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CABINET

DEFENCE AND OVERSEA POLICY (OFFICIAL) COMMITTEE
SUB-COMMITTEE ON THE SOUTH ATLANTIC AND THE FALKLAND ISLANDS

FINANCIAL RESTRICTION ON ARGENTINA

Note by the Secretaries

The Sub-Committee will recall that at their last meeting (0D0(SA)(82) 2nd Meeting) the Treasury was invited to report on the effects of financial measures against the Argentine. Attached, for the information of the Sub-Committee, is the text of a note which the Chancellor of the Exchequer has circulated to the Defence and Oversea Policy Committee.

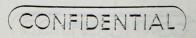
Signed C H O'D ALEXANDER G R G MIDDLETON S D SPIVEY

Cabinet Office 8 April 1982 COMIDEMANA

1. Colleagues may like to have this brief report on the implications and effectiveness, so far as they can be judged at present, of the financial restrictions we have put on Argentina.

#### Freezing of Argentine Assets

- 2. The Order made on 3 April came into immediate operation. It affectively freezes Argentine financial assets in this country, estimated at approaching  $S1\frac{1}{2}$  billion, except where the Treasury gives permission for release.
- 3. Although the Order is widely drafted and can catch many transactions not directly related to assets in this country (to some extent arbitrarily, depending on how the transactions are described and conducted), it does not provide full exchange control powers of kind needed to prevent UK residents from making voluntary payments abroad.
- 4. The Bank of England have been operating the controls under Breasury guidance. They have been responding widely to requests for advice and hope to publish written guidance soon after Easter. Broadly speaking:-
  - (a) Any use of balances here by Argentina to satisfy payments is being refused permission, subject to limited exceptions.



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- (b) The main exceptions are instructions from UK companies in Argentina designed to get money out of their Argentine balances and into UK parent or similar hands, so that they are no longer potentially blocked by Argentine instructions; certain irrevocable letters of credit, bills of exchange, etc., in which the only losers from refusal of permission would be the ultimate UK recipients or the intermediate UK financiers; de minimis payments to prevent hardship for individuals depends on balances in this country (including British employees, returning British residents from Argentina and Argentine residents in this country with no other source of funds); other very minor tidying up cases.
- (c) Generally speaking, and unless there is possibility of by-passing the intention to freeze Argentine assets, no attempt is being made to interfere even where there might be legal power to do so with normal transactions of bank branches, etc., in financial centres outside the UK, or with the entrepot handling by London agents of syndicated international loans, or with roll-over of normal Euro-dollar loans provided no net new resources or shift/resources is involved. Action to interfere in any of these areas would have minimal substantive effect on Argentina, but would bring the UK into conflicts of interest with other financial centres and the Governments and central banks responsible for them.
- 5. It seems that the desired initial effect on Argentina is being obtained. The freeze of assets in the UK probably blocks something approaching one-quarter of the total in all financial centres of Argentine liquid assets. More immediately significant, however, is the consequence for Argentina's standing in capital markets world-wide. The first impact was visible in the withdrawal from the which had been arranged to take place earlier this week, of a British bank which was one of the leaders. Reports from around the world suggest unwillingness to contemplate new occurred towards Argentina and grave worries about existing commitments.

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The focus on the very poor underlying economic position of the Argentine economy is strong, and the massive external borrowing requirement of Argentina during 1982, much of it to service existing debt, has been widely quoted.

- 6. The longer-term effects of our restrictions will depend among other things on the extent to which similar action is taken by our allies, on the continued unwillingness of financial centres to lend oney, and on the Argentine response. If Argentina were driven into formal default, there could be serious implications for the international banking system, whereas the additional strain on argentina would for some time be little if any greater. Argentina has already announced the blocking of transfer to the United Kingdom, presumably including payments to service debt, and may well be short of immediate funds to service debt to other countries. But she could fall into arrears to some extent before the international banking community, or individual members of it, decided that the time had come to declare default. What seems to be virtually certain is that Argentina will have minimal access to any new funds.
- 7. Further points arising on the operation of freezing assets are:-
- (a) It will be for consideration, perhaps early next week, whether permissions should be given to release funds authorised from Argentine sources for payment to UK exporters in settlement of contracts fulfilled before 3 April. One aspect of this is that ECGD is substantially at risk of having to meet payments if permission to use Argentine sources is not granted. ECGD has some £290 million at risk on Argentina under its credit insurance facilities, of which an estimated £72 million is due for payment this year. There is also some £8 million at risk under ECGD Investment Insurance facilities which could be the subject of claims if the Argentine Government retaliates against UK investments.
- (b) Should further legal powers be taken? The potential area which is not cowered (or only very partially and unsatisfactorily cowered) by the Order of 3 April is voluntary payments by UK residents to Argentina. To obtain satisfactory powers would

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involve re-introducing very extensive exchange control arrangements, at a good deal of expense to all concerned. I would be reluctant to contemplate this even if we already foresaw a long period of economic sanctions. Given the ban on imports from Argentina, it seems to me that the likelihood of UK residents wishing to make any substantial payments to Argentina, or incurring significant obligations, is negligible, and it is certainly not worth seeking new and wider powers in that connection. The conclusion is that the Treasury will not need new powers in the planned Emergency Powers Act.

8. Therehas been some criticism of our action in freezing assets the City, but in general the need for such a measure seems to have been well understood, and markets reacted immediately and cooperate. There was considerable concern initially that attempts to interfer with international operations involving London managers, etc., but not drawing on Argentine assets might have been very ill-received in other financial centres, but it is now being realised that we must interfering in that way.

#### Other UK Measures

9. Apart from direct trade measures, we have suspended since just before last week-end all cover for new export contracts to Argenti. This is likely to cause a sharp reduction in trade, even if Argenti does not respond to our import ban by imposing an import ban of the own, but the overall effect will be to make it more difficult for Argentina to obtain necessary supplies.

#### Appeals for Cooperation

10. Appeals have been made to friendly governments to match our action in the trade and export credit field, and to join us in discouraging new international lending, bearing in mind the extradifficult financial position in which Argentina is placed by action we have taken, and by general uncertainties about future developments are limits to the utility of pressing other governments on both because we have in the past refused to respond by direct government action, and because in many countries banking systems and even central banks are independent of government. But the massing action is set the massing systems.

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is getting across, and we shall continue to do what we can to keep before all potential lenders the risks in which they would be ignolving themselves in undertaking new commitments.

#### Alate Effectiveness

11. It has to be recognised that, as so often with economic sanctions, the time-scale in which they can change the policies of the target country may not be very fast. Argentina is a large country, self-sufficient in energy and food, and with a volatile balance of payments on trade in goods which seems at the moment to be marginally in Argentine's favour (the overall balance being a large deficit due to costs of past borrowing). Even a total collapse of oredit would therefore not necessarily cut Argentina off from a flow of imports for cash payment out of export proceeds, and although the disruption of trade must begin to affect the population fairly soon, it might be tolerable for a period if morale were buoyed up from other causes. But there are signs that Argentina has been taken aback, and is now considerably worried, by the extent and seed of our action and its prospective international effects.

#### Further Measures

12. I believe we have taken the most important measures and I have  ${\bf m}$  further measures to propose in the financial field.

M Treasury