

PO-CH/NL/0354

PART A

Part A.

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

Begins : 8/11/87.
Ends : 7/11/88.



PO -CH /NL/0354



PART A

Chancellor's (Lawson) Papers:

**THE FINANCIAL SITUATION
IN THE GULF STATES**

PO -CH /NL/0354

PART A

DD's : 25 Years

Phyllis

22/11/95.

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FM RIYADH

TO PRIORITY FCO

TELNO 541

OF 080630Z NOVEMBER 87

INFO PRIORITY BANK OF ENGLAND, HM TREASURY, DEPARTMENT OF ENERGY
INFO PRIORITY DTI

SAUDI FINANCIAL RESERVES

SUMMARY

1. SAUDI ARABIA'S FINANCIAL RESERVES REMAIN SUBSTANTIAL DESPITE SETBACKS IN WORLD STOCK MARKETS. RECENT PRESS SPECULATION INACCURATE.

DETAIL

2. A NUMBER OF COMMENTATORS HAVE SPECULATED RECENTLY, WITH A GREATER OR LESSER DEGREE OF PESSIMISM, ABOUT THE STATE OF SAUDI FINANCIAL RESERVES. PETROLEUM INTELLIGENCE WEEKLY (PIW) OF 12 OCTOBER CARRIED AN ARTICLE DETAILING THE VIEWS OF SILVAN ROBINSON (EX PRESIDENT OF SHELL INTERNATIONAL TRADING COMPANY) WHO CONSIDERS THAT SAUDI ARABIA'S GENUINE LIQUID RESERVES' WILL FALL TO A CRITICAL LEVEL IN 1988 OR 1989.

3. THIS OPINION WAS ECHOED IN MIDDLE EAST ECONOMIC SURVEY (MEES) OF 12 OCTOBER WHERE IT WAS CLAIMED THAT 'USABLE FINANCIAL RESERVES.. HAVE FALLEN TO BELOW US DOLLARS 30 BILLION'.

4. AGAINST THIS, HOWEVER, A SENIOR AND INFORMED CONTACT AT SAMA TOLD MY HEAD OF CHANCERY PRIVATELY ON 19 OCTOBER THAT THE SAUDIS HAD SUFFICIENT RESERVES FOR SEVEN YEARS AT CURRENT RATES OF DRAW-DOWN. THIS IS CONSISTENT WITH OUR ASSESSMENT OF SAUDI RESERVES AS BEING AROUND US DOLLARS 95-105 BILLION IN EARLY 1987, WITH AN ANNUAL DRAW-DOWN FIGURE OF US DOLLARS 16 BILLION. THE LATTER FIGURE IS A SAMA ESTIMATE WHICH, PERHAPS COINCIDENTALLY, CORRESPONDS WITH OUR OWN.

5. RECENT STOCK MARKET UPHEAVALS WILL HAVE DENTED SAUDI RESERVES BY CLAWING BACK SOME OF THIS YEAR'S CAPITAL GAINS, BUT DAMAGE WAS MINIMISED BY SAUDI FOREIGN HOLDINGS BEING MOSTLY IN US BONDS (PARTICULARLY SHORT TERM CNES). BOND VALUES HAVE, OF

COURSE, RECENTLY INCREASED, BUT IT IS NOT CLEAR TO WHAT EXTENT THEY OFFSET SAUDI LOSSES ON THE EQUITY MARKET. THESE LOSSES HAVE BEEN ESTIMATED BY THE US EMBASSY HERE AT US DOLLARS 3 TO 4 BILLION FROM A TOTAL OF US DOLLARS 12 BILLION IN EQUITIES, ALTHOUGH SIR DAVID SCHOLEY OF WARBURGS TOLD ME THAT HE FOUND EVEN THIS FIGURE TOO HIGH. HE AGREED THAT SAUDI ARABIA'S HOLDING OF EQUITIES REPRESENTED NO MORE THAN 10% OF THE TOTAL PORTFOLIO.

6. FINALLY, HAMAD AL SAYARI, (THE GOVERNOR OF SAMA), ON WHOM I CALLED RECENTLY SEEMED VERY CONFIDENT. HE CLAIMED THAT SAUDI ARABIA HAD 'NOT BEEN MUCH AFFECTED BY THE CRASH'. THIS ECHOED IN LOCAL PRESS REPORTS TO THE EFFECT THAT THE NEXT BUDGETARY YEAR IS BEING PLANNED WITHOUT ANY DISCERNABLE INFLUENCE FROM THE STOCK MARKET FALL.

7. SAMA HAVE SOUND TACTICAL REASONS FOR PLAYING DOWN THE TRUE LEVEL OF THEIR RESERVES - BOTH TO ENCOURAGE SOME FINANCIAL DISCIPLINE AT HOME AND TO FEND OFF IRAQI AND OTHER REQUESTS FOR AID. I AM CONFIDENT, THEREFORE, THAT THE RESERVES ARE SOMEWHAT HIGHER THAN THEY PRETEND, BUT LESS CONFIDENT ABOUT THE CURRENT RATE OF DRAW-DOWN. ON REASONABLE ASSUMPTIONS ABOUT THE LATTER, CURRENT PRESS SPECULATION IS TOO PESSIMISTIC.

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FM RIYADH

TO PRIORITY FCO

TELNO 546

OF 090630Z NOVEMBER 87

INFO PRIORITY TREASUREY, BANK OF ENGLAND, ECGD, DTI

DTI FOR OT4

SAUDI RESPONSE TO WORLD MARKET DISORDER: THE RIYAL

SUMMARY

1. FINANCE MINISTER RE-AFFIRMS SAUDI FINANCIAL AND MONETARY POLICY AND DENIES SPECULATION ABOUT THE EXCHANGE RATE OF THE RIYAL. FURTHER DETAIL GIVEN TO LORD MAYOR OF LONDON. DIFFICULT TO SEE WHY SAUDIS SHOULD WISH TO ADJUST VALUE OF RIYAL.

