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**Falkland Islands Dispute:  
Economic Impact** 

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**An Intelligence Memorandum**

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April 1982*

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# Falkland Islands Dispute: Economic Impact



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An Intelligence Memorandum

*Information available as of 15 April 1982  
has been used in the preparation of this report.*

This paper was prepared by   
 Office of African and Latin American  
Analysis, and  Office of Global  
Issues, in cooperation with the Department of the  
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may be addressed to the Chief, South American  
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[Redacted]

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**Falkland Islands Dispute:  
Economic Impact** [Redacted]

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**Summary**

The sanctions against Buenos Aires stemming from the Falkland crisis probably will have minimal impact on the Argentine economy in the next 30 to 60 days. The limitations on imports by the United Kingdom and the European Community from Argentina will require some time to take effect. Although there have been a few loan cancellations, Buenos Aires still is far from financial disaster. And, even though some serious technical problems are arising in covering obligations to British banks, there appears to be enough interest on the part of both debtors and creditors to arrange mechanisms to service Argentina's external debts.

Beyond the next few months, the duration of the conflict and the intensity of British measures will be important factors in determining how much disruption occurs to Argentina's economy and foreign financing. At the limit, Buenos Aires has reserves adequate to meet its debt obligations and basic import requirements over the next three to five months, so long as the British do not choose to blockade Argentine merchant shipping. Such a lengthening of the crisis would, however, add to existing Argentine economic problems and substantially raise the risk of a generalized debt rescheduling in 1982. Moreover, the political fallout of growing inflationary pressures and shortages would seriously constrain the Galtieri administration's options for stabilization policies.

In the event of a major armed conflict that seriously impaired Argentina's ability and willingness to service its external debt, many US and European banks that have lent heavily to Argentina would suffer serious profit declines or even net losses, but the international banking system as a whole could probably manage with little lasting damage. The real danger to the international financial system is a combination of adverse events. A simultaneous loss of payments from Argentina, Poland, and a few other large East European or LDC borrowers would be very difficult to manage without official intervention.

[Redacted]

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[Redacted]

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**Falklands Islands Dispute:**  
**Economic Impact** [Redacted]

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**European Economic Sanctions**

The British were quick to react to the affront represented by Argentina's invasion of the Falklands. London:

- Announced a ban on imports of Argentine goods.
- Froze Argentine financial assets in the United Kingdom.
- Cut off export credits and military sales.

The European Community (EC) weighed in by approving a 30-day ban on trade with Argentina. This measure, which follows a previously approved cutoff in arms sales, at first appeared more immediately stringent than subsequent information made clear. It will not apply to goods under prior existing contracts, and most EC imports from Argentina are covered by long-term contracts. [Redacted]

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**Argentine Reprisals**

Buenos Aires was quick to retaliate. On 5 April the Argentine Central Bank froze British assets and announced legal measures to restrict foreign exchange payments to British entities—exporters, importers, banks. The government also ordered the suspension of export credit insurance for UK-bound shipments and denied trade credit without prior approval. [Redacted]

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**Financial Repercussions**

Argentine borrowers were caught in a sudden financial crossfire:

- A \$250 million loan for an Argentine utility was canceled when a UK financial institution withdrew from the syndication.
- National Westminster Bank canceled its participation in a \$200 million Eurocredit, jeopardizing the success of that syndication.

[Redacted]

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Argentine exchange restrictions have imperiled debt servicing commitments by preventing payments to UK banks. Failure to make loan repayments to these banks could enable them to declare Argentine loans in default under the loan agreements terms.<sup>1</sup> This situation could be complicated by any increase in national pressures within Britain to demand strict adherence to original loan payment provisions, even though it is in the best interest of the banks to reach an amicable conclusion. [Redacted]

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<sup>1</sup> The provisions for such declarations depend on the terms and circumstances of the loan agreements. Syndicated credits often call for declarations of default to be based on a decision made by a majority of the participating banks. [Redacted]

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**Table 1**

Million US \$

**Argentina:  
Direction of Trade, 1981<sup>a</sup>**

	Exports	Percent	Imports	Percent
<b>Total</b>	<b>9,130</b>	<b>100</b>	<b>9,200</b>	<b>100</b>
EC	2,200	24	2,445	26
Of which:				
United Kingdom	230	2	315	3
Soviet Union	2,700	30	NA	NA
LAFTA	1,935	21	1,815	20
United States	670	7	2,055	22
Japan	275	3	800	9
Other	1,350	15	2,085	23

<sup>a</sup> Revised estimates.

