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## CABINET

## DEFENCE AND OVERSEA POLICY (OFFICIAL) COMMITTEE

## SUB-COMMITTEE ON THE SOUTH ATLANTIC AND THE FALKLAND ISLANDS

## THE COST TO OUR SUPPORTERS OF ECONOMIC MEASURES AGAINST ARGENTINA

Note by Foreign and Commonwealth Office

1. This paper attempts to give some estimate of the cost to our Community partners and other supporters of the economic sanctions they have adopted against Argentina and of the retaliatory measures Argentina herself has adopted. This exercise bristles with difficulties. The paper is therefore impressionistic. Some of the methodological difficulties are described in the course of the paper.
2. The paper is largely based on reports from British Embassies in the countries concerned. It does not cover action by the Argentine authorities against the Dutch, French and German airlines since it is unclear what the Argentines have in fact done. But it is unlikely that any costs will yet have arisen; they may do so after June 30.

## BAN ON IMPORTS FROM ARGENTINA

3. The overall impression is that the economies concerned have not yet suffered significant damage. Concern is, however, growing as sanctions continue to be applied. Part of the reason for the lack of impact so far is the exemption of existing contracts. In addition Argentine exports to the countries which have adopted measures are of agricultural or other products which are not in short supply. Countries should

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therefore have experienced little difficulty in obtaining substitute supplies and without much additional cost.

#### ARGENTINA'S BAN ON IMPORTS

4. The effect on our supporters of adopting economic measures against Argentina is potentially most acute as a result of Argentina's retaliatory actions against their exports. But the impact of Argentina's ban on imports is difficult to assess. On the onehand, our supporters will experience difficulties in finding alternative markets for their exports. On the other hand, the Argentine economy was in a very depressed state even before the Falklands crisis began: Argentina's own figures indicate that imports in the first quarter of 1982 were 51% down on the same period of 1981. (Our own estimate is 25%). The crisis will have reduced even further Argentina's capacity and willingness to import, so that our supporters' exports would have been hit whether or not they had adopted economic measures against Argentina. It is by no means clear that the ban is being applied consistently. German trade and industry bodies have admitted wryly to the Embassy that some companies may have found ways round the ban. Moreover our supporters' exports to Argentina are likely to be in the main manufactures (97% in the case of Germany). Since these are probably supplied on longer-term contracts the effect of the ban should not be felt for some time. The Argentines have drawn up their regulations to allow the import of essential goods.

5. All these factors will tend to limit the impact of the Argentine ban on the exports of our supporters. The impact appears to be insignificant so far but will increase over time.

#### ARMS EMBARGO

6. Few of the countries who have applied economic sanctions are significant suppliers of arms to Argentina. The Germans have significant warship building contracts. Latest indications are that all the contracts are at risk as a result of the interruption of supplies for ships being constructed in Argentina. The total value of the business at risk is US\$ 1,242 million over 8 years. Cancellation could incur significant costs of

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compensation for the German Government. The United States embargo on arms, which has been in existence since 1976, has been far more restrictively and intensively applied since the beginning of the Falklands crisis. This has resulted in some loss of business. French arms manufacturers are concerned about the long-term impact of the arms embargo on their future sales (this, of course, may in the long-term be counter-balanced by publicity for French weapons and weapons systems).

#### MAJOR CONTRACTS

7. We are not aware of the loss by our supporters of any significant export contracts to Argentina as a direct result of economic sanctions. Dutch firms have failed to secure a gas pipeline contract, but for reasons unrelated to the agreed measures. But most countries are concerned about the impact over time. This, of course, was a powerful factor leading to the Italian Government's decision not to renew economic measures in the middle of May. Italian companies had lobbied heavily on the basis that a prolonged application of sanctions could have damaged Italo-Argentine trade to the tune of hundreds of millions of dollars. Vague threats of nationalisation of Italian assets had also caused alarm. But the depressed state of the Argentine economy, exacerbated by the Falklands crisis, means that it is important to distinguish between major contracts which have been lost because of general economic factors (as in the case of Japan) and major contracts which have been lost as a result of discrimination against our supporters.

8. The key test will be whether other countries, perhaps Japan or Italy, pick up much new business over the coming period. There has been no indication of this so far. The Italians are inclined to think any such increase will not be significant.

#### FINANCIAL DEALINGS

9. No other country has adopted formal financial measures against Argentina. But the general malaise of the Argentine economy, the shock to confidence caused by the invasion and the impact of the UK's own measures have caused banks throughout the world to exercise greater prudence in their dealings with

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Argentina, irrespective of the economic measures adopted by other countries. Belgian banks, for example, are not renewing credits to Argentina. German banks overall believe that the Argentine authorities are seeking to preserve their financial credibility while slowing down outflows of hand currency whenever possible. The Dutch expect payments on a pipeline project to fall behind schedule.

10. Many countries, including some who are not taking any other measures against Argentina, are also adopting a very cautious attitude towards granting new export credits on prudential grounds.

#### ECONOMIC RELATIONS WITH THE REST OF LATIN AMERICA

11. In general our supporters are most concerned with the effects of economic measures on the long-term prospects for their trade with Argentina and, especially, other Latin American countries. This notably applies to our European partners who are worried by the adverse reaction throughout Latin America to the Community's import ban. The fact that the measures have so far caused them little direct damage, either in Argentina or in Latin America at large, has not dispelled their anxieties, since they are counting the cost in political as much as economic terms.

#### 12. Conclusions

- a) Insignificant impact on supporters so far, but expected to have more if maintained. Main concern is loss of exports and public contracts. Imports can be obtained from elsewhere.
- b) Lower commercial and economic activity inevitable because of recession in Argentina and constraints produced by military activities, whether or not measures were introduced.
- c) Financial impact likewise due to actions of banks and export credit agencies on prudential grounds, not due to economic measures.
- d) Countries most seriously concerned are France and Germany, now that Italy has given up import ban, since of the countries which have adopted comprehensive economic measures they have the most significant economic and commercial relations with Argentina.

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e) No evidence so far that Italy or Japan or the US are picking up extra business because they have not banned imports.

f) Main anxiety of our supporters remains longer-term impact on their position in Latin America as a whole, even though this has not visibly suffered so far.

Foreign and Commonwealth Office

10 June 1982