DETAIL

2. IN A STATEMENT TO THE SAUDI PRESS AGENCY ON 6 NOVEMBER, MOHAMMED ABA AL KHAİL SAID THAT CURRENT TURMOIL IN WORLD MARKETS WOULD NOT AFFECT THE FINANCIAL AND MONETARY POLICY OF SAUDI ARABIA AND THAT THE EXCHANGE RATE OF THE RIYAL WOULD CONTINUE TO REMAIN STABLE. HE ADDED THAT INTERNATIONAL MARKET DISORDER MIGHT BENEFIT SAUDI ARABIA BY ENCOURAGING REPATRIATION OF SAUDI FUNDS.

3. WHEN LORD MAYOR CALLED ON DEPUTY MINISTER OF FINANCE, SALEH AL OMAIR, ON 8 NOVEMBER, AL OMAIR SAID THAT MINISTER'S STATEMENT HAD BEEN AIMED AT DAMPENING SPECULATION AGAINST THE RIYAL. HE SAW NO REASON TO INTERFERE WITH US/DOLLAR/ RIYAL PARITY - THERE WOULD BE NO ADVANTAGE. HE ACKNOWLEDGED THAT THE SITUATION WAS WORRYING FOR THE SAUDIS. FRAMING THE 1988 BUDGET, DUE TO BE ANNOUNCED IN JANUARY, WAS BEING MADE VERY DIFFICULT BY NOT BEING ABLE TO PREDICT THE VALUE OF THE DOLLAR (AND, HE MIGHT HAVE ADDED, THE DEMAND FOR OIL IF WORLD-WIDE RECESSION SETS IN). 1988 WOULD BE THE FIFTH CONSECUTIVE YEAR OF BUDGET DEFICIT: A TIME WOULD COME WHEN THE SAUDIS WOULD HAVE NO CHOICE BUT TO BORROW. AL OMAIR AGREED THAT US ACTION TO CUT THEIR DEFICIT WAS REQUIRED. THE GERMANS AND JAPANESE OUGHT ALSO TO ASSUME THEIR RESPONSIBILITIES.

COMMENT

4. THE LAST DEVALUATION OF 2.74 PER CENT TOOK PLACE IN JUNE 1986 (RIYADH TELNO 5 OF 2 JUNE 1986 TO THE BANK OF ENGLAND) THIS WAS PART OF A SERIES OF SMALL DOWNWARD ADJUSTMENTS

PAGE 1
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AGAINST THE DOLLAR WHICH HAD TAKEN PLACE SINCE MID 1980.

5. THE RIYAL HAS, OF COURSE, FOLLOWED THE DOLLAR DOWN SO THERE IS NO CASE FOR FURTHER DEVALUATION. REVALUATION WOULD, OF COURSE, REDUCE THE IMPACT OF THE PRICE OF IMPORTED GOODS BUT INFLATION IS NOT CURRENTLY A PROBLEM HERE. AS SAUDI OIL IS DENOMINATED IN DOLLARS, THE GOVERNMENT WOULD SUFFER A LOSS OF INCOME IN RIYAL TERMS WHICH THEY CANNOT AFFORD. THEY WOULD ALSO MAKE THEIR NON-OIL EXPORTS LESS COMPETITIVE.

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Foreign and Commonwealth Office

London SW1A 2AH

From The Minister of State

22 December 1987

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ECONOMIC SECRETARY	
REC'D	- 1 JAN 1988
ACTION	for information
COPIES TO	Mr M Williams
	PS/chancellor
	PS/FST
	Ms Leahy

Dear Peter,

*Mr Johns - IR
PS/IR.*

Thank you for your letter of 15 December about the informal discussion in IEA on 2 December of reactions to a closure of the Straits of Hormuz.

Whilst I agree with you that complete assurance is not possible, I believe the degree of common ground which now appears to exist amongst those present at the meeting should make it easier for them to act effectively together should there be a crisis. I am most grateful to you and your officials for the efforts that were made to bring about the meeting.

I understand that those involved agreed to keep in touch and consult one another rapidly in the event of a crisis. Given the unpredictability of the Gulf situation, I believe it will be important for officials to keep the situation under review, as necessary, in their periodic contacts with their opposite numbers in the countries concerned.

I am copying this letter to Peter Lilley at the Treasury and Sir Robert Armstrong.

Glynis

THE LORD GLENARTHUR

The Hon Peter Morrison MP
Minister of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

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FM RIYADH

TO IMMEDIATE FCO

TELNO 659

OF 311130Z DECEMBER 87

INFO PRIORITY TREASURY, BANK OF ENGLAND, DTI, ECGD

DTI FOR OT4

FCO FOR MED

FROM FORMSTONE: SAUDI BUDGET FOR 1988.

SUMMARY

SAUDI GOVT. ISSUED STATEMENT OF BUDGET FOR YEAR COMMENCING 31.12.87 ON 30.12.87. 1987 ECONOMY ACHIEVED POSITIVE GROWTH. REAL NON-OIL GDP UP BY 0.8% COMPARED WITH 2.3% DECLINE IN 1986. COST OF LIVING INDEX DOWN 1.4%. TRADE BALANCE SURPLUS SR 14 BILLION - NON-OIL EXPORTS UP 25%. TOTAL GOVERNMENT REVENUES FOR 1988 ESTIMATED AT SR 105 BILLION - NON-OIL REVENUES SR 36.3 BILLION. AUTHORISED EXPENDITURES SR 141.2 BILLION (SR 28.8 BILLION DOWN ON 1987 BUDGET). DEFECIT TO BE MET BY SR 8 BILLION TRANSFER FROM RESERVES AND GOVERNMENT BOND ISSUE OF UP TO SR 30 BILLION. DOMESTIC SUBSIDIES APPROPRIATION WILL BE SR 6.1 BILLION.

DETAIL

1. SAUDI GOVERNMENT ISSUED BUDGET STATEMENT FOR THE YEAR COMMENCING 31.12.87 ON 30.12.87. FURTHER DETAILS RELEASED BY MINISTRY OF FINANCE AND NATIONAL ECONOMY 10.00 GMT ON 31.12.87.