[Redacted]

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Buenos Aires is working to avert a financial crisis. [Redacted]

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[Redacted]

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[Redacted] The Central Bank is proposing to make direct repayments to non-British banks, while monies due to British institutions may be held in escrow accounts.<sup>2</sup> To avoid problems in syndicating new credits, the Argentines are trying to reassign UK bank positions to other Western lenders. [Redacted]

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**Near-Term Impact**

For the moment, the British and Argentine countermeasures are having only a limited impact. The bilateral trade cutoff affects only about \$550 million in trade with the United Kingdom. This represents about 3 percent of Argentina's total trade, and an even smaller percentage of UK trade. [Redacted]

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A crisis lasting no more than one or two months would be unlikely to cripple the Argentine economy. Despite the cancellation of some foreign loans, Argentina can probably meet foreign exchange requirements. Buenos Aires still has in excess of \$3 billion in foreign exchange reserves and additional gold that could be sold on the spot market for \$1.2-1.5 billion. Moreover, the government retains access to some \$1.1 billion in

<sup>2</sup> The issue of where the funds are to be held in escrow could be an important stumbling point. At the moment, the Argentines are insisting that an escrow account with an Argentine bank should be adequate. Not satisfied with this arrangement because they do not consider it to be a true escrow, the British are still apparently willing to discuss alternatives. [Redacted]

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swap lines established with other South American central banks. Consequently, Buenos Aires probably has enough foreign exchange reserves and access to additional funds to avoid sharp increases in unemployment, cutbacks in imports, or serious rationing for the near term. [REDACTED] 25

Even so, we cannot rule out a sudden Falkland-related financial panic. There are already some signs of edginess in Argentine financial markets. Maturing dollar deposits, for example, are not being renewed and exchange rate speculation is again evident. For the moment, the government remains in control and is bolstered by widespread domestic political support for its military and diplomatic initiatives. [REDACTED] 25

Although Buenos Aires has sufficient foreign exchange to function normally over the next few months, an eroding international credit standing will make borrowing more difficult in the near future. Argentina will continue to experience technical difficulties in arranging loan repayments to British banks and syndicates. Credit may tighten as US and other international financial institutions become more cautious regarding debt rollovers and extensions of new credits. [REDACTED] 25

#### Longer Range Impact

If the crisis is prolonged, externally imposed trade restrictions will take an increasing toll.<sup>3</sup> The suspension of trade with the EC potentially could extend to affect some 25 percent of Argentina's total foreign commerce. At a minimum, the Falkland dispute will impede Buenos Aires's ability to improve its current account position in 1982. Should access to credit facilities dry up, reserve drawdown by itself would not be sufficient to meet debt service obligations this year. Argentina could thus be forced to a rescheduling by the end of 1982. [REDACTED] 25

The broader risks for the Argentine economy are severe. Concern is growing over Buenos Aires's ability to sustain necessary economic reforms. The Central Bank, for example, has recently increased monetary expansion. Moreover, military spending in support of the Falkland campaign would increase the public deficit. Taken together, these additional economic stimuli would push inflation beyond the present 130-percent level. A drawn out Falkland crisis could enhance the power of Argentine blue-collar workers and other factions interested in a return to Peronist economic policies, thereby gutting efforts to revitalize the economy. [REDACTED] 25

