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Treasury Chambers, Parliament Street, SW1P 3AG
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PRIME MINISTER

~~Prime Minister ②
This is the note you asked for at
Cabinet on 3 November. You will
want to discuss it but~~

ARGENTINA

Noting the possibility of resumed US arms sales to Argentina - the risk of which has since increased - Cabinet on 3 November invited the Foreign Secretary, in consultation with me, to review our policy on debt relief for Argentina.

2. The attached paper, prepared by the Treasury in consultation with the FCO and the Bank, has been seen and agreed by the Foreign Secretary. It raises no immediate issues, and you may wish to defer any Cabinet discussion until the Foreign Secretary's return.

3. Copies of this minute and enclosure go to the Foreign Secretary, our other Cabinet colleagues, the Attorney General, the Chief Whip, and Sir Robert Armstrong.

A handwritten signature in blue ink, appearing to be 'N.L.'.

(N.L.)

5 December 1983

ARGENTINA: ARMS SALES AND BANK LENDING

Cabinet on 3 November commissioned an examination of ways in which British banks could be stopped from lending money to Argentina, which might help finance purchase of arms from the USA. That remit has been partly overtaken by events, relating to an initial round of disbursements under an existing loan agreement (see below). But the problem will be likely to arise in future, over further disbursement of the existing loan, or over new loan agreements or any new IMF programme.

2. After an account of disbursements under the existing loan, the remainder of this note examines the scope for future action, and concludes:

(i) Where there is an existing loan agreement and its conditions are fulfilled, the British banks could only be prevented from disbursing their shares by primary legislation which might entail breach of contract;

(ii) If British banks alone were prevented from participation, the major row which this would create could well hurt the United Kingdom more than Argentina, at least financially;

(iii) It would be possible to prevent British banks from participating in any future loan, but this would have little effect on Argentina and could damage UK interests.

Recent Developments

3. In August, after the IMF at our insistence had persuaded Argentina to take steps to end discrimination against the UK in certain financial payments, international commercial banks, including British banks, signed a long-planned agreement for a loan of \$1.5 billion to Argentina. The share of UK-based banks is just over 10%, of which British-owned banks account for 7%. The first tranche of \$500 million was intended to be drawn pari passu with the May 1983 drawing on the IMF, but was repeatedly postponed, largely because of failure by Argentina to satisfy certain criteria relating to arrears and rescheduling of public sector debt. That first tranche is destined to return immediately to the lending banks: \$350 million retained in

settlement of the instalment due on an earlier bridging loan; and the remainder to be paid into a special escrow account from which other arrears outstanding to the banks would be settled.

4. During November, considerable pressure developed, primarily from United States banks, to implement the first disbursement, in order to settle earlier arrears and thus improve the appearance of bank balance-sheets by 30 November. To this end, all participating banks were being urged to agree to waive various unsatisfied conditions.

5. When it became clear on 22 November that a recommendation from the banks' Advisory Committee was imminent, Ministers decided:

- to ensure that the IMF approval still stood, despite Argentine failure to meet all the criteria of the Fund programme and the consequent de facto suspension of further drawings on the IMF;
- to make it clear to the British banks that HMG thought their action premature and ill-advised; but
- not to attempt to block the operation or participation by British banks in it.

Ministers also decided to say, in response to press or parliamentary criticism of the loan, that it was a matter for the commercial judgment of the banks, but that HMG considered the disbursements premature, before there had been opportunity for the new Argentine Government to establish new and satisfactory arrangements with the IMF.

6. In accordance with the first point, the IMF Managing Director was approached, and he reported to the Board late on 22 November that he had told the banks that the IMF welcomed their proposed disbursement: there was no dissent and the banks took this as a clear signal to go ahead. They did so on 2 December.

7. Ministers have not taken, nor are they at this moment called upon to take, any view on further disbursements under the loan signed in August. It appears to be the clear understanding among the banks

concerned that there will be no further disbursements until there is a satisfactory new programme agreed with the IMF. This condition was not held to apply to the first tranche, partly because of its link with settlement of arrears, and partly because it was regarded throughout as being an overdue transaction linked with the position last May.

8. No further loan agreement is currently being considered. But, given Argentine balance of payments prospects, fresh lending will almost certainly be sought during 1984, although probably not until the new government is firmly in office and has negotiated a fresh IMF programme.

