



Prime Minister *Wm 9/8* 1
 As things are, the Argentines will not get the next IMF drawing due on 20 August. If they come under financial pressure, the matters discussed in this note could suddenly come to a crunch.

So are you content with:-

Treasury Chambers, Parliament Street, SW1P 3AG

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i. The line we are taking in the IMF and particularly with our minimum conditions for the next IMF drawing (para. 6)?

ii. The line we are taking with the US, e.g. on the Argentine interest in fishing in the Falklands exclusion zone (para 8)?

1 August 1983

iii. The position we would take

(a) in the IMF

(b) with British banks involved in the commercial loan

if unexpectedly support in the IMF swings away from us?

F E R Butler Esq
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 London SW1

Dear Robert,

ARGENTINA/IMF

The second tranche of Argentine drawings from the IMF under the agreement reached on 24 January this year is due to be available on 20 August, subject to satisfactory economic performance and subject also to the requirement that discriminatory exchange restrictions (against the UK) should have been removed by 31 July. Argentina has met the performance criteria laid down by the IMF, but has not yet fully removed the discriminatory exchange restrictions.

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2.8.

... I attach a note, agreed by the Chancellor and the Foreign Secretary, explaining the present position and proposing the line which HMG should take, both in relation to the IMF loan, and in relation to the participation of British banks in a dependent international commercial loan. We believe that the IMF will not agree to the second tranche drawing, and that the commercial loan will therefore not go ahead, unless and until discrimination is removed, de facto if not de jure. But the note also covers what our policy should be, if things go badly. The Chancellor would be grateful to know if the Prime Minister agrees.

Copies of this letter and the attached note go to Brian Fall at the FCO and John Bartlett at the Bank of England.

Yours ever,

J O Kerr

J O KERR

ARGENTINABackground

The IMF Executive Board agreed on 24 January 1983 to an IMF programme for Argentina supported by a 1.5 billion SDR Stand By Arrangement. The next drawing under this arrangement becomes available on 20 August, conditionally upon Argentina having met the performance criteria laid down by the IMF under the programme. In addition to the normal economic performance criteria the programme required Argentina to have removed by 31 July discriminatory exchange restrictions against the UK. This condition was inscribed at UK insistence, but with the ready agreement of others in the IMF Executive Board, because discrimination in current payments is prohibited as an important IMF principle.

2. The discriminatory restrictions were introduced by Argentina in April 1982, in parallel with the UK action to freeze Argentine assets in this country. They were imposed under Law 22591, explicitly aimed against UK-owned banks and companies in Argentina. When parallel removal of Argentine and UK restrictions was being considered last Autumn, with the Argentine financial authorities anxious to make progress in order to clear the way for IMF assistance, but the military authorities resisting, the best the former could achieve was the enactment of a further Law 22820 which enabled the first Law to be over-ridden. Given evident good will on the part of the Argentine financial authorities, and the international interests in a financial rescue operation which could contribute to saner Government, HMG decided to accept reciprocal removal of restrictions on this basis. (Consideration was briefly given to the possibility of keeping the UK Order in being and over-riding it by general permissions, but this would have been a pointless way of proceeding in dealing with a stock of frozen assets, rather than a continuing flow of transactions, and the UK proceeded by simple revocation of the original Order. We did this, even though we knew that the Argentinians would keep their law on their statute book).

2. The Argentine financial authorities have made some progress - although slowly. Within the last month or two, the restrictions have effectively been over-ridden in favour of UK banks, where the debate locally has doubtless been helped by the desire to encourage the international commercial loan in which UK banks have been expected to play a part. But discrimination appears still to be in full force against UK companies other than banks.

4. There is an additional potential problem of discrimination. Argentina at present maintains considerable non-discriminatory restrictions to limit foreign exchange costs. There have been suggestions of an easing of restrictions to be introduced on 15 August which, however, would not be applied to UK companies and banks. If this happened, an additional element of discrimination would arise, like the first against British interests and in breach of the IMF principle of non-discrimination.

IMF Drawing

5. Formally, the position is that Argentina cannot take a further drawing unless:

- Discrimination has been removed; or
- the IMF grants a waiver.

The grant of a waiver would require approval/acquiescence by a majority of members of the IMF Executive Board, in which the UK alone could not block a decision. There could also be scope for judgment on the first point. The attitudes of the IMF management and of other leading countries therefore matter considerably.

UK Requirements

6. Ideally, the UK would want to see the original Argentine Law 22591 repealed, thus removing the basis for present and future discrimination. This is not only a matter of presentation: it must be judged a little less likely that Argentina would reintroduce discriminatory legislation than resume use of existing legislation

in future. But it has to be recognised that the IMF and other countries, particularly the United States, will be looking for a pragmatic solution, and are therefore likely to be content with de facto removal of discrimination without insisting on repeal of the Law. At present we are continuing to urge on the IMF managing director and the United States Treasury the importance of removal of the Law, particularly in the light of possible renewed discrimination after 15 August. But this may not succeed. In that event, it is important to specify the minimum conditions under which the UK should be prepared to acquiesce in a further IMF drawing. It is proposed that these conditions should be:-

- a. Firm evidence in practice that the discriminatory restrictions have been lifted, with payments on behalf of UK companies which are now blocked having been allowed through before any further loan tranche is released.
- b. An IMF requirement accepted by Argentina that discriminatory restrictions would not be reimposed. A statement should be required in writing from the Argentine authorities to this effect, with specific reference to future liberalisation being extended in a non-discriminatory way.
- c. Agreement in the Executive Board that, if discriminatory restrictions were reimposed, IMF drawings would be suspended (in practice this would mean obstructing the final two drawings due on 20 November 1983 and 20 February 1984).

