

CPC



Foreign and Commonwealth Office

London SW1A 2AH

27 April 1989

CDD  
27/4.

Dear Charles,

International Economic Assistance to PolandThank you for your letter of 24 April. *CPC*

George Soros called on Patrick Wright on 25 April and explained his ideas in some detail. He had recently visited Poland and claimed to have had a positive response from Solidarity and the Government. (We know from a report from our Ambassador that the government's reaction was in fact fairly cautious.) Our impression is that Soros underestimates the difficulty of the problems presented by economic reform in Poland.

He said that his proposed agency (which he said would be Polish rather than foreign, as implied in his paper) would be responsible for restructuring Poland's 150 largest enterprises in the course of 3 years. We think that a much longer timeframe will be needed, and that Soros underestimates the difficulty of dealing with the problems of unemployment, retraining etc which would result. Moreover, the Poles might balk at the considerable loss of sovereignty which such a scheme would entail.

He also seemed to underestimate the difficulty the Poles would have in following a credible macroeconomic policy. He regarded cutting the budget deficit and stabilising the currency as essential to the success of his plan, but argued at the same time that living standards should not be depressed any further as, in his view, the IMF would insist.

We would not wish to pour too much cold water on his ideas. As you know he is an energetic and influential figure and may be able to devise ways of helping the Poles. But we are concerned that he may give the impression of being able to deliver debt relief and an easy ride with the IMF. We do not believe that he should involve himself with the IMF/Paris Club which are the concern of Governments.

We think that he should focus on the private sector and on seeking possible investors. If he can interest private banks in debt/equity swap arrangements we would certainly welcome this. It is very much in line with President Bush's statement of 13 April.

/Finally,

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Finally, we see no difficulty about the informal meeting which he hopes to arrange in Warsaw in June or July, although we are doubtful about IMF participation. If the meeting takes place we should certainly like to send an observer from the Embassy in Warsaw.

I am copying this letter to Jonathan Taylor (HM Treasury).

Yours ever,

*Richard Gozney*

(R H T Gozney)  
Private Secretary

C D Powell Esq  
10 Downing Street

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10 DOWNING STREET

LONDON SW1A 2AA

*From the Private Secretary*

24 April 1989

INTERNATIONAL ECONOMIC ASSISTANCE FOR POLAND

Thank you for your letter of 21 April commenting on the note from George Soros setting out his ideas for an international economic programme of assistance for Poland. Mr Soros subsequently telephoned me and I was able to make the points in your letter. He said that he had also seen the Economic Secretary and Treasury officials.

Soros claimed to have had quite a positive response from Polish officials to his ideas. He is now contemplating organising a round table discussion, involving Polish officials and representatives of Western donor governments, sometime in May in Warsaw. The purpose will be to discuss very informally how his ideas could be taken forward. He had put this to the Americans and was hoping for a positive response. He thought it would be very helpful if there could be some British participation. He emphasised that it would be entirely without obligation. I said that I would consult about this and be in touch with him (I shall in fact be at a dinner with him on 27 April). Might we in fact be ready to send someone from our Embassy in Warsaw, at least as an observer at such a meeting, if it happens?

I am copying this letter to Jonathan Taylor (HM Treasury).

C. D. POWELL

Richard Gozney, Esq.  
Foreign and Commonwealth Office

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Foreign and Commonwealth Office

London SW1A 2AH

21 April 1989

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24/4.

Dear Charles,

International Economic Assistance for Poland

Your letter to me of 12 April enclosed a note from George Soros outlining his ideas for an international economic programme of assistance for Poland.

We very much agree with Soros' comment that the central problem of reform in Eastern European countries involves the effective use of capital and the problem of defining who owns fixed capital and property. It is a vexed question for Communist societies. The Hungarians are about to bring in legislation to establish in law that the State formally owns property and can dispose of it as it wishes, but, as Soros comments, other Eastern European countries have yet to address the issue.

But implementation of much of the programme would depend on a voluntary cession of sovereignty by the Poles investing the ownership and management of State enterprises in an "agency" involving foreign advisers, and in handing the conduct of monetary policy to foreign advisers. It seems to us politically unrealistic to imagine the Poles ceding sovereignty in these areas.

