



ADDRESSED TO THE GOVERNOR

FCS/82/219CHANCELLOR OF THE EXCHEQUERYugoslavia: Economic Crisis

1. You will recall that when we discussed Yugoslavia's economic problems informally on 23 December, together with Arthur Cockfield and Gordon Richardson, we concluded that we should be ready to reconsider and, if we agreed, improve our contribution to an assistance package once we had more information from the IMF team in Belgrade.
2. Your officials have no doubt reported to you the briefing given by the leader of the IMF team here in London on 30 December. It is clear that the IMF have at last forced the Yugoslavs to face up to the structural changes they need to make to their economy if it is to survive in the competitive world of the 1980s. The IMF also made it clear, however, that without an assistance programme, Yugoslavia's economy would almost certainly collapse early in 1983. This would have long term political and also important economic consequences, for the UK as well, given our position as Yugoslavia's leading official Western creditor. On the political side, the collapse of the Yugoslav economy would lead to a collapse in the authority of the present relatively competent Government; they might be replaced by a more inward looking group, whose sympathies are thought to lie in stronger links with the East. Whether this assessment is accurate or not there can be absolutely no doubt that a failure to sustain Yugoslavia's economic links with the West must lead to a considerable strengthening of Yugoslavia's already growing links with the East, and above all the Soviet Union. The long term strategic implications of this are clear.
3. Against this background we have now to decide on our line at both the next meeting of the Western Creditors Group on 6/7 January in Berne and thereafter at the BIS central

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banks' meeting in Basle on 10/11 January. If agreement to assist Yugoslavia is not reached at both these meetings, then the IMF consider that the chances of averting an uncontrolled default by the Yugoslavs in January are slim.

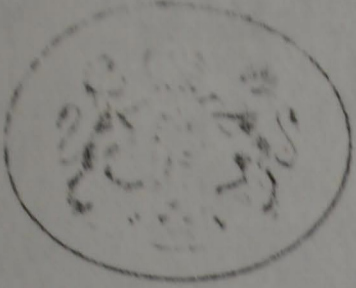
4. I understand that / ^{following} discussion among officials our position for the Berne meeting is likely to consist of the following elements:

- (a) Agreement to allow \$65 million medium term commercial credit already in the pipeline for 1983, to stand;
- (b) An offer to refinance \$65 million of UK Government backed maturities falling due in 1983;
- (c) Continuation of approximately \$25 million short term credit.

I recognise that for a country in Yugoslavia's present economic situation, such an offer would by normal standards be considered generous. Nevertheless, at the last creditors' meeting on 17 December we put forward a package on substantially similar lines and it was not considered to provide the sort of contribution which might be expected from one of Yugoslavia's leading Western partners, taking into account also the political importance of the problem. I therefore hope that we can improve our position at the next meeting by offering a further \$45 million medium term commercial credit, which would bring our total contribution to \$200 million. I think such a move very important if we are to convince both our friends and the Yugoslavs that we are taking this Yugoslav crisis as seriously as it deserves.

5. As far as the BIS operation is concerned, I also hope that Gordon Richardson will be able to meet the UK share of a collective operation to provide a \$500 million short term bridging loan which the IMF consider a crucial element in the package. I expect he would wish to see the outcome of the Governmental creditors meeting on 6/7 January before deciding on the most appropriate terms for the Bank of

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England's participation. If, however, he should decide that a government guarantee was needed, I would hope that you would be prepared to grant one.

6. In the spirit of our meeting on 23 December, I hope you and the others concerned can agree that this falls within the scope of our existing consensus and can be agreed by minuting in reply without the necessity for a meeting before 6 January. If, however, you or one of the others felt that a meeting was necessary I would hope that it could be arranged as early as possible.

7. I am sending copies of this minute to the Prime Minister, Arthur Cockfield, Gordon Richardson and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'FP', is located in the lower right quadrant of the page.

(FRANCIS PYM)

Foreign and Commonwealth Office

31 December, 1982

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