

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

ODO(SA)(82)42

COPY NO 86

13 May 1982

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

THE FALKLANDS CRISIS: ECONOMIC RETALIATION AGAINST THE UK BY
ARGENTINA AND OTHER SOUTH AMERICAN STATES

Note by the Foreign and Commonwealth Office

1. This paper assesses the scope for action against British economic interests in Argentina and the threat to British economic interests in other South American countries. It consolidates and updates ODO(SA)(82)23, 24, 28 and 35 which considered these subjects separately.

(a) The Present Position

2. Following the imposition of economic sanctions by the UK, Argentina retaliated by suspending all financial transactions with the UK, including service payments on loans from UK banks. It is understood that payments due to British banks and importers are being blocked in a special account (inaccurately described as an escrow account). But there are unconfirmed rumours that Argentina may make some loan repayments to British banks direct. On 19 April Argentina introduced measures to enable her to ban imports from the UK and from those countries which had, at our request, taken economic sanctions against her, while allowing for exceptions.

3. On 17 April declarations supporting Argentina and deploring the EC import ban were issued by the Andean Pact and other regional Latin American organisations. But these statements had no economic impact and no direct

offers of help to Argentina were forthcoming. At the OAS meeting on 26-28 April Argentina made no attempt to promote a resolution calling for economic measures by signatories of the Rio Treaty against the UK because of clear divisions among OAS members. The resolution finally adopted made no reference to such measures although it deplored the Community import ban and called for its early removal. It did however keep open the possibility of reviewing at a later stage whether additional measures were needed to bring the dispute to a peaceful conclusion.

4. No further economic measures have been taken by other South American governments to date, though the Venezuelan President has said that the contract to supply the Hawk aircraft (see paragraph 10) is now on ice. Peruvian and Venezuelan dock workers, without Government backing, have imposed a sporadic and selective boycott of British ships. Peruvian airport workers have gone further and threatened to refuse to handle British aircraft and cargoes. (This is covered in greater detail in ODO(SA)(82)38.) However there are indications that the Peruvian Government would intervene to prevent any such action.

5. There has been some withdrawal of Venezuelan dollar deposits from London and there is evidence that some British banks are becoming nervous about lending to Venezuela.

(b) British Economic Interests in Argentina

6. Our exports to Argentina are predominantly of machinery and power generation equipment. In 1980 they amounted to £173 million (1981 figures not available). Because of the recession in Argentina it is likely that 1982 figures will show a significant drop, even before the Falklands crisis. Argentina is nevertheless our third largest market in Latin America, although only 42nd in our world table of trading partners. Shipping and airline interests are not insignificant: shipping generates some £12 million per year; British Caledonian (the only British

airline flying to Argentina) earns about £9 million per year (about 30% of total earnings in Latin America and 10% of total revenue). About 60% of our exports are covered by ECGD who have firm commitments for business worth £290 million. We have just over 3% of Argentina's market.

7. The UK has about 8% of Argentina's foreign investment, the book value of which may be around £250 million. This represents about 15% of our total investment in South America.

8. The claims of all UK banks on Argentina were US \$5.8 billion at the end of 1981. The claims of UK registered banks alone were US \$3.6 billion making us Argentina's second largest creditor after the USA. Barclays Bank and Lloyd's Bank International lend on the domestic Argentine market. They are understood to have lost deposits heavily in recent weeks, as have other banks.

(c) British Economic Interests in main markets of Latin

9. 'The attached Annex gives details of British trade with and investment in the main countries of South America (other than Argentina), and Mexico. Brazil and Mexico are the most important UK markets taking 28.5% and 25% respectively of our exports to these countries totalling £762 million (excluding invisibles) in 1980 (1.5% of total UK exports). This importance is also reflected in UK investment in these countries of which Brazil has far and away the largest amount. Our imports from these countries totalled £824 million in 1980 (1.6% of our imports from all sources). UK bank loans amounted to some US \$32.5 billion with offsetting liabilities ie, assets in London of US \$13 billion. By far the largest amounts of loans were for Mexico, Brazil and Venezuela; for Venezuela assets in London exceed loans outstanding.'

10. British companies stand to gain from valuable public sector contracts in South America eg, in Brazil negotiations continue successfully on projects worth nearly £400 million which have not been affected by the Falklands crisis. In Venezuela a £200 million contract for the supply of Hawk

aircraft was agreed in March. UK companies are also bidding for substantial transport and naval port facility construction contracts in Panama and Peru.