You will not be surprised that Mr Soros' ideas about the handling of Paris Club debt would cause a number of difficulties for us. We have repeatedly made it clear that debt and credit problems should be addressed only after the negotiation of an agreement between Poland and the IMF. This remains our policy (and it appears, that of most other Western creditors) despite the conclusion of the Round Table accords. Indeed we believe the latter provide some hope that a political consensus can be developed on which the Poles can agree forceful policies for economic reform and adjustment, which will have the support of the international community. Nonetheless we recognise that it will not be easy to secure a Poland/IMF agreement. The Polish economy is in a parlous state, and a weak IMF programme is in neither the Poles' nor our interests. It may be necessary to take measures to bring the IMF and Poland into a closer relationship leading to a full stand-by arrangement.

/Once



Once an IMF programme begins to be implemented, we are ready to consider debt rescheduling. We believe a three year repayment moratorium ought not to be necessary. Mr Soros' proposal that the Paris Club could in due course exchange its debt for equity in the state enterprise Agency is unlikely to find favour among governments which have not previously become involved in such mechanisms. We are sceptical also that many commercial banks would be prepared to convert some of their debts in Eastern Europe into equity shares (even after local legislation has advanced to the point that this would be possible) as they have already done in certain Latin American countries, although you will have noted that President Bush, in his statement on aid to Poland on 17 April, undertook to encourage business and private groups to "implement creative debt-equity, debt-nature and debt-charity projects".

I shall be replying separately to your letter of 19 April.

*Yours ever,*

*Richard Gozney*

(R H T Gozney)  
Private Secretary

C D Powell Esq  
10 Downing Street



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bc PC

10 DOWNING STREET  
LONDON SW1A 2AA

*From the Private Secretary*

12 April 1989

**INTERNATIONAL ECONOMIC ASSISTANCE  
FOR POLAND**

I enclose a note from George Soros about international economic assistance for Poland. It looks very unrealistic to me: in effect handing over the Polish economy to be run by a group of receivers. But I should be interested in any views, since I have to see Soros shortly.

I am copying this letter to Jonathan Taylor (HM Treasury).

(C. D. POWELL)

Richard Gozney, Esq.,  
Foreign and Commonwealth Office.



## International Economic Assistance for Poland

- 1) A political solution in Poland cannot endure without economic assistance from the West. Indeed, both sides are entering into a social contract in the firm expectation of such assistance.
- 2) The fact that the Polish economy is so devastated creates an opportunity. A comprehensive restructuring scheme, which would be otherwise inconceivable because of existing structures and practices, becomes feasible.
- 3) There are three major tasks to be accomplished:
  - a) restructuring of the international debt;
  - b) monetary stabilization;
  - c) internal economic reform.

The three tasks can be accomplished more effectively in combination than separately.

- 4) The central problem in internal economic reform involves the more effective use of capital. This is the main stumbling block in all reform attempts and it has not been overcome in China, Yugoslavia or Hungary (although the latest moves in Hungary look promising).

The problem is that the interests of capital are not properly represented. Communist systems treat capital as a free good and the function that in a capitalist system is performed by the owner is left unfulfilled. Economic reform has difficulty in dealing with the problem because the owners are missing. Even the managements of so-called independent enterprises are more responsive to political pressures, keeping employees satisfied and making barter deals with third parties, than concerned with maximizing the return on capital.

- 5) The problem could be resolved in conjunction with a debt reorganization scheme. The enterprises owned by the Polish state could be put in trust to serve as collateral for the reorganized debt. The trust could be administered by an independent Agency with the participation of foreign advisors. The Agency would be responsible for selecting and supervis-

ing managements, and it would be empowered to sell companies to investors at home or abroad.

