties in doing so. Two had taken a small loss in the past on selling off or swapping some of their debt. The UK was not barred by law from accepting a loss but Ministers were not willing to do so at present. The Economic Secretary reminded Mr Soros that the Paris Club was not in the business of writing off debt. At most, debt was rescheduled on occasion.

10. Mr Soros said that he wished to see informal, round-table discussions on his proposals in Poland between Solidarity, the Government and foreign participants. His next step was a meeting with Sir Patrick Wright on 25 April. He hoped that a Government conference might be possible in May/June. Before that he would need to discuss with the West, and perhaps the Paris Club, what concessions they were prepared to make.

11. The Economic Secretary said that the Prime Minister recognised the importance of what had happened in Poland, and indeed she had been part of the process of making it happen. Nevertheless the Government did not believe in throwing money at problems. Structural reforms were

needed in Poland. Where a breathing space in debt repayment was necessary, Poland should look to the commercial banks to provide it.

Mexico

12. Mr Soros was interested in finding out more background to the Spring meetings. Why in particular was the Chancellor opposed to the Brady Plan for Mexico? The Economic Secretary said that the UK's position was clear. We did not believe that IFIs should prop up commercial banks. The banks should come to agreements with the debtor countries themselves. The banks were now in a position to take a hit if necessary. Britain did not maintain a root and branch opposition to all Brady's proposals in Mexico but sought a more selective response to different aspects of Mexican problems.

13. Mr Soros asked whether the issue of interest guarantees was still being disputed. The Economic Secretary said the issue was still under discussion and the UK were not alone in opposing interest guarantees. The split was roughly Europe on one side, the US and Japan on the other. Mr Mountfield added that the details of the proposals had still to be worked out.

James

S M A JAMES
Private Secretary

cc: PS/Chancellor
Mr Wicks
Mr Lankester
Mr Mountfield
Mr H Evans
Mr Bottrill
Mr Powell - 10
PS/Mr Waldegrave - FCO
PS/Chief Executive - ECGD