(1).

10 DOWNING STREET

Prime Minister

(i) It is most unsatisfactory that the advice of the Bank, endorsed by Treasury, FCO and Solicitor General, was so wide of the mark.

(ii) Although we could try to lean on UK banks not to renew the facility after 31 January, Chancellor recommends acting as in para 7.

Agree? Reluctantly.

AT 18/1

Perhaps we can enquire how I came to be given the wrong 'facts'. I could have repeated them to the House and

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

ARGENTINA: COMMERCIAL BANK LENDING

At your meeting on 22 December you asked me to prepare a further note clarifying the conditions under which Argentina might make further drawings on the commercial banks' $1.5 billion medium term loan, dealing in particular with the way in which future drawings might be dependent on the establishment of a new IMF programme.

2. I enclose a note prepared by my officials, in consultation with those of the FCO and the Bank of England, which sets out the position in detail.

3. As the note shows, the banks could make further money available in advance of progress between the IMF and Argentina on a new programme (or re-establishment of the old one), by waiving the loan conditions for further drawings, as they did for the 2 December drawing. However, the overall impression following last week's meeting between Grinspun, the Argentine Economy Minister, and the banks' Working Committee in New York is that the commercial banks are not disposed at present to allow early release of a second tranche, though the position could change if banks worried about the build up of payment arrears saw advantage in releasing a further sum tied to the settlement of payments due to them.

4. At your meeting on 22 December we accepted (on the basis of assurances which the Bank of England had obtained from Lloyds

Bank International), that the loan agreement was legally binding. We concluded that participation by the British banks could only be stopped by primary legislation. It transpires now that we had not been given the full facts, and that a means of stopping the bank loan does in fact exist. As paragraph 10 of the note explains, the drawdown period for the loan will expire on 31 January, and a positive decision is needed by all banks if the remaining $1 billion is to remain available after then.

5. It is of course wholly unsatisfactory that the Bank's contacts with LBI did not bring this to light earlier: I shall be pursuing that separately.

6. We now have to consider whether to take advantage of this opportunity and bring pressure to bear on the British banks to end their participation and abort the loan agreement. I understand that the banks themselves are likely to want to extend the drawdown period. I myself think that on balance it would be wrong for us to try to force "foreclosure", particularly if we might want to seek some limited improvement in other areas of Anglo-Argentine relations. But I am quite sure that we should take the opportunity to strengthen the conditional links between drawings under the loan agreement and a new IMF programme.

7. Subject to your views, I therefore propose to ask the Bank of England to press the British banks to insist that an extension should be granted only on condition that further drawings are conditional on Argentina reinstating its IMF programme (and being in conformity with it at any time when drawings on the loan are made).

8. Finally, you will wish to know that Grinspun indicated to the commercial banks that Argentina intends to seek debt relief from the Paris Club, possibly in the first half of this year, although

the IMF representative at the Paris Club last week maintained that a final decision had not been taken. The paper we discussed on 22 December set out the main considerations, and I shall put forward proposals in due course.

9. I am sending copies of this minute to the Foreign and Commonwealth Secretary, and Sir Robert Armstrong.

N.L.

17 January 1984

ARGENTINE $1.5 BILLION LOAN CONDITIONS

Note by Treasury officials

This note sets out the main conditions under which drawings on the commercial banks' $1.5 billion medium term loan can be made and their relationship to the establishment of a new IMF programme.

Drawing of 2 December 1983*

2. For the first advance, released on 2 December, the original loan documentation imposed conditions of which the main ones required:

(a) the elimination of arrears,

(b) progress on public sector debt rescheduling including the completion of the agreement with the state airline, intended to serve as a model for the rest,

(c) the availability of foreign exchange for interest payments on foreign debt, and

(d) a certificate of good standing from the IMF confirming, in particular, that the first two advances had been made under the IMF standby.

3. The last of these conditions was met. The others were waived under the provisions, contained in the agreement, for amending the original terms.

Further drawings

4. Similar conditions are associated with the second and third (ie final) tranches of the loan eg a certificate stating that there are no interest arrears due to banks (subsequent to a date to be agreed) and a requirement on foreign exchange availability as in para 2(c) above. Further progress on public sector rescheduling is also required for the second tranche and, for the final tranche, completion of substantially all agreements.

*$0.5bn

The most important requirement is for a new certificate of good standing from the IMF, before the next drawing, confirming:

(a) that the standby continues in effect,

(b) that, subject to the terms of the standby, Argentina remains eligible to make purchases from the Fund, and

(c) that a further drawing (the third) under the standby has been made.