- 6) I believe Poland would welcome such an arrangement because it would bring an expertise that is lacking and give the Agency a stature and independence that would be otherwise unattainable. Polish acceptance would, in turn, demonstrate their commitment to economic reform and justify Western participation.
- 7) Foreign advisors would also participate in running the central bank and controlling the domestic money supply. This would give the central bank the independence needed to carry out a successful monetary reform. Monetary reform would, in turn, be made possible by a reorganization of the international debt and a reduction in debt service payments.
- 8) The foreign advisors would be engaged as individuals, not as representatives of foreign governments. The two functions -- managing state capital and managing the money supply -- would be kept separate, much as the IMF and the World Bank are separate.
- 9) There would be a three-year moratorium on Paris Club debt. After that time, if the Paris Club is satisfied with the performance of the Agency, it would exchange the debt into preference shares of the Agency. Interest would be fixed at a relatively low rate, say 3 to 5%. In addition, the Agency could use part of its income, especially the part coming from the sale of assets, to repurchase its preference share through an auction process.
- 10) To flesh out this proposal, I suggest setting up an international task force with the participation of all interested parties. To keep the discussions informal, the task force could, if necessary, be sponsored jointly by the Rockefeller and Soros Foundations.

George Soros  
April 10, 1989



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George Soros  
April 10, 1989



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STEFAN BATORY TRUST  
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(Reg. Charity No: 327797)

29th March, 1989.

Mr. Charles Powell,  
The Prime Minister's Private Secretary,  
10 Downing Street,  
London SW1A 2AA.

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Dear Mr. Powell,

Encouraged by the progress of the round table talks in Poland and the likelihood that a new "social contract" will soon be concluded between the Government and the opposition, Mr. Soros has been giving some thought to the problem of the Polish debt. He has put down his ideas on paper at the request of Mr. David Rockefeller (whom he hopes to involve in the preparation of his plan) and has asked me to pass them on to the British and the Polish Government for comment.

Mr. Soros will be in London for the last week in April and most of May and may actually go to Poland to discuss his ideas. His address is:

in case there was need to contact him directly.

Yours sincerely,

Zbigniew Pelczynski

Enc.

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**F A X**

March 24, 1989

To: Dr. Zbigniew A. Pelczynski

From: George Soros

David Rockefeller asked me to put my idea in writing. Here it is. You may pass it on to the Polish and British governments to get their response.

Best,



### International Economic Assistance for Poland

- 1) A political solution in Poland cannot endure without economic assistance from the West. Indeed, both sides are entering into a social contract in the firm expectation of such assistance.
- 2) The fact that the Polish economy is so devastated creates an opportunity. A comprehensive restructuring scheme, which would be otherwise inconceivable because of existing structures and practices, becomes feasible.
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- 5) The problem could be resolved in conjunction with a debt reorganization scheme. The enterprises owned by the Polish state could be put in trust to serve as collateral for the reorganized debt. The trust could be administered by an independent Agency with foreign participation. The Agency would be responsible for selecting and supervising manage-



- ments; it would be empowered to sell companies to investors at home or abroad, but sales to foreigners would be subject to a Polish veto.
- 6) I believe Poland would welcome such an arrangement because it would bring an expertise that is lacking and give the Agency a stature and independence that would be otherwise unattainable. Polish acceptance would, in turn, demonstrate their commitment to economic reform and justify Western participation.
  - 7) The Agency would also participate in running the central bank and controlling the domestic money supply. This would give the central bank the independence needed to carry out a successful monetary reform. Monetary reform would, in turn, be made possible by a reorganization of the international debt and a reduction in debt service payments.
  - 8) The foreign participants in the Agency would act as international civil servants. The two functions -- managing state capital and managing the money supply -- would be kept separate, much as the IMF and the World Bank are separate.
  - 9) Poland's international debt would be converted into long-term obligations of the Agency, preferably with some international guarantees in order to enhance their resale value. Part of the interest would be fixed and part tied to the performance of the Polish economy. In addition, the Agency could use part of its income, especially the part coming from the sale of assets, to repurchase its obligations in the open market.
  - 10) To flesh out this proposal, I suggest setting up an international task force with the participation of all interested parties. To keep the discussions informal, the task force could, if necessary, be sponsored jointly by the Rockefeller and Soros Foundations.

George Soros  
March 24, 1989