Reference 148/2

→ LOP

To: MR PETTER
OT4/1

cc Mr Baker, PEP2
Mr Khanna, OT4/1a

From: A R TITCHENER
OT4
V/113
215-5345

11 February 1986

TORNADO - Saudi Arabia

I attended Mr Chandler's briefing on 28 January about the present state of play on the Tornado deal. Treasury, Cabinet Office, FCO and DEn were also present. There is no immediate action for us but the background may be useful to you.

The Project

2. The entire deal, Tornado, Hawk PC9 and possibly two bases (engineering consultants and some local construction) could now be worth around £7½ billion (the bases would account for £2 billion). The first contracts are due for signature on 15 February (when there would be a further press release) and the rest by 31 March. The Saudis were clearly keen to get on with contract completion and there was no reason to doubt their commitment, despite recent reports to the contrary.

Payment

3. Although the Saudis had already made a first down payment of £50 million (itself evidence of commitment) and had promised a further £50 million by 15 February, payment would mostly be through an "oil trading scheme", the agreement on which was signed a few days earlier (cf the Ambassador's report by telegram). The essence of the agreement is that Shell/BP will lift 300,000 bpd (+ or -10%) over three years, recoverable if payment for Tornado not by then completed (calculations were made on a price of $20pb which seems optimistic). In other words, if lower oil prices depress revenue, period will be extended. The first lifting (1.8-1.9 mb) was on 31 January with payment due on a net bank basis on 15 February (but as I understood the MoD, payment will be into a London account controlled by the Saudis). The DEn representative thought that the oil supplied under the agreement would substitute for and not be additional to existing shipments elsewhere.

4. The Saudis have emphasised that they wish these arrangements to remain confidential; in particular there should be no mention of barter. Neither HMG nor BAe would take title to the oil.

5. Notwithstanding the downpayments and oil trading arrangements, the MoD conceded that there would be some mis-matching of payments due and payments offered. This problem is currently under discussion in EGC.

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Aircraft Delivery

6. Deliveries of Tornado would begin in March. The first six aircraft would be diverted from the RAF and are clearly already largely completed; hence BAe concern to have upfront payments. The Defence Secretary is likely to visit Saudi in May as deliveries build up. He would not be accompanied by businessmen, other than someone from BAe and perhaps RR.

Industrial Collaboration

7, The Saudis recently suggested that the sales MOU should provide for BAe to invest 5% of their earnings from Tornado in the US Peaceshield. This was the first mention of offset since the Heseltine letter in September and was resisted. The MOU (standard sales provisions I was assured) has however yet to be signed and MoD fear that the Saudis may return to the charge.

8. In discussion, the MoD conceded that the most promising areas for industrial collaboration with the Saudis lay in defence related sectors: tanks, radar, communications, ordinance etc. The Saudis could be invited to put forward suggestions, possibly for further discussion during the Defence Secretary's visit. I reiterated that we did not favour an MOU on industrial collaboration in the civil sector. MoD remain unhappy about this (they would like something up their sleeves if the going gets tough in the next round of negotiations) but did not press me hard. For the present at least therefore I believe we should stand our ground.

9. Finally, it was agreed that Mr Chandler's coordinating group should meet on an ad hoc basis, any members being at liberty to call for a meeting.

Kate Blakeney.

PP A R TITCHENER

(DICTATED BY MR TITCHENER AND
SIGNED IN HIS ABSENCE)

CODE 18-77

FINANCE REQUIRED FROM BANK

CASE NO 1 (300K/$20)

in £m
$ exchange = 1.40

	1986		1987		1988		1989		1990		1991	
HALF YEARS	1	2	1	2	1	2	1	2	1	2	1	2
Cash Flow Funds Required	(1641)	(842)	(726)	(636)	(426)	(407)	(69)	(68)	(50)	(45)	(40)	(10)
PLUS:-												
Interest - 12% Bank Charges) (½% of O'draft)	(63)	(99)	(101)	(98)	(81)	(64)	(27)					
LESS:-												
Oil Income	583	789	776	789	780	789	776					
Inflow/(Outflow)	(1121)	(152)	(51)	55	273	318	680					
Bank Overdraft												
Balance B/FWD	-	(1121)	(1273)	(1324)	(1269)	(998)	(680)					
Inflow/(Outflow) (as above)	(1121)	(152)	(51)	55	273	318	680					
Balance	(1121)	(1273)	(1324)	(1269)	(996)	(680)	0					
Excess Funds	237	396	236	398	200	100	0	0				
Net ECGD Liability	(884)	(877)	(1088)	(871)	(796)	(580)	0					
Worst case based on ECGD's liability for full overdraft amount		113.8	117.9	398.2	417.4	769.9						TOTAL 1817.2)

CASE NO 2 (300K/$15)

	1986		1987		1988		1989		1990		1991	
HALF YEARS	1	2	1	2	1	2	1	2	1	2	1	2
Cash Flow Funds Required	(1641)	(842)	(726)	(636)	(426)	(407)	(69)	(68)	(50)	(45)	(40)	(10)
PLUS:-												
Interest - 12% Bank Charges) (½% of O'draft))	(66)	(114)	(128)	(142)	(139)	(138)	(112)	(88)	(59)	(29)	(4)	-
LESS:-												
Oil Income	437	592	582	592	585	592	582	591	582	591	582	591
Inflow/(Outflow)	(1270)	(364)	(272)	(186)	20	47	401	435	473	517	538	581
Bank Overdraft												
Balance B/FWD	-	(1270)	(1634)	(1906)	(2092)	(2072)	(2025)	(1624)	(1189)	(716)	(199)	343
Inflow/(Outflow) (as above)	(1270)	(364)	(272)	(186)	20	47	401	435	473	517	538	581
Balance	(1270)	(1634)	(1906)	(2092)	(2072)	(2025)	(1624)	(1189)	(716)	(199)	339	924
Excess Funds	(237)	(396)	(236)	(398)	(200)	(100)	0	0	0	0		
Net ECGD Liability	(1033)	(1238)	(1670)	(1694)	(1872)	(1925)	(1624)	(1189)	(716)	(199)		
Worst case based on ECGD's liability for full overdraft amount				207.8	232	599.1	596.1	599.5	601.9	225.4		**TOTAL** 3061.8