(d) Impact of Economic Retaliation against the UK

(i) By Argentina

11. The Argentine measures taken so far are unlikely to have a significant impact and could be quickly reversed, like our own. If they went further eg, by restricting domestic operations of British companies and/or abrogating contracts (as has been rumoured in press reports), there would be some inevitable losses and claims of up to £300 million against ECGD. But there should be no serious damage to UK total exports, industry or employment, though some individual companies might suffer.

12. British companies' and banks' investments in Argentina are not significant in relation to their global operations and confiscation/nationalisation of their assets would not cause major damage. Lloyd's Bank International are the most seriously exposed, but the Chairman has said publicly that the risks are within their prudential capacity. The repudiation of Argentine debts to British banks would be more serious and could cause considerable damage to the international banking system. But Argentina would have strong reasons for avoiding such a course, even in the event of all out war, because of the damage it would do to her reputation in the international market. She has indeed been at pains to show that loan repayments will continue. Even so, in the emotional climate which an escalation of the fighting could generate, such a step could not be ruled out.

(ii) By other Latin American Countries

13. A general Latin American export/import embargo would not have a severe impact on the UK economy although further discrimination against UK companies in public sector project business might adversely affect our long-term commercial interests in Latin America. The

halt of loan repayments would be harmful, but South American countries must be aware that if they were to take this action as parties not directly involved in the dispute it would make banks everywhere extremely cautious in lending to them. These arguments apply to attracting much needed overseas investment as well as to loans.

14. If other Latin American countries join with Argentina in taking economic action against us by far the most serious risks would be in Mexico, Brazil and Venezuela. However, Mexico and Brazil seem unlikely to go far in this direction: Mexico in particular is giving little support to Argentina. Brazil (like most others) cannot risk upsetting banking confidence, a point that has been made by the Brazilian Minister of Planning, Delfim Netto, in urging moderation on his Ministerial colleagues. Venezuela has hitherto been the most hostile towards the UK; but her uncertain economic situation combined with a soft oil market, should work as a deterrent. Chile, Brazil, Venezuela and Peru have however indicated that a British attack on main-land Argentina could radically alter the situation. In such an event, moderate OAS members would find it difficult to resist calls for economic sanctions.

Conclusion

15. The risk of economic sanctions being applied against us by South American countries other than Argentina has so far been avoided, although the climate for future trade may well have been soured, particularly in Venezuela. But the danger will increase if fighting grows worse and leads to greater loss of life. Argentina may then find herself obliged to take drastic action against British economic interests, if only as a sop to domestic public opinion. Other Latin American countries would also be more inclined to take tangible measures either on a national basis or in support of mandatory resolutions under the Rio Treaty. But economic measures in other

countries against us are likely to be implemented without enthusiasm except perhaps in Venezuela.

16. In trade terms, the immediate impact on the UK is not likely to be great. A general repudiation of bank loans, although unlikely, could however have serious repercussions for the world banking system. We would also stand to lose from a trade and financial war with South American countries in both political terms and in terms of what those countries offer in the way of expanding trade and investment opportunities: this is particularly true in the case of Brazil. In the event of a break in trading relations, Latin American countries would have little difficulty in replacing the UK as a supplier while we would find it much harder to acquire new markets.

Foreign and Commonwealth Office

13 May 1982

TRADE 1980

INVEST
MENT

UK BANKS

	<u>TRADE 1980</u>		SITC 7	Book Value 1978 £m	<u>UK BANKS</u>		<u>ECGD Liabilities</u>	
	UK Exports £m	UK Imports £m			31 December 1981 Liabil- ities US \$m	Claims US \$m	Sect I £m	Sect II £m
Mexico	188.1	111.6	121.1	98.1	1986	12139	577.1	218.9
Colombia	41.9	34.3	21.1	12.7	1058	823	26.1	0.7
Venezuela	131.7	117.6	39.7	12.7	7174	5023	51.0	0.5
Ecuador	30.9	8.8	14.8	n/a	41	749	31.2	17.2
Peru	46.5	77.5	25.1	7.7	148	657	41.7	53.1
Chile	55.7	126.3	27.5	35.6	1174	1984	24.2	14.9
Bolivia	8.7	33.2	3.1	n/a	63	152	13.9	17.3
Brazil	218.2	296.4	118.0	678.2	1240	10742	197.6	729.1
Paraguay	13.4	1.3	1.1	n/a	n/a	n/a	2.6	12.9
Uruguay	26.6	16.9	13.3	4.2	190	248	8.4	0

CONFIDENTIAL

CONFIDENTIAL

ANNEX