

CONFIDENTIAL

CONFIDENTIAL

FM BUDAPEST

TO DESKBY 280900Z FCO

TELNO 239

OF 251615Z OCTOBER 85

INFO ROUTINE EAST EUROPEAN POSTS, WASHINGTON, UKDEL NATO.

KADAR'S VISIT TO LONDON: SCENE-SETTER.

SUMMARY

1. KADAR COMES TO LONDON AT A GOOD TIME, AFTER THE NEW YORK AND SOFIA MEETINGS AND BEFORE GENEVA. ON EAST/WEST RELATIONS HE HAS SOMETHING TO OFFER FROM MEETINGS WITH GORBACHEV IN SEPTEMBER AND IN SOFIA: AND WITH HONECKER HERE NEXT WEEK. HE THINKS THAT HE HAS SECURED GORBACHEV'S APPROVAL FOR FURTHER REFORM AND HIS UNDERSTANDING OVER HUNGARY'S ECONOMIC DIFFICULTIES. BUT HE ALSO NEEDS THE HELP OF THE WEST.

DETAIL

EXTERNAL

2. THE HUNGARIANS HOPE FOR A POSITIVE OUTCOME OF THE GENEVA SUMMIT AND BELIEVE THAT THEIR DIPLOMACY, AND PARTICULARLY KADAR'S VISIT TO LONDON, HAS A CONTRIBUTION TO MAKE. HUNGARY'S DIPLOMATIC PROFILE THIS YEAR MAY HAVE BEEN LOWER THAN IN 1984, BUT EVEN AFTER THE 21 JUNE PRAVDA ARTICLE THERE WAS NO BREAK IN THEIR ADVOCACY OF THE ROLE OF MEDIUM AND SMALL POWERS OR IN THEIR EMPHASIS ON THE ESSENTIAL UNITY OF EUROPE.

3. ON THE ARMS RACE, KADAR IS BOUND TO ARGUE POST SOFIA THAT THE CENTRAL ISSUE IS SDI. THE HUNGARIANS ARE DESPERATE FOR AN ARMS LIMITATION AGREEMENT AND A SDI FREEZE. THEY FEAR THE POLITICAL CONSEQUENCES IF THE OCCASION IS MISSED: AND THEY KNOW THAT THEY WOULD NOT AVOID PART OF THE SOVIET BILL FOR STILL HIGHER ARMS EXPENDITURE.

4. KADAR CAN SPEAK WITH SOME CONFIDENCE ABOUT GORBACHEV, HAVING TALKED TO HIM TWICE IN A MONTH. THE HUNGARIANS SEEM TO HAVE CONVINCED THEMSELVES THAT HE IS GOOD NEWS. IN EAST-WEST CONTACTS IN PARTICULAR, HE HAS COME ROUND TO THE POSITION TOWARDS WHICH THEY WERE TRYING TO NUDGE HIS PREDECESSORS. THE HONECKER VISIT HERE MAY ALSO BE SIGNIFICANT: THE TWO SATELLITES WITH MOST TO LOSE FROM EAST-WEST TENSIONS GETTING TOGETHER.

5. ABOVE ALL, THE HUNGARIANS WANT A REDUCTION IN EAST-WEST TENSIONS TO IMPROVE THEIR CHANCES OF WESTERN TRADE, INVESTMENT, TECHNOLOGY AND CREDIT WHICH THEY BADLY NEED IF THEY ARE TO MODERNISE HUNGARY'S ECONOMY, IMPROVE LIVING STANDARDS AND AVOID THE SLIDE TOWARDS SOME GHASTLY RUMANIAN PIT.

CONFIDENTIAL

INTERNAL

INTERNAL

6. THE ECONOMIC PICTURE HERE LOOKS PRETTY BLACK. HAVING COME BACK FROM THE BRINK OF INSOLVENCY IN 1982, THE REGIME CLAIMED IN THE EARLY MONTHS OF THIS YEAR TO SEE LIGHT AT THE END OF THE TUNNEL. DEBT REPAYMENT WOULD CONTINUE: BUT LIVING STANDARDS COULD BEGIN TO RISE AFTER FOUR YEARS STAGNATION. THEY PLAYED THIS TUNE VIGOROUSLY AT THE PARTY CONGRESS IN MARCH AND AT THE ELECTIONS IN JUNE. MANY HUNGARIANS BELIEVED THEM. BUT BUDAPEST WAGS ARE SAYING THAT THE LIGHT IN THE TUNNEL WAS AN EXPRESS TRAIN COMING IN THE OPPOSITE DIRECTION. THE BALANCE OF HUNGARY'S FOREIGN TRADE HAS DRAMATICALLY WORSENE DUE TO A HARSH WINTER, DETERIORATING TERMS OF TRADE, LACK OF COMPETITIVITY, NOTABLY IN THE MANUFACTURING SECTOR, AND TOUGHER DEMANDS FROM CMEA PARTNERS, NOTABLY THE USSR, OVER ENERGY PRICES, QUALITY OF GOODS AND PAYMENT TERMS. THE PICTURE IS PARTICULARLY BAD ON TRADE WITH THE WEST, WHICH MAY BE SUFFERING FROM THE DIVERSION OF SOME OF HUNGARY'S LIMITED HIGH QUALITY EXPORTS TO PAY FOR SOVIET OIL AND GAS.

