

Al Yamamah: the National Archive documents

Background - Saudi Arabia's deteriorating financial health

Saudi Arabia is almost entirely dependent on its one main export – oil. In May 1985 ECGD recommended downgrading Saudi from its "A" credit rating to "B". The fall in the world oil price in the early 1980s meant that Saudi Arabia was running up large deficits and drawing down its reserves on a massive and unsustainable scale. Thatcher was told in September 1985 that Saudi Arabia's financial reserves "could be exhausted in less than two years". (PJ5_39_Thatcher_Sultan_1985)

ECGD recognised that "the [Saudi] government will seek to limit expenditure" and that it had implications "for the payment prospects on some contracts". ECGD noted there was a low level of recoveries achieved for Saudi Arabia and "it is also extremely difficult to seek redress through the Courts for payment default. Saudi Arabia has yet to evolve a system of commercial law which can be easily applied particularly by those not resident in the Kingdom". (PJ5_39_ECGD_want_downgrade)

In the knowledge of the ongoing Al Yamamah negotiations, the Embassy in Riyadh lobbied hard against the downgrading of Saudi Arabia. The official leading the lobbying, Sir Jeremy Greenstock, then a Counsellor (Economic) at the Embassy, did so though conceding that on paying its bills "MODA [Ministry of Defence and Aviation]'s record is not good". (PJ5_39_FCO_successfully_lobby)

Two weeks before the Al Yamamah Memorandum of Understanding (MoU) was agreed the Export Guarantees Advisory Council decided to downgrade Saudi Arabia but this was overruled within days (the files do not disclose by whom).

Other documents

- ECGD policy on Saudi July 1982
- ECGD downgrade Saudi credit April 1986

The Memorandum of Understanding is signed (26 September 1985)

Colin Chandler had been Group Marketing Director at BAe and was likely to have been involved in the Al Yamamah negotiations. On 13 May 1985 he became head of the MoD's Defence Export Services Organisation (DESO) and played a major part in finalising the deal for BAe within Government, where only the MoD and No.10 were kept in the loop (PJ5_39_Heseltine_apologises_secretive). BAe therefore got what it wanted despite the massive risks the Government then had to take (see below).

Six days before the MoU was signed ECGD were told no credit would be needed (PJ5_39_Heseltine_signs_AY). However, the MoU itself said "production of Tornado aircraft and equipment must commence before detailed planning is complete" (PJ5_39_AY_MoU_1985). But as the MoD admitted in October 1985 "nor have the Saudis told us yet exactly how the deal is to be financed" (PJ5_39_MoD_admits_Oct85).

The Al Yamamah deals are Government-to-Government. The MoD contracts with Saudi Arabia to provide the arms and related services and the MoD contracts with BAe who do all the work. So BAe started work on Al Yamamah without any guarantee the MoD would be paid. In early December Heseltine told Thatcher that "Prince Sultan told Mr Chandler that he hoped to be able to make an initial cash payment" and said "the only fly in the ointment so far is the lack of any funding mechanism". (PJ5_39_Thatcher_AY_sitrep)

Other documents

- [Minutes of Mrs Thatcher's meeting with Prince Sultan 26 September 1985](#)
- [DTI Minute 2 October 1985](#)
- [DTI Minute 2 October 1985](#)
- [Brief for Trade & Industry Secretary meeting with BAe Chief Executive Sir Raymond Lygo](#)
- [DTI Minute 3 October 1985](#)
- [DTI letter to MoD 16 October 1985](#)
- [DTI Minute 24 January 1986](#)
- [DTI Minute 11 February 1986](#)

The overdraft request (early 1986)

Al Yamamah is a barter agreement – the Saudis pay for their planes in oil. The Saudis contract with the MoD to pay a fixed number of barrels per day. The oil is given to Shell and BP who sell it on the world market and take commission for doing so. The proceeds then sit in a bank account and the MoD takes payment as BAe provide the support services (and the aircraft, when it was producing them).

In January 1986 the Saudis agreed to give Shell and BP 300,000 barrels per day as payment ([PJ5_40_DESO_oil_agreement](#)). The problem was because of their deficit the Saudis could not pay in cash, and the low oil prices meant the 300,000 bpd would not cover the cost of the deal until prices recovered. To avoid a BAe cash flow crisis, BAe asked ECGD to guarantee an overdraft facility of £3 billion (£6 billion in 2005/6 prices). The Saudis would borrow money from a bank and use it on top of the oil deal to pay BAe. If the Saudis failed to pay the bank back, ECGD would pick up the bill ([PJ5_40_ECGD_ask_Treasury](#)). Effectively, ECGD was being asked to bear the risk of world oil price fluctuations.

As a meeting of the Export Guarantees Committee noted in January 1986 “the reluctance of HMT and other departments to endorse the overdraft guarantee as presently proposed was tempered by a recognition of the political commitment already made to the project” ([PJ5_40_EGC_meeting_Jan](#)). The MoD conceded in February 1986 “work has started well in advance of formal contract approval and revenues either in oil, or in cash, have been lower, over the period from September 1985, than originally envisaged” ([PJ5_40_DESO_on_ECGD](#)). The Bank of England complained “there is all too much evidence of Saudi reluctance to be bound by the letter of contractual commitments, as is evident from ECGD’s claims record” ([PJ5_40_BoE_respond_DESO](#)).