Buenos Aires's international credit rating may suffer over the longer term should a protracted Argentine-UK encounter cause the country to abandon fiscal restraint. There are already indications that the interest spread may rise from last year's average 0.75 percent over LIBOR to as high as 2 percent for new loans. Additionally, traditional lenders are now considering

<sup>3</sup> This section and succeeding sections assume that the EC trade ban, currently approved for only 30 days, will be renewed. [REDACTED] 25

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Table 2

Million US \$

**Argentina:  
Current Account Balance**

	1981 <sup>a</sup>	1982 <sup>b</sup>
<b>Trade balance</b>	-70	3,000
Exports	9,130	10,300
Imports	9,200	7,300
<b>Net services and transfers</b>	-3,835	-4,000
Net interest <sup>c</sup>	-2,600	-2,800
<b>Current account balance</b>	<b>-3,905</b>	<b>-1,000</b>
<b>Amortizations</b>	-3,480	-2,650
<b>Financial gap</b>	-7,385	-3,650

<sup>a</sup> Revised estimate.<sup>b</sup> Projected before Falkland crisis.<sup>c</sup> Includes interest on short-term debt.

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the possibility of setting lower lending limits for Argentina over the next several years. Following an economic derailment, a severe cutback in international lending would intensify difficulties in reinstating reform measures.

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**International Financial  
Impact**

Allowing maneuvering by the British and nervous rumblings from the weaker banks in loan syndicates, there is still little immediate likelihood that bankers will declare Argentina in default. Indeed, Buenos Aires will probably be able to avoid default so long as large banks are able to control any inclination of smaller institutions in syndicates to act rashly, and so long as Argentina is perceived as trying to meet its obligations. International banks have accommodated Poland and seem no less likely to do the same for Argentina, a country with far greater debt repayment capacity.

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Argentina, the third-largest LDC debtor behind Brazil and Mexico, must pay \$5 billion this year to service medium- and long-term debt and/or roll over almost \$12 billion in short-term obligations. US banks here and abroad hold one-third of Argentina's \$24 billion total bank debt, mainly short term. UK banks, in contrast, hold only about \$3 billion. Argentina also has about \$10 billion in debt outstanding to nonbank institutions.

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Export shortfalls could imperil Buenos Aires's ability to meet debt payments over the course of 1982. Over the past two years Argentina has allocated 40 to 50 percent of its export earnings for debt servicing. If the EC trade embargo is extended, it could affect this year about 15 percent of the \$10 billion in export earnings that had been projected for Argentina,

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Table 3

Percent

Argentina:  
Structure of External Bank Debt <sup>a</sup>

Total	100
Short-term	51
1-2 years	9
More than 2 years	37
Unallocated	3

<sup>a</sup> Based on June 1981 data.



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Table 4

Million US \$


Argentina: Servicing Payments  
on Medium- and Long-Term Debt, 1982 <sup>a</sup>

Total	4,780
Principal repayments	2,635
Interest payments	2,145


<sup>a</sup> IMF estimates.



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but the bulk of the EC purchases is grain, meat, and other foods that could be diverted to alternative markets at some reduction in revenues. A British naval blockade of Argentina's few major ports, however, would cut off nearly all exports, including the lucrative \$2.6 billion annual grain trade with the USSR. 

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The duration of the conflict and the intensity of British measures will be important factors in determining how much disruption occurs to Argentina's foreign financing. As long as the United Kingdom does not blockade Argentine exports, Buenos Aires can probably afford to continue debt servicing over the next three to five months. Should the crisis persist this long, however, the domestic economy would have borne serious financial and material stresses and the need for a later generalized rescheduling would have risen appreciably. Even in the worst case, the impact of a total loss of bank claims on Argentina—\$24 billion in liabilities offset in part by about \$8 billion in Argentine assets—could probably be contained by the international financial system, even though many banks would suffer serious declines in profitability. 

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The real danger to the international financial system is a combination of adverse events. A simultaneous loss of payments from Argentina, Poland, and a few other large East European or LDC borrowers would be impossible to manage without official intervention.

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