ECONOMY IN 1987

2. ACCORDING TO MINISTRY STATEMENT (ON WHICH ALL DETAIL BASED) ECONOMY ACHIEVED REAL POSITIVE GROWTH IN 1987 FOR FIRST TIME IN THREE YEARS. REAL NON-OIL GDP GREW BY 0.8% COMPARED WITH 5.7% DECLINE IN 1985 AND 2.3% DECLINE IN 1986. REAL NON-OIL GDD DEFLATOR DOWN BY 1.5% AND COST OF LIVING INDEX DOWN 1.4%. COST OF LIVING INDEX DECLINED 9.2% SINCE 1983. TRADE SURPLUS ROSE FROM SR 4 BILLION IN 1986 TO SR 14 BILLION IN 1987. THIS ACHIEVED AT A TIME WHEN IMPORTS GREW (BY 5% TO TOTAL SR 73 BILLION) FOR FIRST TIME IN THREE

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YEARS. EXPORTS INCREASED BY 16% TO SR 87 BILLION WITH INCREASE IN NON-OIL EXPORTS 25% TO SR 9.4 BILLION. GOVERNMENTS LENDING INSTITUTIONS DISBURSED SR 6.1 BILLION IN 1987.

REVENUES

3. REVENUES FOR 1988 ESTIMATED AT SR 105 BILLION WHICH OIL SR 68.9 BILLION AND NON-OIL SR 36.3 BILLION. ESTIMATED NON-OIL REVENUES IN 1988 EXPECTED TO BE SR 7.8 BILLION HIGHER THAN ACTUAL LEVEL IN 1987. MAJOR ITEMS OF REVENUE ESTIMATED AT: OIL SR 68.9 BILLION SEMI COLON TAXES SR 1.7 BILLION SEMI COLON ZAKAT SR 0.9 BILLION SEMI COLON CUSTOMS DUTIES SR 6.0 BILLION SEMI COLON PTT 4.2 BILLION SEMI COLON PUBLIC SERVICE FEES SR 2.0 BILLION SEMI COLON OTHER GOVT SERVICES SR 0.7 BILLION SEMI COLON OTHER SR 19.7 BILLION.

EXPENDITURE

4. EXPENDITURE AUTHORISED FOR 1988 IS SR 141.2 BILLION - SR 28.8 BILLION DOWN FROM 1987. MAIN APPROPRIATIONS ARE SR 67.9 BILLION FOR ADMINISTRATIVE EXPENSES SEMI COLON SR 51.1 BILLION FOR CAPITAL AND OPERATIONAL EXPENSES SEMI COLON SR 6.1 BILLION FOR DOMESTIC SUBSIDIES. GOVERNMENTS SPECIALISED LENDING INSTITUTIONS WILL LEND SR 6.8 MILLION OUT OF ACCUMULATED REPAYMENTS WITH SR 0.790 MILLION SUPPLEMENT FROM BUDGET.

5. MORE DETAILED EXPENDITURES ARE : NATIONAL GUARD DEFENCE AND INTERIOR SR 50.8 BILLION SEMI COLON MUNICIPAL AFFAIRS SR 8.7 BILLION SEMI COLON EDUCATION AND UNIVERSITIES SR 21.8 BILLION SEMI COLON INFORMATION SR 0.8 BILLION SEMI COLON HEALTH SR 8.8 BILLION SEMI COLON LABOUR SOCIAL AFFAIRS AND TRAINING SR 1.3 BILLION SEMI COLON CIVIL AVIATION SR 2.4 BILLION SEMI COLON PORTS SR 0.8 BILLION SEMI COLON AGRICULTURE AND WATER SR 3.9 BILLION SEMI COLON INDUSTRY AND ELECTRICITY SR 2.1 BILLION SEMI COLON PETROLEUM AND MINERAL RESOURCES SR 0.3 BILLION SEMI COLON WORKS AND HOUSING SR 1.0 BILLION SEMI COLON ROYAL COMMISSION SR 2.1 BILLION : MISC ADMIN SR 6.4 BILLION SEMI COLON GOVT CREDIT INSTITUTIONS SR 7.5 BILLION SEMI COLON LOCAL SUBSIDIES SR 7.0 BILLION SEMI COLON OTHER SR 18.0 BILLION.

DEFECIT

6. THE DEFECIT WILL BE FINANCED BY (1) A SR 8 BILLION

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TRANSFER FROM THE GOVERNMENTS GENERAL RESERVES (11) ISSUE OF GOVERNMENT BONDS OF UP TO SR 30 BILLION. THESE WILL BE ISSUED GRADUALLY THROUGHOUT THE YEAR TO AUGMENT FINANCING OF DOMESTIC EXPENDITURES AND TO PROVIDE AN INVESTMENT INSTRUMENT FOR DOMESTIC SAVINGS FREE FROM FLUCTUATIONS OF INTERNATIONAL MARKETS.

COMMENTS

7. DETAILED COMMENT WITH CLARIFYING DATA WHERE POSSIBLE (EG LIST OF EXPENDITURES ADDS UP TO SOME SR 7 BILLION MORE THAN GIVEN TOTAL) WILL FOLLOW IN DUE COURSE.

8. OFF THE CUFF COMMENTS: IMPORTANT FACT IS THAT BUDGET ISSUED ON TIME SEMI COLON OIL REVENUE ESTIMATE (AT SOME SR 5 BILLION ABOVE REPORTED SR 64 BILLION ACTUAL IN 1987) COULD BE OPTIMISTIC SEMI COLON EXPENDITURE CUT CONSIDERABLY - DEFENCE EXPENDITURE IS (ON ROUGH CALCULATION) REDUCED AS SMALLER PERCENTAGE ALLOCATION OF SMALLER BUDGET SEMI COLON FUND RAISING BY BOND ISSUE IS A NEW DEPARTURE - SEEM TO BE FOR INTERNAL PURCHASE ONLY AND FOR PRIORITY EXPENDITURE ON DEVELOPMENT PROJECTS. OTHER FEATURES REFERRED TO IN PUBLIC PRONOUNCEMENTS BUT NOT CONTAINED IN ENGLISH TEXT OF MINISTRY STATEMENTS INCLUDE FREEZE ON GENERAL GOVT. RECRUITMENT AND PROMOTION AND NEW DUTIES TO PROTECT LOCAL INDUSTRY. FURTHER DETAILS WILL FOLLOW.

