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12 Copies of
for Mr Giffard
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Mr Giffard

cc: Lord Bridges
Mr Gillmore
Mr Fearn
Mr Crowe
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ECONOMIC AND FINANCIAL MEASURES AGAINST ARGENTINA

1. As agreed at Sir A Acland's meeting this afternoon,
I attach a Note on this subject.
2. This is very much a first attempt, prepared without consultation. Except where they are drawn from Mr Fearn's earlier Note, the figures will need checking and updating. The legal advisers may have views on references to our international obligations. ECD(E) and MAED will likewise have views on Community aspects and on aviation and shipping.
3. However, I tried the idea of restricting bank lending to Argentina on the Treasury today and their reaction was quite favourable.

N.P. Bayne

3 April 1982

N P Bayne
Economic Relations Department

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ECONOMIC AND FINANCIAL MEASURES AGAINST ARGENTINA

1. This Note considers the prospects for economic and financial action which might exert pressure on Argentina in the context of the Falkland Islands' invasion. It draws on Mr Fearn's Note of 1 April and the record by Mr Littler (HM Treasury) of his meeting on 2 April but is meant to be self-contained.

Anglo/Argentina Economic Relations

2. These can be summarised as follows:-

(a) Visible Trade: Exports (1980)

£173 million - three per cent of market.

Imports (1980) £114 million - three per cent of Argentina's exports.

ECGD firm commitments amount to £290 million. There is no major project business.

(b) Banking

X The claims (ie loans) of UK banks (British and foreign) in Argentina were \$5.8 billion at the end of 1981.

X Liabilities (ie deposits) with these banks were

\$1.4 billion. The claims of British alone were

\$2.9 billion in mid-1981.

(c) Investment

There is substantial British manufacturing and banking investment in Argentina with total value not known but far in excess of its 1979 book value. Seventeen major British firms are present and Lloyds International (Bolsa) is the third largest foreign bank.

Argentinian investment in the UK is slight; there is one bank, possibly some presence in the meat business.

/(d) Air Service

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(d) Air Services

BCAL flies twice weekly to Buenos Aires en route to Santiago, earning £9 million per year. Argentine Air Lines flies twice weekly to London earning £7 million.

(e) Shipping

UK earnings from merchant shipping in 1980 were £12 million; Argentina's earnings were £10.5 million.

Scope for UK Action

3. The UK can act under existing powers:-

- (a) To prevent the export or import of goods using the 1939 Import and Export Act. It would be necessary to invoke Article 224 of the Treaty of Rome and Article 21 of the GATT, which allow for special action in time of war or similar emergency.
- (b) To freeze assets in the UK under the 1964 Emergency Laws Act, as we have already done.
- (c) To suspend Argentine Air Lines operating permit using powers under the Air Navigation Order 1980.

Further action, for example, to ban contracts or other service transactions or to confiscate assets would require new legislation.

4. We have already taken some action partly of a pre-cautionary kind; suspending ECGD cover and freezing assets. But neither these measures nor indeed a complete cessation of economic relations would, on their own, cause serious damage to Argentina. Argentina can hurt us more by retaliation than we can hurt them in this field, because their debts to us exceed their deposits and because of the scale of UK investment.

5. Any effective action would therefore need to be taken in concert with our partners and allies.

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Argentina's Wider Economic Relations

6. Argentina's economy is in a fragile condition and suffered serious difficulties until President Galtieri's Administration took over. He has, however, introduced restrictive policies which have had some success in restoring external equilibrium. But Argentina has a high level of external debt and needs to maintain export earnings or continued borrowing (or both) to service its debt and finance its development.

7. Argentina sends only about three per cent of its visible exports to the UK; but it sends thirty per cent to the European Community as a whole, with a further six per cent to the United States and five per cent to Japan. Restriction of access to these important markets would be a serious setback to Argentina.

8. Argentina has been the fifth largest borrower on the international financial markets among developing countries. Its total debt is estimated at \$34 billion, of which \$21 billion is to banks in OECD countries. Argentina's current account deficit was about \$5 billion in 1980 and of the same order in 1981; it raised \$3.5 billion in the Euro currency markets last year. Although the current deficit may be lower in 1982, if restrictive policies are maintained, there will still be a substantial financing need, aggravated by an outflow of short-term capital. Banking confidence will already have been shaken by aggressive actions. Anything which made it harder for Argentina to borrow on the markets could create serious problems.

