



PM/81/53

PRIME MINISTER

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Falkland Islands

1. At earlier OD meetings (OD(80)25th meeting and OD(81)1st meeting), I was invited to consider, in consultation with the Chancellor of the Exchequer, how certain aspects of the Falkland Islands' economic situation could be improved. These related specifically to:

- (i) the interest rate paid to Islanders on savings held in the Government Savings Bank; and
- (ii) the potential for raising capital for the Islands' development.

2. Savings

The interest rate paid by the Government Savings Bank on private deposits (at present 5% tax free) is set at the discretion of the Falkland Islands Government (FIG). This is an internal matter within FIG's competence and we have no locus standi to intervene. The FIG consider that a higher rate of interest would reduce their income without attracting compensatory new deposits. Given the present depressed economic conditions in the Islands it might require them to raise additional taxes or to seek further aid. They point out that Islanders can and do invest their savings overseas, notably in the UK, where they receive the going rate.

3. As I mentioned in my minute of 13 March (PM/81/12), proposals are being carried forward which would transform the Falkland Islands Government Savings Bank into an institution which would offer a wider range of normal commercial services.

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The Falkland Islands' Government have agreed that this should be done and the Bank of England are at present working on a draft ordinance, which will then need to be adapted to the particular circumstances of the Islands. It is hoped that this process will be completed within the next year. While the formation of a commercial bank will not on its own affect the rate of interest paid on private deposits, it will be for the commercial judgement of the bank's manager whether to make the rates more competitive (even if they are unlikely ever to be as attractive as those obtainable in the UK).

4. The Falkland Islands' Government are aware of our interest in this. I believe that we should continue to encourage the formation of the new commercial bank.

5. Capital for Development

We have explored, with the Treasury and with commercial institutions, the scope for securing access to credit for the Falkland Islands' Government. It is clear that private institutions will not lend the FIG even the relatively small sums they are looking for without a British Government guarantee to cover the loan. This attitude stems partly from apprehension about the fate of their investment in the event of the political dispute becoming more difficult, partly from fear of Argentine retaliation against companies' much larger interests on the mainland and partly from inexperience of the Falkland Islands as a risk: the Falkland Islands' Government have never tried to borrow on the open market before.

6. It is open to the Government to issue the sort of guarantee that would be required, with ODA accepting the contingent liability. But we would wish to avoid this. In so far as they build up contingent liabilities which might, at some point, have to be met, guarantees make control of an
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expenditure programme more difficult. And if a guarantee were given in the case of the Falklands, it could well stimulate requests for guarantees from other Dependent Territories. The Gibraltar Government, in particular, has requested a guarantee and been refused. They would certainly renew their demands if the Falklands were to be offered a guarantee, and some other Dependent Territories would probably ask to be assisted in the same way. Finally, issuing a guarantee would entail closer involvement by HMG in the financial affairs of FIG.

7. Although direct assistance from HMG does not appear possible, there are alternatives. One is that the Falkland Islands' Government purchase some of the equipment it needs on credit terms from Britain and that the supplier should be guaranteed by the Export Credits Guarantee Department; FIG are already purchasing road-making equipment on this basis. A more comprehensive and lasting solution would be for the Falkland Islands' Government either to move administration of their reserves from the Crown Agents to a merchant bank (they would then be in the position of a client wishing to borrow from his own bank) or for the Crown Agents to obtain a commercial loan for the Falkland Islands' Government. The Governor accepts that this is the path to follow and is already discussing these options with the Crown Agents. I conclude therefore that we need take no further action at this stage; but I shall ensure that you are kept informed of developments.

8. I am copying this minute to other members of OD, to the Secretary of State for Energy, to the Attorney-General and to Sir Robert Armstrong.

24 November 1981

(CARRINGTON)



24 NOV 1987