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TO DESKBY 041500Z FCO

TELNO 005

OF 041130Z JANUARY 87

INFO IMMEDIATE JEDDA, DTI, BANK OF ENGLAND, ECGD

INFO IMMEDIATE MODUK, HM TREASURY,

INFO PRIORITY GULF POSTS

INFO SAVING AL-KHOBAR

MODIUK FOR HDES

DTI FOR OT4

MY TELNO 659: SAUDI FINANCIAL MEASURES

SUMMARY

1. SAUDIS HAVE FOLLOWED UP THE AUSTERITY BUDGET REPORTED IN TUR BY ANNOUNCING THE REINTRODUCTION OF INCOME TAX CONFINED TO EXPATRIATES. WE MAY NEED TO SEEK EXEMPTIONS FOR CERTAIN CATEGORIES OF BRITISH NATIONALS.

DETAIL

2. ROYAL DECREE NO. M/13 DATED 31 DECEMBER 1987, PUBLISHED IN THE OFFICIAL GAZETTE OF 1 JANUARY (ONLY RELEASED ON 3 JANUARY), PROVIDES FOR THE REIMPOSITION OF INCOME TAX ON EXPATRIATES WITH THE SAME RATES, CATEGORIES AND EXEMPTIONS AS BEFORE ITS REPEAL IN 1975. THE RATES OF INCOME TAX, APPLICABLE FROM 20 JANUARY, WILL BE:

- (A) UP TO SR6000 PER YEAR (SR1 EQUALS 0.14 POUNDS) - EXEMPT
- (B) SR6000 TO SR16000 PA - 5 PER CENT
- (C) SR16000 TO SR36000 PA - 10 PER CENT
- (D) SR36000 TO SR66000 PA - 20 PER CENT
- (E) OVER SR 66000 PA - 30 PER CENT

COMPANY TAXES ARE APPARENTLY UNCHANGED.

COMMENT

3. WE UNDERSTAND THAT THE SAUDIS PRIVATELY EXPECT TO GARNER SR 8-12 BILLION BY THESE MEASURES, ALTHOUGH THIS WAS NOT ANNOUNCED IN THE BUDGET.
4. THE EXPATRIATE COMMUNITY HAS BEEN TAKEN ABACK. THE MAJORITY OF BRITISH EXPATRIATES ARE PAID IN RIYALS, AND HAVE ALREADY BEEN HIT BY THE DOLLAR-LINKED RIYAL'S FALL AGAINST THE POUND. THIS LATEST BLOW COULD MAKE MANY CALL IT A DAY IN THE KINGDOM, THUS, OF COURSE, REDUCING THE REVENUE ACHIEVED.
5. WE MAY COME UNDER PRESSURE TO MAKE REPRESENTATIONS TO THE SAUDIS, BUT I THINK MOST EXPATRIATES WILL REALISE THAT TAXATION IS A SOVEREIGN MATTER, HOWEVER UNWELCOME THE RENEWED DISCRIMINATION AGAINST FOREIGNERS.
6. I HAVE AN APPOINTMENT TO SEE THE VICE MINISTER OF FINANCE, SALEH AL OMAIR, ON 10 JANUARY AND INTEND TO SEEK CLARIFICATION OF SEVERAL IMPORTANT ASPECTS AND EXPRESS INFORMALLY THE CONCERNS OF OUR EXPATRIATES. I SHALL PROBE TO SEE IF THERE IS ANY 'GIVE' IN, FOR EXAMPLE, THE DATE OF INTRODUCTION OF THIS NEW TAX: OR IN THE THRESHHOLDS, WHICH ARE LOW.
7. WE HAVE BEEN IN TOUCH WITH THE US EMBASSY WHOSE COMMUNITY IS EVEN LARGER THAN OUR OWN. WE HAVE AGREED TO EXCHANGE VIEWS WITH THEM ABOUT THE IMPLICATIONS FOR OUR DEFENCE AND DEFENCE CONTRACTORS PERSONNEL HERE. WE SHALL WORK ON THE ASSUMPTION THAT EMBASSY LOCAL STAFF AND HOUSEHOLD SERVANTS WILL BE EXCLUDED, AND WE MAY SEEK EXEMPTION FOR THE BRITISH-RUN SCHOOLS ON THE GROUNDS THAT THEY ARE NOT (NOT) PROFIT-MAKING. I EXPECT THAT THE EUROPEAN COMMUNITY WILL ALSO COORDINATE BEFORE LONG.
8. PRELIMINARY ENQUIRIES OF BRITISH AEROSPACE INDICATE THAT THEIR BRITISH CONTRACT AND SECONDED PERSONNEL APPEAR TO BE EXEMPT FROM INCOME TAX UNDER THEIR CONTRACTS, BUT THE COMPANY ITSELF MAY BE LIABLE. WE ARE LOOKING INTO THE POSITION OF THE BRITISH MILITARY TEAMS, BUT DO NOT (NOT) EXPECT THEM TO BE AFFECTED.
9. I RECOMMEND THE FOLLOWING PRESS LINE, IF QUESTIONED:

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' 'THE BRITISH COMMUNITY IS CONCERNED ABOUT THE NEW MEASURES.
WE ARE STUDYING THEM CAREFULLY AND SEEKING CLARIFICATION
WHERE APPROPRIATE, WHILE RECOGNISING THAT GOVERNMENTS
HAVE A RIGHT TO TAX RESIDENTS IN THEIR OWN COUNTRIES.' '

MY APPOINTMENT WITH AL OMAIR SHOULD PLEASE NOT (NOT) BE MENTIONED,
LEST IT RAISF EXPECTATIONS.