7. THE REALISTS IN THE PARTY, ALMOST CERTAINLY INCLUDING KADAR, NOW RECOGNISE THAT THEY GOT THINGS SERIOUSLY WRONG AT THE CONGRESS: THAT HARD ECONOMIC DECISIONS WILL BE UNAVOIDABLE: AND THAT THE NEXT FIVE YEAR PLAN WILL NEED TO CONCENTRATE ON INVESTMENT IN ITS FIRST HALF BEFORE LIVING STANDARDS CAN IMPROVE IN THE SECOND. THEY ARE CONFIDENT OF BEING ABLE TO HANDLE THE SITUATION: AND THEY ARE PROBABLY RIGHT. BUT THERE COULD BE DIFFICULTIES. PRICE RISES WOULD BE EXTREMELY UNPOPULAR AND MIGHT BE RESISTED. THERE ARE OTHER SKELETONS IN THE CUPBOARD. HUNGARY'S COMMITMENT TO THE RUINOUSLY EXPENSIVE DANUBE DAM PROJECT (AND TO FUNDING SOVIET GAS PIPELINES) WOULD, IN A MORE OPEN SOCIETY, TAKE A LOT OF EXPLAINING: THEY ARE BAD DECISIONS WHICH WILL PREEMPT RESOURCES DESPERATELY NEEDED TO UPGRADE HUNGARY'S MANUFACTURING BASE.

8. AGAINST THIS GLOOMY BACKGROUND, IT WAS VITAL FOR KADAR TO GET A SYMPATHETIC HEARING IN MOSCOW AT THE END OF LAST MONTH. HE RECEIVED WISDOM IS THAT HE INDEED GOT THE GREEN LIGHT FROM GORBACHEV FOR CONTINUED ECONOMIC REFORM AND, IN PRINCIPLE AT LEAST (AND THE DETAIL WILL BE WHAT REALLY MATTERS), SOVIET UNDERSTANDING OF HUNGARY'S DIFFICULTIES OVER THE NEXT TWO YEARS. HOWEVER, WE ALSO BELIEVE THAT GORBACHEV WARNED KADAR THAT THE LEADING ROLE OF THE PARTY WOULD BE AT RISK IF OPPOSITION IN HUNGARY WAS NOT KEPT ON A TIGHT REIN. IN THE WAKE OF THE MULTI-CANDIDATE PARLIAMENTARY ELECTIONS LAST JUNE, VARIOUS ELEMENTS OF POLITICAL OPPOSITION GOT TOGETHER FOR THE FIRST TIME EVER TO CONSIDER HUNGARY'S COURSE WHEN KADAR GOES: EVIDENTLY THE RUSSIANS DID NOT LIKE IT. THE LAST THING THEY WANT IS TROUBLE IN EASTERN EUROPE WHILE THEY ARE TACKLING THEIR OWN INTERNAL PROBLEMS. THE BANNING OF THE UNOFFICIAL CULTURAL FORUM LAST WEEK AT SOVIET BEHEST (BUDAPEST TELNO 219) MAY BE FURTHER EVIDENCE OF THEIR DETERMINATION TO SHOW WHO IS BOSS.

CONFIDENTIAL

/a.1f.

9. IF KADAR'S EASTERN FLANK HAS BEEN SECURED, THE WESTERN NEEDS ATTENTION. LOWER HARD CURRENCY EARNINGS LIMIT HUNGARY'S CHANCES OF RAISING INDUSTRIAL STANDARDS BY IMPORTING PLANT, PARTICULARLY HIGH TECHNOLOGY. THE SHORTAGE OF DOMESTIC FUNDS FOR INVESTMENT CONTINUES. HENCE THE INCREASED HUNGARIAN EMPHASIS ON FOREIGN INVESTMENT, JOINT VENTURES, AND WESTERN TECHNOLOGY. HUNGARY'S CREDIT WITH WESTERN BANKERS REMAINS REASONABLY HIGH. KADAR IN LONDON WILL BE LOOKING FOR WAYS TO INTEREST BRITISH BUSINESS IN INVESTMENT AND COOPERATION. POLITICALLY IT WOULD BE GOOD IF WE COULD HELP HIM. BUT IT IS HARD TO SEE THIS COUNTRY BEING ABLE TO OFFER MANY ATTRACTIVE PROSPECTS FOR WESTERN DIRECT INVESTMENT.

UNWIN

[COPIES SENT TO NO 10 DOWNING STREET]

LIMITED

EED

SOVIET D

DEFENCE D

RESEARCH D

PLANNING STAFF

EED

NAD

WED

ACDD

CRD

FED

NED

PUSD

PS

PS/LADY YOUNG

PS/MR RIFKIND

PS/MR RENTON

PS/PUS

MR DEREK THOMAS

SIR W HARDING

MR FERGUSSON

MR GOODALL

MR SAMUEL

MR DAUNT

MR DAVID THOMAS

MR LONG

-3-  
CONFIDENTIAL