9. There is a network of airline links between Argentina and European capitals. While therefore the blocking of links with the UK would not be significant, the blocking of all or nearly all of Argentina's transatlantic air traffic would have a much greater effect.

Scope for Collective Action

10. We cannot expect the UN Security Council to adopt a Resolution imposing sanctions on Argentina. Collective action must therefore be sought separately with our Community partners, the United States, Japan and possibly other countries.

Trade

11. Collective action in this field must be sought first through the Community. National action would require us to invoke Article 224 of the Treaty of Rome. We could ask that other Members take supporting action under the same Article. (The use of other Articles, eg 113, raise greater difficulties.)

12. The possibilities are:-

- (a) a full embargo on trade with Argentina (as imposed on Iran in 1980);
- (b) raising tariffs or imposing restrictions on individual items;
- (c) denial of subsidised or guaranteed export credit.

13. It is doubtful how much support we will find in the Community. All will deplore Argentina's scandalous action (though Greece may do so less than the rest). But there has been no direct action against the other Members. Furthermore, Germany, Italy, the Netherlands and France all have more at stake commercially with Argentina than we have.

14. For this reason a full embargo seems unattainable. We might have more chance of action on specific products, though this would have a weaker impact. In this context, meat looks the most promising; it provides one-sixth of Argentina's exports to the Community, with the UK the ^{second} largest single market. There may be a chance of restricting export credit guarantees if it appeared that Argentina was becoming a less attractive credit risk (see below).

/15. For action

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15. For action on trade we would need to work through the Community first. If we succeeded, we should seek similar action from the United States and Japan.

16. We could seek separate action with those of our allies which supply military equipment to Argentina. As a first step, we could withhold the naval equipment, worth some £50 million, which we supply to Germany for warships for sale to Argentina. But we could go further and ask all Argentina's Western suppliers to suspend deliveries of arms, equipment and spare parts.

Finance

17. Collective action in this field could be sought initially through the Group of Ten, made up of the major OECD economies. We will need to involve the United States, Japan and the leading European banking centres, including Switzerland.

18. There is no chance that other countries will freeze Argentina's assets, as we have done. The United States was unable to persuade other countries to copy their freeze on Iran in 1980. The prospects are worse this time as debts outstanding to G10 banks exceed the Argentinian deposits they hold by nearly four to one. For this reason also banks will be very reluctant to force Argentina into default.

19. A better approach might be to ask our G10 partners to advise their banks against lending new funds to Argentina. Such guidance would not be mandatory nor would it be wholly effective. But it could reinforce the adverse impact of the invasion on banking confidence and make it very hard for Argentina to borrow. The G10 countries could also obstruct efforts by Argentina to draw finance from the IMF, even though the Fund is strictly meant to decide on technical and not political criteria.

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Aviation

20. Most European countries regulate their air services with Argentina by agreements which can only be denounced with several months warning. But they are likely to have powers, as we have, to suspend operations in emergencies. But, as with a trade embargo, it will be difficult to persuade other European countries to suspend flights to and from Argentina. They are not faced with an emergency in the way that we are. Many of them (such as Spain) have more flights per week than us and would stand to lose more.

Other Areas

21. Denial of access to European ports for Argentina's shipping would be as hard to achieve as restriction of air services and would act more slowly. We ourselves would need new legislation. There are no measures available in the field of investment which is a prime area where Argentina can retaliate.

Tactics

22. If we decide to pursue any collective action we should approach our partners as soon as possible. We should be clear about what we ourselves intend to do. But we should not act first and then expect our partners to match our actions (as the Americans so often do); we should seek genuine consultation.

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business

Conclusions

23(a) We cannot on our own do serious economic and financial damage to Argentina. The only way of doing this is through collective action.

(b) Trade sanctions and financial measures look the most promising.

(c) Trade sanctions would involve the Community. Our partners would not join in a complete embargo. But we might achieve action against specific products eg meat. Separately (outside the Community) we could seek limits on arms sales and deliveries.

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- (d) Financial action could be sought through the G10. Other countries will not freeze assets, as we have done, but might discourage their banks from new lending to Argentina.
- (e) If any actions on these lines are pursued, we must be prepared for retaliation, especially against our investments.

Other Countries 3

3 April 1982