10. COD PLEASE ADVANCE COPY OF THIS TELEGRAM TO NEWS DEPARTMENT
BEFORE 1230Z IF HUMANLY POSSIBLE.

11. MED REGISTRY PASS TO PUSD.

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TO IMMEDIATE FCO

TELNO 12

OF 061030Z JANUARY 88

INFO IMMEDIATE DTI, BANK OF ENGLAND, ECGD, MODUK. HM TREASURY

INFO PRIORITY GULF POSTS

INFO SAVING AL-KHOBAR

DTI FOR OT4

MODUK FOR HDES AND SAPO

MY TWO IPTS (NOT TO ALL) AND MY TELNO 005: SAUDI FINANCIAL
MEASURES

1. THE OFFICIAL SAUDI PRESS AGENCY REPORTED LATE ON
5 JANUARY THAT QUOTE (UNDERLINED) IN VIEW OF THE PRESENCE OF FACTORS
DEMANDING RECONSIDERATION OF WHAT HAS BEEN ISSUED UNQUOTE
(UNDERLINED), THE KING HAS ORDERED THE CANCELLATION OF THE DECREE
REIMPOSING INCOME TAX ON EXPATRIATES.

2. THIS IS BEING INTERPRETED BY THE OFFICIAL MEDIA AS
COMPLETE ABANDONMENT OF THE IDEA, AND THE PRESS IS FULL OF
STATEMENTS BY EXPATRIATES AND LOCAL BUSINESSMEN WELCOMING
THE KING'S WISE AND GENEROUS DECISION.

3. THE CANCELLATION FOLLOWS REPORTS OF A WAVE OF
PROTESTS AND RESIGNATIONS (ESPECIALLY IN THE HOSPITALS).

SAUDI BUSINESSMEN FACED WITH COMPENSATING INDISPENSIBLE
FOREIGN STAFF HAD ALSO BEEN WEIGHING IN.

4. IT WILL BE INTERESTING TO SEE WHETHER THE DECREE
EMBODYING THE KING'S DECISION, WHEN IT EMERGES, LEAVES
THE DOOR OPEN FOR SUBSEQUENT REVIVAL OF INCOME TAX IN SOME
LESS PUNITIVE FORM. BUT THE IMMEDIATE PANIC IS OVER, AND
THE BRITISH COMMUNITY HIGHLY RELIEVED.

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FM RIYADH

TO IMMEDIATE FCO

TELNO 011

OF 061015Z JANUARY 88

INFO PRIORITY DTI, HM TREASURY, BANK OF ENGLAND, ECGD, MODUK

DTI FOR OT4

MODUK FOR SAPO, CASTLEWOOD HOUSE

MIPT: SAUDI BUDGET FOR 1988

1. FOLLOWING IS BREAKDOWN BY VOTE, IN BILLION SAUDI RIYALS:

	1988	PERCENT OF TOTAL	PERCENT CHANGE 1987/88
A. TOTAL REVENUE	143.3	100	- 15.7
OIL REVENUE	68.9	48.1	5.7
OTHER REVENUES	36.4	25.4	- 30.2
FROM GENERAL RESERVES	8.0	5.6	- 84.8
FROM TREASURY BONDS	30.0	20.9	
B. EXPENDITURE BY CATEGORY			
TOTAL	141.7	100	- 16.6
MANPOWER DEVELOPMENT	21.7	15.3	- 8.4
TRANSPORTS AND COMMUNICATIONS	10.2	7.2	- 14.6
ECONOMIC RESOURCE DEVELOPMENT	6.5	4.6	- 22.9
HEALTH AND SOCIAL DEVELOPMENT	9.8	6.9	- 11.3
INFRASTRUCTURE	3.1	2.2	- 27.3
MUNICIPAL SERVICES	7.7	5.4	5.0
DEFENCE AND SECURITY	50.8	35.8	- 16.4
ADMINISTRATION AND			

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OTHER SPENDING	25.0	17.7	- 20.0
GOVERNMENT LENDING INSTITUTIONS	0.8	0.6	- 78.3
LOCAL SUBSIDIES	6.0	4.3	- 11.3

2. SEE MIFT

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TO IMMEDIATE FCO

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OF 061015Z JANUARY 88

INFO PRIORITY DTI, HM TREASURY, BANK OF ENGLAND, ECGD, MODUK

INFO PRIORITY GULF POSTS

INFO SAVING AL KHOBAR

MODUK (SAPO, CASTLEWOOD HOUSE)

DTI FOR OT4

MY TELNO 659 (NOT TO ALL): SAUDI BUDGET FOR 1988

SUMMARY

1. A TOUGH BUDGET. PLANNED EXPENDITURE IS DOWN NEARLY 17%. DEFENCE CUT (BY A SIMILAR PERCENTAGE) FOR THE FIRST TIME IN RECENT YEARS. HIGHER IMPORT DUTIES WILL IMPROVE REVENUE AND PROTECT LOCAL INDUSTRY. NOTABLE ABSENCE OF MEASURES AFFECTING THE ORDINARY CITIZEN. INTRODUCTION OF DOMESTIC BORROWING DESIGNED TO MINIMISE DRAWDOWN OF STILL SUBSTANTIAL FOREIGN RESERVES. OUTCOME WILL DEPEND ON THE OIL MARKET, BUT SAUDIS HAVE BEEN REALISTIC AND PRUDENT. THEY ARE HUSBANDING THEIR RESERVES.

DETAIL

2. THE SAUDIS HAVE CLEARLY DECIDED TO TIGHTEN THEIR BELTS IN THE FACE OF CONTINUING OIL MARKET UNCERTAINTY. THE 17% REDUCTION IN EXPENDITURE COMPARES WITH APPROXIMATELY 10% OVERALL CUTS IN RECENT YEARS. THE CUTS ARE FAIRLY EVENLY SPREAD, WITH ONLY THE DETERIORATING MUNICIPAL SERVICES BEING GIVEN SIGNIFICANTLY MORE MONEY. A BREAKDOWN OF EXPENDITURE BY AGENCY FOLLOWS BY BAG. MIFT CONTAINS A BREAKDOWN BY VOTE.

3. THE STEEP CUT IN THE DEFENCE VOTE MAY EXPLAIN PRINCE SULTAN'S CAUTION IN RECENT NEGOTIATIONS AS WELL AS THE APPARENT POSTPONEMENT OF THE SUBMARINE PROJECT AND, PERHAPS, THE DELAYS OVER THE NAVAL PACKAGE. HOWEVER, I WOULD EXPECT MONEY TO BE FOUND FOR ESSENTIAL MILITARY EXPENDITURE, ESPECIALLY IF THE GULF SITUATION DETERIORATES.

