

EG(86)3rd Meeting

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Vile Saudi Arabia

WAP/2
EGD
SAUDI
ARABIA

HER MAJESTY'S TREASURY
EXPORT GUARANTEES COMMITTEE

Minutes of a meeting of the Committee held in Conference Room 47, Second Floor, Treasury Chambers, Parliament Street, London SW1 on Friday 14 February at 11.15 am

PRESENT

Mr P Mountfield (Chairman)

Mr L F T Smith
Bank of England

Miss F Mann
Bank of England

Mr J Hibberd
Cabinet Office

Mr S K Khanna
Department of Trade and Industry

Mr W A Pedder
Department of Trade and Industry

Mr R T Kemp
Export Credit Guarantee Department

Mr G E Breach
Export Credit Guarantee Department

Mr P Henley
Export Credit Guarantee Department

Mr R Van Slooten
Export Credit Guarantee Department

Mr G H Boyce
Foreign and Commonwealth Office

Mr I Cliff
Foreign and Commonwealth Office

Mr J M C Rollo
Foreign and Commonwealth Office

Miss J Simmonds
Foreign and Commonwealth Office

Mr Barrow
Ministry of Defence

Mr D G Jones
Ministry of Defence

Mrs A F Case
Treasury

Mr R Spink
Treasury

SECRETARIAT

Mr R E Adams
Ms R J Wilson

AGENDA

SAUDI ARABIA:

Mr T J H Downing, Bank of England, to Mr R E Adams, 13 February
Mr D G Jones, MOD, to Mr R E Adams, 10 February
JIC(86)(N)20 Draft
ECGD figures (circulated at the meeting)

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SAUDI ARABIA

The meeting was called to consider further the proposal that ECGD provide cover in support of the proposed sale of military aircraft to Saudi Arabia.

2. MOD said that though they were the prime contractors with the Saudis, their aim throughout had been to minimize the risks to MOD. They had done this through a back to back arrangement with British Aerospace (BAe), operated outside MOD Votes, under which BAe would only be paid if MOD was paid. The risk to MOD was therefore minimal relating only to payments actually due to them. The deal was important to BAe because it would fill the gap between Tornado production for the RAF and production of a successor aircraft. However MOD did not think that the Saudi deal went to the root of the viability of BAe or Rolls-Royce, their major sub-contractor in the aircraft. Prices, deliveries and progress payments had been negotiated as a single package and the need for the overdraft arose out of the agreement on progress payments. The true risk on the overdraft was less than the sum borrowed by the amounts of cash in hand of BAe and the cost of work in progress less its realizable value. The cash in hand in excess of commitments was needed by BAe to pay for goods delivered, to fund work in progress and to produce sufficient resources to enable BAe to provide replacements to the RAF at a later date but without extra charges. The extra cash in hand plus payment for the Tornado aircraft received from the Saudis in addition to the payments previously made by MOD in respect of these aircraft, and the accruing interest, allowed BAe to charge the Saudis lower prices. MOD said that if oil proceeds fell short, Saudi Arabia would have to make up the difference in cash or pump oil for a longer period. They agreed that in these circumstances the overdraft would take longer to clear and BAe could be at risk unless deliveries were delayed, which anyway would be more beneficial to BAe than the present production profile. The Saudis had until the end of 1987 to decide whether or not to commit themselves to the final batch of aircraft, and if they expected difficulties in paying for them could presumably then decide not to do so.

3. ECGD said that their powers to give guarantees to encourage exports meant that they could only give guarantees for specific deals and could not, for example, guarantee exporters' working capital. They therefore went to some lengths to ensure that the money was drawn only in respect of commitments. They wondered therefore whether provision for 'cancellation/termination'

should be included in the total overdraft they guaranteed. They were being asked to give a guarantee on an overdraft of £1,127 million and to take a chance that this net liability would be reduced to at most £890 million by use of the cash in hand and the proceeds from the sales to others of work done. It was absolutely necessary to know how and why BAe arrived at a total figure of £1,641 million for 'funds required'. ECGD said that the banks paid the premium and there was no problem with that. They were looking to this project to restore their AB:CD ratio. Overall, there were strong arguments for giving BAe incentives to minimise the risks involved in this project. Given this, and in order to leave room to take on other business in Saudi, ECGD suggested, though without commitment at this stage, that they might be able to offer cover up to £1 billion for this project. This would cover the first batch of aircraft with money to spare. They would need further discussions with MOD on this basis.

4. The Bank of England said they had problems with the proposal. MOD and ECGD seemed to be estimating the risk on the assumption that Saudi Arabia would pay, whereas normal practice was to work out the risk if the buyer did not pay. They said the premium on this market would be hefty if it was downgraded to a C market.

5. The Foreign Office said that there was a high degree of political commitment to this project in Saudi Arabia and the risk of cancellation by them was very low. It was much more likely that if problems arose the Saudis would ask for a longer production profile rather than a reduction in aircraft.

6. The Cabinet Office said that Saudi Arabia needed large savings on imports if they were to secure a controlled rundown of their reserves. Even so, they could still need to borrow some US \$30 billion over the next 5 years. The longer they deferred action to cut their deficit the more severe would be their problems and the measures needed to remedy them. Defence contracts had been immune in the past, but this could change. The JIC paper highlighted a possible banking crisis in Saudi Arabia and MOD should note this in connection with the escrow account which was to receive the proceeds from the sale of the oil. MOD said the escrow account would be in London and they would have drawing rights on it.

7. The Chairman said the meeting had been useful in identifying points which needed to be investigated and there was further work to be done. He took note of ECGD's proposed offer of £1 billion and asked MOD and ECGD to

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work on this basis. He said that the question of cover for this project should be cleared with Ministers, including the Prime Minister, and Mr Channon should take the lead on this. Ministers would also need to be briefed on the public sector implications if the deal fell through. ECGD and MOD should clear a draft of their Secretary of State's paper round departments represented at EGC, but unless there were significant problems on the cover proposals, a further meeting would be unnecessary.

5 March 1986