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10 DOWNING STREET

From the Private Secretary

23 December 1983

Top Copy on Economic
Policy, Indebtedness,
Pt 3
cc Master

Dear John

Argentina: Arms Sales and Bank Lending

The Prime Minister held a meeting yesterday with the Chancellor, the Foreign Secretary and the Solicitor General. They considered the paper attached to the Chancellor's minute of 5 December.

The Prime Minister was concerned that the Government could be accused of permitting British banks to lend to Argentina who could use the money to finance weapons for use against Britain. She found this a very difficult argument to counter.

The discussion turned to the current loan agreement for \$1.5 billion, of which \$0.5 billion was drawn on 30 November. The Prime Minister said that the Government had reluctantly acquiesced in this when it was signed in August as, at the time, it was told that to oppose it would exacerbate the international debt crisis. The Chancellor said that the Government had not been shown a copy of the loan agreement but had been assured by Lloyds Bank International, who are the British bank represented on the Committee of International Banks dealing with Argentine debt, that the agreement constitutes a legally binding contract enforceable in the New York courts. Participation by British banks in further drawings could be stopped only by primary legislation which would open the Government to claims for damages. This interpretation was confirmed by the Solicitor General.

The Prime Minister asked about the conditions under which further drawings were made. The Treasury's latest report on the international debt scene had referred to the possibility of a drawing as early as mid January. This was puzzling as the new Argentine Government could not by then have established a new agreement with the IMF. Would the next drawing be a further arrears-clearing exercise like the first?

The discussion then turned to future loans to Argentina. The Solicitor General said the power of the Bank of England to issue instructions had to be general; it could not be directed at specific customer transactions. It was therefore unlikely that

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instructions could be used to prevent further loans. The Chancellor said the only other course was primary legislation which was extremely unattractive. Furthermore, it was not possible, in the IMF, to impose political conditions on its lending.

His preferred approach, therefore, was to work within the IMF to ensure that the new Argentine programme had tight limits for public expenditure, and that public expenditure should be directed towards strengthening the base of the economy, and in particular exports. This would limit the scope for arms purchases. In addition, he would ensure that the Government was given advance warning via the Bank of England of any further drawings or any new loans. He recognised the political problems though he thought the reality was that the absence of British banks, who provided only about 10% of current lending to Argentina, would not seriously limit Argentina's ability to buy arms. The Prime Minister said it might also be necessary to make clear to British banks that the UK Government would deplore their participation.

Summing up, the Prime Minister said the political prospect was very unattractive. If it were the case that the present agreement was legally binding, all she could say, if questioned, was that this was a matter for the banks and not the UK Government. The latter had not approved the agreement, nor even seen the detailed terms. On future loans, the Chancellor should establish an advance warning system. The Government should work to make IMF programmes, on which bank lending was based, as tight as possible. Nevertheless it might be necessary for the Government to make it clear that the participation of UK banks would not have its endorsement. She asked the Chancellor to prepare a further note clarifying, as far as possible, the conditions under which further drawings of the existing loan could be made and whether they were in any way dependent upon the establishment of a new IMF programme. She asked the Solicitor General to consider whether a general instruction could be issued by the Bank forbidding lending by UK banks to a country in a state of hostilities with the UK.

I am copying this letter to Brian Fall (Foreign and Commonwealth Office), Henry Steel (Solicitor General's Office), Alex Galloway (Office of the Chancellor of the Duchy of Lancaster), John Bartlett (Governor of the Bank of England's Office) and Richard Hatfield (Cabinet Office).

Your sincerely

Andrew Turnbull

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John Kerr, Esq.,
H.M. Treasury.