4. THE SAUDIS HAVE BEEN FORCED INTO THESE CUTS BY THE UNCERTAIN

PROSPECTS FOR THEIR OIL REVENUES. THE OIL PRICE IS HOLDING UP FOR THE PRESENT BUT ONLY BECAUSE A NUMBER OF GULF COUNTRIES (INCLUDING SAUDI ARABIA) ARE APPARENTLY RESTRAINING PRODUCTION. THE BUDGET SEEMS DESIGNED TO CAMOUFLAGE SAUDI EXPECTATIONS FOR THE OIL PRICE. OFFICIAL GUIDANCE HAS SUGGESTED THAT IT WAS CALCULATED ON THE BASIS OF US DOLLARS 20 PER BARREL. HOWEVER, WE BELIEVE THAT THEY ARE MORE LIKELY TO HAVE USED A FIGURE OF US DOLLARS 15. THE OIL REVENUE ESTIMATE OF SR69 BILLION (WHEN 1987 REVENUES WERE ONLY SR 65 BILLION) COULD BE EXPLAINED BY THE INCLUSION OF RECEIPTS FROM EXPATRIATE INCOME TAX WHICH, WHEN THE BUDGET ISSUED ON 30 DECEMBER, HAD NOT BEEN ANNOUNCED.

5. CUSTOMS DUTIES ARE ESTIMATED TO GENERATE SR 6.5 BILLION, AND WILL STIMULATE LOCAL INDUSTRY ALTHOUGH AT THE COST OF SOME INFLATION. SOME MERCHANTS WILL PROTEST, BUT THOSE WHO HAVE MANUFACTURING INTERESTS WILL NATURALLY WELCOME THE ENHANCED PROTECTION NOW AFFORDED. THERE WILL BE DISAPPOINTMENT THAT ONLY SR 9 BILLION HAS BEEN MADE AVAILABLE FOR NEW PROJECTS (COMPARED TO SR 50 BILLION LAST YEAR, NOT ALL OF WHICH WAS SPENT).

6. THE GOVERNMENT HAVE AVOIDED IMPOSING CUSTOMS DUTIES ON STAPLES AND OTHER GOODS WIDELY PURCHASED BY SAUDIS. INDEED, THERE IS A NOTABLE ABSENCE OF ANY MEASURES, SUCH AS A REDUCTION IN SUBSIDIES, WHICH DIRECTLY AFFECT THE CITIZEN. THIS SUGGESTS THAT THE KING DOES NOT (NOT) CONSIDER THAT THE SITUATION JUSTIFIES ALIENATING POPULAR SUPPORT. INDEED, HE RAPIDLY CANCELLED THE PROPOSED INCOME TAX ON FOREIGNERS IN THE FACE OF A STORM OF PROTESTS FROM FOREIGNERS THEMSELVES AND FROM THEIR SAUDI EMPLOYERS (SEE MY SECOND IFT). WE BELIEVE THAT THE AUTHORITIES HAD HOPED TO RAISE SR 8 - 12 BILLION BY THIS MEANS, AS WELL AS GIVING SAUDIZATION A BOOST.

7. THE BUSINESS COMMUNITY EXPECT THAT THE BANKS WILL PURCHASE MOST OF THE SR 30 BILLION OF GOVERNMENT BONDS, PERHAPS BY CONVERTING THEIR PRESENT DEPOSITS WITH SAMA. THERE IS NO (NO) QUESTION OF BORROWING ABROAD.

8. THE IMPLICATIONS FOR TORNADO OFFSET MAY, ON BALANCE BE FAVOURABLE. LOWER GOVERNMENT SPENDING AND HIGHER CUSTOMS DUTIES WILL MAKE IT HARD TO SUSTAIN LAST YEAR'S MODEST GROWTH IN THE NON-OIL SECTOR. HOWEVER, THE GREATER PROTECTION FOR LOCAL MANUFACTURING COULD MAKE THE ESTABLISHMENT OF JOINT VENTURES OF MORE INTEREST.

9. IN PRESENTING THE BUDGET, GOVERNMENT MINISTERS HAVE STRESSED THE NEED TO ADJUST THE LOWER OIL INCOME, AND THE FACT THAT EARLIER MASSIVE EXPENDITURE ON INFRASTRUCTURE IS NOW COMING TO AN END. THEY HOPE TO SEE THE PRIVATE SECTOR TAKE ON A LARGER ROLE (THEY POINT TO ITS GROWTH LAST YEAR) , AND DESCRIBE THE NEW TARIFFS AS DESIGNED TO ENCOURAGE THAT. SO FAR THERE HAS BEEN LITTLE REACTION (EXCEPT TO THE INCOME TAX): A TOUGH BUDGET WAS GENERALLY EXPECTED.

10. THE GOVERNMENT WILL HAVE DIFFICULTY IN MEETING THEIR TARGETS FOR BOTH REVENUE AND EXPENDITURE, BUT THEY ARE SHOWING A RENEWED DETERMINATION TO GET THEIR EXPENDITURE UNDER CONTROL. WE HAVE REASON TO BELIEVE THAT THEIR RESERVES ARE STILL CONSIDERABLE AND WELL DIVERSIFIED. BUT THEY SEEM TO BE PREPARING FOR THE POSSIBILITY THAT IT COULD BE SEVERAL YEARS BEFORE THE OIL MARKET MOVES IN THEIR FAVOUR.

11. SEE MY 2 I.F.TS (NOT TO ALL).

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2-
 Mrs Case / Mr Seaman
 February 1988
 Cx, Mr Anson, Sir C. Litter
 Mr Lankester, Mr Bonyner, Mr Moore,
 Mr Mansfield,
 Mr Roberts,
 Mr Turnbull,
 Mr P.G.F. Davis,
 Mr Call

Copy to:
 PS/Minister (DP)
 PSU/CDE
 PS/PUS
 PS/CAS

Dear Charles,

PRIME MINISTER'S MEETING WITH KING HUSSEIN OF JORDAN

The Prime Minister will be aware of the background to the sale of Tornado to Jordan. We had been working with the Jordanians on the basis of the supply of the Air Defence Variant. On 11th December King Hussein told the Prime Minister that he wanted IDS aircraft instead. After a delay obtaining Washington agreement to the supply of American sourced components an offer was formally presented in Amman to the Jordanian CinC, Field Marshal Bin Shaker, on 30th January.

