

183/1



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*Jafa* cc CR  
Please time to:-

*Mr Titchener*  
*Mr Pedder*

*Then return*  
*Dear J.*  
*14/1*

P Henley Esq  
Export Credit Guarantee Department  
Aldermanbury House  
Aldermanbury  
London EC2P 2EL

*1, 1/2s*  
*2 1/2p (or) 1/2s*  
*CB, minimum*  
*Keep is reserve if there is a serious problem, necessary*  
*Section 8 can be deployed - pay any costs!*  
*Section 8 can be deployed - pay any costs!*  
*Section 8 can be deployed - pay any costs!*

Your reference  
Our reference  
Date

13 January 1986

CONFIDENTIAL

*Dear Sir*

SAUDI ARABIA - MILITARY AIRCRAFT FOR OIL

Thank you for your letter of 8 January on the proposal that you should provide about £3 billion plus interest of cover to facilitate the sale of various military aircraft and associated goods to Saudi Arabia. You will have seen the Bank's initial comments on your proposal. Clearly this is a major proposal and one that will need to be given detailed consideration before a final decision can be taken.

I understand that since you wrote MOD/BAe have reached formal agreement with the Saudis on a number of issues including prices for certainly the Tornado and possibly also the Hawk. The Saudis are due to make a payment now of £100 million with further payments ostensibly from the oil sales to bring the total amount to £1600 million by the time of formal signature of the Letters of Agreement. You will recall that original expectation was that, except at the very beginning, the oil flow in support of this sale would be 200,000 barrels a day. How satisfied can we be that this can be increased by 50 per cent. You will need to adjust your estimates of the funds required to bridge the gap between the Saudis' obligations to MOD/BAe and the revenues from actual oil sales. BAe are then asked to consider with banking advisers how the gap can best be bridged.

The amount of cover proposed for this business would make your exposure on Saudi greater than that on any other market, and this from a situation where your exposure is little more than zero. It would also increase dramatically your exposure on Middle Eastern markets and members of OPEC and of oil producers generally. At the trading level, such a large amount of business would clearly be attractive from ECGD's point of view provided that the risks you would be taking on are reasonable. In this context I would be grateful if you could set out in greater detail your assessment of this market and likely developments against a range of scenarios of possible developments of oil price movements and levels of production and sale by the Saudis. You would also need to take into account the likely

*4* *Rec is a very problem*  
*Section 8 can be deployed*  
*on a strict understanding*  
*BAe must pay any costs!*  
*Anything we should do?*

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effects on other oil producers of actions by the Saudis to increase our oil revenues and their possible responses. You will also need to take into account likely courses of actions by the Saudis if they cannot maintain their oil revenues bearing in mind that if their current account deficits were maintained at its present level, Saudis' reserves would be exhausted within a very short time. The Bank surmises in these circumstances that payment for military goods would take second place to import as necessary to maintain current living standards. Do you agree with this assessment. Perhaps the Department of Energy and the Cabinet Office to whom I am sending copies of this letter and of your and the Bank's letters could advise on this and the appropriate assumptions for an assessment of the likely developments in the Saudi economy over the next few years. As things stand payment for these aircraft is currently a Saudi problem but once you have given your guarantee, such are the sums involved, payment will become very much a problem for the UK.

Could you also set out an assessment of the likely levels of claims payments if this deal went wrong. Under what circumstances might you be landed with total losses rather than a cashflow problem of deferred payments? Also would it be possible to cut losses by withholding supply of aircraft and equipment and possibly selling them elsewhere. Would there be potential buyers?

There are some legal problems that need to be settled before you could go ahead with this business. The first concerns your vires. We had understood that it was the accepted wisdom that covering sales by other government departments was outside your powers. As I understand it, this applied not only to guarantees of payments due to other government departments but also even of buyer credit arranged in support of a sale by a government department. Since the prime contractor in this case is the MOD, and if my understanding of your vires is right, you would be precluded from covering this business. Has there been a change in the interpretation of your vires or indeed had I misunderstood the point? If there has been a change could you spell out the basis for it and the effects that such a change would have on the conduct of your business more generally.

I understand that the guaranteeing of an overdraft is a novelty and neither is it usual for you to provide cover in support of a sub contract between a UK sub-contractor and a UK prime contractor. Are there any potential difficulties about either of these aspects of this business?

There is also the question of the applicability of Sharia law. Are you satisfied that the problems over the payment of interest

can be satisfactorily resolved and to what extent would this depend upon the continued goodwill of the Saudi authorities and indeed their complicity in circumventing the formal requirements of Sharia law. Does this have any effect upon your assessment of the risk of undertaking this business.

*John*  
*Bob Adams*

R E Adams

cc  
T J H Downing-BOE  
M M Baker - DTI  
J Bowder - DTI(AIR)  
P Sullivan - FCO  
R A Ludford ODA  
L J Davidson - MOD(DS13)  
A D Harris - MOD(DESO STUART HOUSE)  
W A Pedder - DTI  
J Hibberd - CO  
W Ricketts - Dept of Energy } with enclosures  
D. Jones. - MOD (Sentinel House)  
R. Gilts - ECAD  
P. Kitcatt - HMT  
Mr D. Seaman - HMT  
S. Robson - HMT  
Mr Carr - HMT