5. The IMF is in no position to issue such a certificate at present. The Argentine programme has broken down and the most likely course now is that it will be replaced by a new programme and a new standby facility. There is no possibility of an IMF mission to Argentina until late January or early February. The negotiating process is bound to take some months, quite possibly extending into the Summer; even then the IMF certificate would relate to the new agreement, rather than the old as is strictly required by the loan conditions. This would presumably cause the banks no difficulties if the general effect were the same. Even if the present standby can be reinstated, the process will take time.

6. It is open to the banks to amend or waive the original loan conditions and the loan documentation contains provisions specifying the procedures for doing so. For the $1.5 billion medium term loan most amendments require the consent of banks whose exposure is at least two-thirds of the total and a few require the support of all banks. Moreover, changes to the medium term loan may also require parallel changes to the $1.1 billion short term bridging loan agreed in December 1982 eg the timing of bridging loan repayments might need to be amended to match the timing of drawings on the IMF and/or the availability of advances on the new facility. The requirement for the short term loan is 100 per cent agreement to any amendments, ie all participating banks must give their consent.

Effectively amendments or waivers may therefore depend on a 100 per cent acceptance by participating banks. Provided, therefore, that there were sufficient support, the commercial banks could decouple the next tranche under the medium term loan from the establishment of a new IMF programme.

7. The UK clearing banks are believed to have taken a view that no further advance should be made until the existing IMF programme is reinstated or until a new IMF programme has been approved by the Board.

8. At last week's meeting between the Argentine Economy Minister and the leading international bankers, the general impression was that Grinspun had not given a very effective presentation of the Argentine position and of its need for early and substantial help. Led by LBI, a number of banks questioned the sense of going ahead with any further release of bank money in advance of much clearer progress with the IMF. There was also protest, again led by LBI, against the implied blackmail in hints that help with urgent trade credits might be linked to payment of interest. Such a link appears to have been dropped for the moment.

9. Nevertheless many, especially American, banks were worried about keeping payments from falling too far behind, even though the end year balance sheet pressures which weighed heavily on the US banks have receded for the moment. But the banks might at any time see advantage in releasing a further sum strictly tied, as with the 2 December tranche, to the settlement of payments due to themselves including a $350 million instalment under the bridging loan.

Time limit on drawing

10. The drawdown period under the medium term loan agreement technically expires on 31 January. Beyond that date the obligation of the banks to provide funds to Argentina under the medium term loan agreement would cease, unless an extension is agreed by all participating banks. The banks have not yet discussed this; they will need to do so in the week beginning 23 January but are likely to conclude in favour of extension

on the following grounds:-

(a) the existence of a sizeable undrawn amount under the facility gives them leverage over the Argentines which may reduce the risk of pushing Argentina into default;

(b) if the present agreement was scrapped and fresh negotiations had to be started from scratch, not only would all the past time and effort have been wasted but, more important, the Argentines would be able to reopen the whole 1983 package, including the rescheduling of public sector debt, and the banks might find themselves having to agree to less favourable terms.

11. The existence of this condition offers scope, in theory, for intervention by the Government (on the lines discussed by Ministers on 22 December) to end participation by British banks by preventing them from agreeing to an extension. But, given that no new drawing is likely in the immediate future and that the link with IMF conditionality is maintained, UK interests would not be served in forcing British banks to "foreclose" this loan, if there is general support for an extension. It would however be possible to take the opportunity of pressing British banks to agree to extension only on condition that further drawings are conditional on Argentina agreeing a new and satisfactory IMF programme and being in conformity with it at any time when drawings on the bank loan are made.

Conclusion

12. Our conclusion is that there is little likelihood of an early drawing from the medium term loan in advance of a new IMF programme. The commercial banks will shortly need to decide whether to extend the drawdown period of the medium term loan beyond 31 January. They seem likely to do so. There would be little advantage in preventing the British banks agreeing to this. And as a quid pro quo they might be

able to use extension to secure firm agreement to the line they have already taken, resisting any further release of bank money in advance of a reinstatement of a satisfactory IMF programme. This would strengthen the links which already exist between drawings and a satisfactory IMF programme.

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Indebtedness Part 3

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10 DOWNING STREET

From the Private Secretary

19 January 1984

ARGENTINA: COMMERCIAL BANK LENDING

The Prime Minister has seen the Chancellor's minute of 17 January and the paper attached to it. She accepts the Chancellor's proposal that the Bank of England should press British banks to insist that an extension of the current loan agreement should be granted only on condition that further drawings are conditional on Argentina reinstating its IMF programme and being in conformity with it at any time when drawings on the loan are made.

The Prime Minister has noted with concern that the account given in earlier papers of the provisions of the loan agreement was not accurate. Though, in practice, it did not happen, she could easily have reported this misinformation to the House. She knows that the Chancellor will be seeking to establish what went wrong and she looks forward to an account in due course.

BF

I am sending copies of this letter to Brian Fall (Foreign and Commonwealth Office) and Richard Hatfield (Cabinet Office).

Andrew Turnbull

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

SH