The offer was well received. A British team was invited to visit Jordan quickly to discuss a concept of operations and training and to assess available support facilities. The visit was made on 7th-13th February and the team report will be submitted to the Royal Jordanian Air Force (RJAF) on 2nd March. A copy will be available to the CinC, now in London, before the Prime Minister's meeting. The report concludes that the RJAF has a sound infrastructure on which to build for the operation and maintenance of the IDS aircraft. A RJAF visit to Britain for further discussion is expected March.

The IDS aircraft price proposed at about £27M (January 1988 prices) is some 8% lower than that offered for the ADV. But the total cost of the package, £425M, is higher as it includes a number of extra weapons systems that Jordan asked to be costed. Detailed discussions still have to take place on the scope of the equipment to be supplied. Delivery of the aircraft would commence end-January 1991 based on a July 1988 contract date. Credit terms included in the offer are as for the ADV - 85% cover; repayment over 8 years; sterling interest 8.75%. Ministerial approval exists to improve these to 90% cover over 10 years with a grace period; the Jordanians are aware that improved terms will be on offer but not what they are.

Charles Powell Esq
 No 10 Downing Street



We had understood that the RJAF would be updating their French F1 fleet. But while the King was in Paris recently it was announced that he had agreed additionally to purchase 20 Mirage 2000 aircraft. This was a surprise. Reports are unclear on the status of the French agreement — but attractive credit terms appear to have been offered: possibly 5 year grace period, 12 years repayment, 7% interest.

Our improved terms can get close to this French offer except on interest rates. But the Prime Minister will wish to be cautious, even in the face of the King's expressed wish to finalise the deal now. It is clearly not possible until the exact shape and content of the package is decided. There remains also a domestic problem resulting from the high level of risk sharing from industry and the wish of British Aerospace to see ECGD take a higher level of recourse than normal; changes to the company's financial exposure resulting from exchange rate fluctuations have led both the company and ECGD to review the level of government support necessary to maintain the project.

In any case the Prime Minister will wish to determine whether the King intends to buy French aircraft also and if so how he intends to cover the extra commitments in addition to existing loans. The status of the French deal is uncertain and it may have been no more than a ploy by the King; the Prime Minister will wish to persuade the King to buy Tornados first. It is possible that some Saudi finance has been made available, in which case we should expect to get some advantage from that given our generous loan on previous defence packages. We should not wish to see the Tornado bought on UK credit with the French getting a cash deal.

It will not be possible to finalise the deal or even perhaps to agree terms. But we do understand that the King wishes to release a joint press statement on Wednesday morning, the terms of which have been agreed with officials here. The Prime Minister will wish to welcome this, particularly since the French are showing signs of representing Jordan as a coup in their battle with us for future aircraft markets in India and the Far East. The text is as follows:

"Agreement has been reached between the British and Jordanian Governments on the purchase by Jordan of 8 Tornado IDS aircraft. Detailed discussions are already underway, and it is expected that these will soon lead to contract signature. This purchase will further cement the already close relations in the defence field between the two countries."

A brief summary of points to make is attached.

Yours sincerely
D C J Ball

(D C J BALL)
Private Secretary



TORNADO IDS FOR JORDAN

Points to make

1. Pleased at your decision to purchase 8 Tornado IDS aircraft. Hope that the further discussions planned between the RJAF and MOD will lead to formal negotiations and early contract signature.
2. Aware of your plans to upgrade some of your existing F1 aircraft and employ them in the air defence role; but surprised to read in the press that you also intend to order (some 20) Mirage 2000s. Grateful for the background to this and how these aircraft fit into your long term plans.
3. Understand that you were considering the purchase of Tornado from your own resources in the absence of Saudi finance. Is this still the position.
4. Pleased at agreement on joint statement of intentions.

Defensive if question of improvement to credit terms is raised

5. I am sure there is room for improvements; I suggest that we leave this our negotiators to handle the details.

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PS. TO CHANCELLOR OF THE EXCHEQUER.
TREASURY.

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FM RIYADH

TO PRIORITY FCO

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INFO ROUTINE UK DEL OECD PARIS, UKREP BRUSSELS, OPEC POSTS

INFO ROUTINE DEPT OF ENERGY

INFO SAVING JEDDA, AL-KHOBAR

MY TELNO 49 (NOT TO ALL): SAUDI ARABIA: VIEWS ON THE OIL PRICE

SUMMARY

1. THE KING AND OIL MINISTER URGE ADHERENCE TO OPEC QUOTAS. SIGNS OF SAUDI PRESSURE ON OTHER PRODUCERS. ONE INDICATION THAT THE AL SAUD ARE RESIGNED TO A SEVERE FALL IN THE OIL PRICE LATER THIS YEAR.

DETAIL

2. IN A STATEMENT TO THE SAUDI PRESS AGENCY ON 21 MARCH, THE OIL MINISTER, HISHAM NAZER, SAID THAT THE OIL PRICE WOULD RISE IF OPEC MEMBERS REMAINED COMMITTED TO THEIR QUOTAS. THE DIFFICULTIES FACING OPEC NOW WERE SIMILAR TO THOSE FACED LAST YEAR: THEY WOULD BE OVERCOME THIS YEAR, AS LAST. ADHERENCE TO PRODUCTION QUOTAS AND AVOIDANCE OF ANY KIND OF PREMIUM (SC. DISCOUNT) WOULD KEEP SUPPLY AND DEMAND IN BALANCE. HE CLAIMED THAT SAUDI ARABIA WAS CONDUCTING CONSULTATIONS WITH OIL PRODUCING STATES 'INSIDE AND OUTSIDE OPEC' TO ENSURE SUCH A BALANCE.

3. NAZER'S STATEMENT WAS UNDERLINED BY THE KING AFTER THE WEEKLY MEETING OF THE COUNCIL OF MINISTERS ON 21 MARCH. THE KING SAID THAT THE MAIN FACTOR IN ACHIEVING A BALANCE IN SUPPLY AND DEMAND WAS THE COMMITMENT TO QUOTAS, AND WARNED OF THE CONSEQUENCES OF BREACHING IT.