The IMF Programme

9. The IMF agreed in January 1983 to a standby facility for Argentina totalling SDR 1.5 billion to be drawn in stages over 15 months. Drawings are conditional on economic performance criteria. So far only two drawings, totalling SDR 600 million, have been made. Since May, further drawings have been suspended, first because of continuing discriminatory payments restrictions against UK companies (now removed) then because of unsatisfactory performance on clearance of other payments arrears, and most recently because of the deterioration of Argentine economic performance and the need to establish a fresh programme with the new Argentine government. Indications have been that the new government does want to get into early negotiations with the IMF.

Options For Government Action: Loans by Banks

10. If the commercial banks are satisfied that the loan conditions have been met, participation in the August agreement would be legally enforceable. A distinction therefore has to be drawn between the remaining drawings under the August loan, and any future loans. There are four options:

(a) Instructions to the Banks

A direction by the Bank of England under the Bank of England Act might be sufficient to prevent British banks signing a new loan agreement. However, given that the August loan documentation has been signed, a direction under this Act to desist from actual disbursement would almost certainly be ultra vires. This is one

reason why no action was taken in respect of the November drawing.

(b) Sanctions and Exchange Control

Reintroduction of the sanctions originally imposed at the start of the Falklands conflict under the Emergency Laws (Re-enactments and Repeals Act) 1964 would require the Treasury to be satisfied that Argentina is taking, or is likely to take action to the detriment of the economic position of the UK. This option was not pursued in the case of the November drawings. It remains open in respect of future drawings or of new loans. But it would be hard to establish that potential sales of US arms to Argentina had this effect, at a time when there is no active conflict. Other powers available to the Treasury under the Exchange Control Act 1947 are also constrained.

(c) Primary Legislation

Fresh primary legislation remains a possible option. It could in principle be made retrospective, so as to forbid disbursement under the August agreement. (There could be some embarrassment, but not insuperable, in doing so for subsequent tranches when the first had been allowed to proceed.) But, as with any action of this kind, legislation could well lead to action being taken in foreign courts against the banks for breaking their contract and to demands for compensation from H.M.G. No such objection would lie against legislation to forbid British banks participating in any new loan agreement.

(d) Pressure

A further option would be to secure the non-participation of British banks by a mixture of persuasion and the threat of public opinion. Once a loan agreement had been signed, the banks would be in a strong position to resist. They have not been deterred by the threat of publicly-expressed Government criticism of the November drawing. If they bowed to pressure on a future occasion, they would lay the blame on H.M.G., and might seek compensation for any losses incurred. They might be more susceptible to pressure in the case of new loans but experience earlier this year is not encouraging and the banks would want the Government's involvement made public.

11. For the future, the banks now understand that they must consult the Government again before making any new loan agreements with Argentina. If we wanted to stop them where their judgment was to participate, the choice would lie between a direction and fresh legislation. The Bank of England has already told Lloyds Bank International (as coordinator for the British banks) that the Government should be kept informed about proposals for future disbursements under the August agreement and for future loans.

Possible UK Action on IMF Programme

12. As an alternative to action targetted on the banks, H.M.G. could take action at the IMF to try to block the Argentine programme and thus seek indirectly to frustrate the bank agreement. The question will arise some time in 1984, when a new Argentine programme is likely to be presented to the IMF. To attempt to stop the new programme would introduce a direct political element into Fund judgments. We doubt if this would be successful, and it would be an awkward precedent for the future.

Official Rescheduling

13. One further possible instrument, mentioned in the Cabinet discussion, but not involving the banks, is to withhold UK participation in rescheduling of official debt should the new Government seek that. The UK could not veto a Paris Club rescheduling but it could refuse to join in. However, the effect would be that other creditors would take precedence over the UK in obtaining a share of any money available for debt service. Assuming Argentina continued to withhold payment on non-rescheduled debt, it would still secure the benefits of debt relief to its balance of payments, which would release resources for arms purchase.

Implications of Financial Measures

14. For H.M.G. to take overt action to frustrate an existing agreement would run counter to our policy of seeking to restore more normal relations with Argentina especially in financial and commercial matters. Similar arguments apply to future agreements or new IMF programmes.

15. There are also banking considerations. Technically, the full support of the British banks is needed for any further drawings under the August agreement. If this were withheld, Argentina could well be entitled to claim damages for breach of contract and might be tempted to take economic reprisals. In the case of future loans,

the political convenience of not having British banks involved has to be weighed against the reality that Argentina would not in fact be put under any severe financial pressure by their absence. In the view of the Bank of England, British non-participation as a result of explicit government action and in the absence of any new moves by Argentina generally seen to be inimical to HMG's interests, would also damage the UK's ability to influence the handling of debt problems in the wider context, as well as hurting London's position as an international financial centre.

HM Treasury
5 December 1983

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