Considerable opposition to the overdraft idea meant ECGD had to agree to offer a guarantee of £1 billion instead (£2 billion at 2005/6 prices). Paul Channon, the Secretary of State for Trade and Industry, wrote to Nigel Lawson, the Chancellor, asking for his agreement. Mrs Thatcher responded the next day stating “we really have no alternative but to accept this risk, both in the light of the enormous importance of the Tornado order and of our relations with the Saudi Arabian Government” ([PJ5_40_Thatcher_agrees_AY](#)). Foreign Secretary Geoffrey Howe was concerned the Saudis were not adjusting quickly enough to falling oil prices and suggested future deals should “ensure that payment by Saudi Arabia runs ahead of commitments entered into in the United Kingdom” ([PJ5_40_Howe_agrees_AY](#)). Other Ministers were more forthright in their criticism of the MoD’s recklessness: John MacGregor, Chief Secretary to the Treasury, warned “the Exchequer is being drawn inexorably into financial commitments on this deal which would be difficult to control”, pointing out Saudi default would seriously constrain future Budget options ([PJ5_40_MacGregor_agrees_AY](#)). Peter Walker, Secretary of State for Energy, suggested “it hardly seems sensible to increase our exposure to Middle East, oil-exporting countries so dramatically when oil prices have just halved” ([PJ5_40_Walker_AY_bad](#)).

Other documents

- Chandler Telegram to London 6 January 1986
- Bank of England letter to HM Treasury 9 January 1986
- HM Treasury letter to ECGD 13 January 1986
- DoE letter to ECGD 16 January 1986
- DTI Minute 17 January 1986
- DTI Minute 17 January 1986
- ECGD letter to HM Treasury 24 January 1986
- HM Treasury Minute 24 January 1986
- HM Treasury Minute 4 February 1986
- EGC minutes February 1986
- DTI Minute 17 February 1986
- Draft ECGD Ministerial submission March 1986
- ECGD Minute 18 March 1986
- DTI Minute 25 March 1986
- DTI letter to HM Treasury 25 March 1986

The Saudis refuse to borrow (spring 1986)

In April 1986 the Saudis said they did not want to borrow money to finance the deal. As the MoD were now so committed, officials scrambled to make an alternative arrangement. Lloyds would lend BAe the money it required prior to Saudi payments. The plan was for the Saudis to adjust the amount of barrels of oil given to Shell/BP as necessary and, should the oil proceeds not fully cover the costs, pay cash to the MoD for any shortfall. The MoD would then pay Lloyds back. If the barrels per day and Saudi cash did not make up the shortfall ECGD would pick up the bill.

The DTI knew “the contractual arrangements with the KSA [Kingdom of Saudi Arabia] are much more tenuous” and that the deal would mean the Saudis would have to pump much more oil (up to 600,000 barrels per day). Effectively world oil prices would to some extent be driven by BAe’s cash flow needs (PJ5_40_DTI_support_revised).

MacGregor was still hostile, pointing out Treasury officials had not been consulted and that if the Saudis defaulted the ECGD would want to direct MoD actions (for example by suspending deliveries) and effectively dictate British policies towards Saudi Arabia (PJ5_40_MacGregor_revised_bad). Peter Walker pointed out that there would be grave diplomatic and economic problems if Britain got involved in a downward oil market spiral and he opposed the increase in the Saudis’ barrels per day commitment (PJ5_40_Walker_stands_firm).

Other documents

- DTI Minute 30 April 1986
- MoD letter to HM Treasury 30 April 1986
- DoE letter to MoD 2 May 1986
- MoD letter to DoE 2 May 1986
- DTI Minute 19 May 1986

The financing of Al Yamamah is finally agreed (late 1986)

The Saudis declined Lloyds’ offer to finance the deal and the final arrangements involved BAe’s cash flow being covered by a loan from a French bank, Banque Indosuez who led a syndicate of banks guaranteed by ECGD. The loan was to be drawn by BAe in full at

once, and repaid on a monthly basis from the oil sale proceeds. The bank had priority over BAe to the oil proceeds money. If the Saudis didn't deliver the 400,000 barrels per day they had now agreed to, ECGD would make sure Banque Indosuez got their money back.

ECGD admitted that the proposal "does not contain legally enforceable obligations on the part of the Saudis to continue to make oil available to meet all the costs of the Project" and "the legal framework is imperfect and it is very doubtful if the Saudi commitment would be enforceable in the courts" (PJ5_40_AY_revised_Aug). The Treasury complained they had been backed into a corner saying "this is a most unsatisfactory state of affairs and one that would hardly have been contemplated if proposed at the outset" (PJ5_40_Treasury_sceptical).

Channon asked his colleagues to agree to a total ECGD cover of £1.43 billion (PJ5_40_Channon_Lawson_Aug). MacGregor again complained that "the risks under the revised proposals are substantial, and to the extent that the guarantee is not subject to ECGD's normal conditions, including not being legally enforceable, the risks are greater now than previously". But the cover was finally agreed.

Other documents

- MoD/Saudi Arabia exchange of notes July 1986
- DESO letter to HM Treasury 9 September 1986
- BoE letter to HM Treasury 10 September 1986
- ECGD letter to HM Treasury 23 October 1986
- DESO letter to HM Treasury 24 October 1986
- BoE letter to HM Treasury 3 November 1986
- HM Treasury letter to ECGD 5 November 1986
- DESO letter to HM Treasury 7 November 1986
- DTI Minute 18 November 1986
- DoE letter to MoD 25 November 1986
- DESO letter to HM Treasury 3 December 1986
- MoD letter to DoE 4 December 1986
- BoE letter to HM Treasury 8 December 1986
- HM Treasury letter to ECGD 9 December 1986
- HM Treasury letter to DTI 15 December 1986
- DoE letter to DTI 15 December 1986
- ECGD letter to BoE 18 December 1986

[March 2007]

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