Attitude of other Countries

7. We have been canvassing vigorously for support of other countries. There have so far been good responses from some important countries, including the United States, Germany, Netherlands. If such support is maintained, we should be able to obtain our minimum conditions, which are in themselves reasonable and fully in accordance with IMF principles. There has been some sign recently that Argentina, which has been attempting

some canvassing on its own account, is aware of considerable strength of support for the UK position. At an earlier stage they seem to have been planning a request for a waiver, whereas recent indications are that they fear that their application would fail.

8. Meanwhile, it is reported that the Argentine external payments position is deteriorating, which will both strengthen pressure on them to come to terms, and also strengthen the desire of some other countries, possibly including the United States, to look for a compromise solution. The US have been active in cultivating contacts with Argentina, particularly exploring possibilities of a concession by the UK on fishing rights as a face-saver to make it easier for Argentina to remove financial discrimination. We have been trying to demonstrate to the United States the reasonableness of our position and our willingness to consider any constructive proposals which do not endanger the security of the Falkland Islands. We certainly do not want to rebuff United States good offices. Our aim should be to get across the point that it is always open to Argentina to seek our agreement to bona fide fishing in the protection zone. But it is not for the UK to make concessions to buy Argentine fulfilment of this long-standing undertaking.

9. We need to consider what our policy should be if we were in fact to lose support.

If the UK were Isolated

10. If the situation arose in which a majority of members of the IMF Executive Board were prepared to let Argentina off the hook, without the kinds of minimum conditions satisfactory to the UK which were set out in paragraph 6 above, there would in principle be the choice:

- a. To keep the negotiations in being and seek a fall-back position - presumably involving some further "best endeavours" or revised date for compliance.
- b. To force the issue by calling for a vote, formally or informally, in spite of the fact that, in the circumstances, we would expect to lose.

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11. On the one hand any undertakings in a fall-back position would not be worth the paper they were written on. On the other hand it would be an uncomfortable break with precedent in the IMF to demand a formal vote. The outcome would inevitably be seen as a defeat for the UK and a technical victory for Argentina. It would be damaging to UK public and Parliamentary opinion towards the IMF, and would inevitably affect HMG's attitude to the IMF.

12. Nevertheless, our judgment is that the UK could not respectably acquiesce and would therefore be obliged to call for a vote and register its protest in that way. The unfortunate consequences are a point which is being made in pressure on the IMF and the United States to continue their support for us and the IMF principle on which we are relying.

British Banks

13. One part of the overall arrangements to help the Argentine economy, with the IMF in the critical central role, was mobilisation by commercial banks of a commercial loan of \$1.5 billion, with leading world commercial banks participating in some ratio broadly appropriate to their earlier engagement in Argentina. A number of British banks are involved, with Lloyds and Barclays as the most important, to a total of about \$159 million. The loan has not yet been signed. Even after signature, drawings on it are conditional upon a certificate from the IMF stating that performance criteria have been met and IMF drawings are continuing.

14. The British banks have been persuaded to see it as being in their own interest for the time being to refrain from signature. This is likely to continue until the IMF situation is clarified. Arrangements have however also been made to ensure that, if for any reason of external pressure the British banks reached the conclusion that they wanted to sign the agreement, they would give adequate notice to the Bank of England to enable the Bank with HMG to convey a request not to sign, which the banks would be prepared to obey, but would quote to their international colleagues as their reason.

15. It seems right to hold this position until the IMF situation has become clear. At that point, we have two possible scenarios:-

a. If IMF drawings are resumed, UK minimum conditions having been met so that the UK have acquiesced in the IMF decision, it is recommended that HMG would not be in a position to seek to prevent British bank participation. But more general political considerations in relation to Argentina suggest that the Government should distance itself from any decision by the banks on their own commercial judgment to participate. Depending on timing and other conditions, it might also be worth suggesting to the British banks that it would be prudent for them to delay signature to ensure that no additional discrimination was introduced on 15 August. (See paragraph 4 above).

b. If an IMF decision were taken against UK protest, the government would want to prevent the British banks from signing. There is very considerable legal doubt about the power of the government to issue formal directions in a case of this kind, which involves specific commercial business by banks. The banks would certainly prefer to avoid such formal directions. It is suggested that the government should indicate, through the Bank of England, that it would regard participation by British Banks in the circumstances as being ill-judged, and be prepared to say so publicly. This would place the British banks in considerable difficulty, with a conflict of interest in safeguarding their relations with commercial banks of other countries and their existing exposure in Argentina, against the undoubted political embarrassment domestically with government, shareholders and clients.

Other Action

16. We have considered whether, in the event of a vote against the United Kingdom in the IMF, there is other action which could be taken. Only two possibilities seem to be worth mentioning:-

a. One would be to reimpose some or all of the restrictions which were removed last September. This might seem to be an appropriate parallel response to the failure of Argentina to remove restrictions in practice. However, it would have little practical effect, since there would be few, if any, Argentine funds remaining in London. The operation could therefore seem derisory, while giving an excuse to Argentina to continue its restrictions. This possibility should therefore be rejected.

b. The second is diminished cooperation with the IMF, one possible example being refusal to participate in a financial bridging operation which the IMF are likely to need in advance of the flow of additional resources from increased quotas due next year. Such a response could well be forced by Parliamentary and public opinion and will need to be considered at the time. More immediately, its importance may be as an argument to persuade the IMF, United States and others to maintain support for the UK position.