4. FOLLOWING LAST WEEK'S ARAB ENERGY CONFERENCE IN BAGHDAD, WHICH WAS ATTENDED BY NAZER, THERE HAVE BEEN REPORTS IN THE SAUDI PRESS OF A CUT IN IRAQI PRODUCTION OF UP TO 500,000 BPD. A PRESS CONFERENCE GIVEN BY THE EGYPTIAN OIL MINISTER ON 20 MARCH IS ALSO REPORTED IN WHICH THE MINISTER

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DESCRIBED THE LONDON MEETING OF NON-OPEC MINISTERS AS
'EXTREMELY POSITIVE'. THE PARTICIPATING COUNTRIES HAD STRESSED
THEIR BELIEF IN THE IMPORTANCE OF CONSULTATION, COORDINATION
AND FULL COOPERATION AIMED AT STABILISING PRICES AND
PREVENTING A DECLINE ON THE WORLD MARKET. AGREEMENT,
HE SAID, HAD BEEN REACHED ON FURTHER NON-OPEC CONTACTS ON
PRICE STABILISATION. MEANWHILE CONTACTS BETWEEN EGYPT AND
OPEC MEMBERS WERE CONTINUING.

COMMENT

5. LUKMAN'S PRESS CONFERENCE ON WORLD OIL SITUATION IS AWAITED
WITH INTEREST HERE. THE RECENT SLIGHT FIRING OF THE MARKET
IS CLAIMED BY THE SAUDI PRESS TO BE A RESULT OF NAZER'S
STATEMENT, AND OF THE PRESSURE THE SAUDIS HAVE BEEN
EXERTING ON OTHER PRODUCERS. THE AUTHORITIES CONSIDER THIS
SUFFICIENT ACTION FOR THE MOMENT. THEY HAVE MADE IT CLEAR
FOR SOME TIME THAT THEY WILL NOT (NOT) WISH TO EMBARK ON A MEETING
OF THE OPEC PRICING COMMITTEE UNLESS THE OUTCOME HAS BEEN LARGELY
PRE-DETERMINED. A MESSY FAILURE WOULD BE FAR MORE
DAMAGING TO THE OIL MARKET THAN NO MEETING AT ALL.

6. PRINCE SULTAN BIN TURKI, A YOUNG BUSINESSMAN WHO
IS USUALLY BRIEFED BY HIS FATHER, AND BY HIS UNCLE
PRINCE SULTAN (MINISTER OF DEFENCE), ON DISCUSSIONS BETWEEN
THE KING AND TOP PRINCES, TOLD ME ON 21 MARCH THAT THE
AL SAUD ARE RESIGNED TO A SEVERE FALL IN THE OIL PRICE
LATER THIS YEAR. 'IT WILL BE LIKE 1986, BUT WE ARE
READY FOR IT.'

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ECONOMIC ADVISERS
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MR FAIRWEATHER
SIR D MIERS
MR MAUD

ADDITIONAL 41

OIL

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BF 7/4/88

FROM: P J EDWARDS
DATE: 30 MARCH 1988

Ch. X below. Since Dr Omair is only the Vice-Minister, and given the other arrangements being made for him, I see no need for you to see him yourself.

PS/ECONOMIC SECRETARY cc

PS/Chancellor
PS/Chief Secretary
Mr Scholar
Mr Bush

75/14

VISIT TO LONDON OF DR AL OMAIR, VICE MINISTER OF FINANCE, SAUDI ARABIA, BETWEEN SUNDAY, 22 MAY AND THURSDAY 26 MAY

The Economic Secretary and Mr Scholar kindly agreed to receive Dr Omair on 16 March in order to discuss the formulation of the Budget. You will recall that Dr Omair reluctantly had to cancel his trip to London at short notice. I have been informed by the Central Office of Information (COI), who are organising the programme, that the visit has been re-arranged for 22-26 May. The COI would very much like to re-introduce the original programme of meetings. Would the Economic Secretary and Mr Scholar be available during this period in order to receive Dr Omair?

2. The Foreign and Commonwealth Office hope to arrange a formal lunch on either Monday, 23 May, or Tuesday, 24 May. The Foreign and Commonwealth Office have suggested that it would be appropriate for the Chief Secretary to host the lunch at a venue such as Lancaster House, and have formally asked if this can be arranged. The Deputy Governor of the Bank of England hopes to host a lunch on Wednesday, 25 May. The COI have also asked if Dr Omair could possibly make a courtesy call on the Chancellor during his stay but I have said that this may not be appropriate.

3. I would appreciate your early views, and those of addressees, before responding to the COI.

X?

I shall inform, see Mr (Aschbacher) with Dr Omair to the USF.

P J EDWARDS

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~~YOUR TELNO VISIT 13 + VISIT BY DR AL OMAIR~~
FOLLOWING FOR HUMPHRIES - OVIS
FOR HOLMES MED, FCO
FOR VISITS, ID, FCO
FROM LYSKOM

1. WHEN I CALLED YESTERDAY ON DR AL OMAIR HE AGAIN
APOLOGISED FOR THE TROUBLE HE HAD CAUSED. HE WOULD BE VERY
GRATEFUL IF ARRANGEMENTS COULD BE MADE FOR A VISIT IN THE
WEEK BEGINNING MONDAY 23 MAY. HE WOULD BE CONTENT WITH A
PROGRAMME ALONG THE LINES OF THAT ARRANGED FOR 14-16 MARCH.

2. GRATEFUL IF YOU COULD PREPARE AN OUTLINE PROGRAMME
WHICH WE COULD PUT TO DR AL OMAIR IN THE SECOND HALF OF APRIL.

EGERTON

YYYY

REHPAN 8261

NNNN



FROM: J M G TAYLOR

DATE: 8 April 1988

PWP

PS/ECONOMIC SECRETARY

cc PS/Chief Secretary
Mr Scholar
Mr Bush
Mr P J Edwards

**VISIT TO LONDON OF DR AL OMAIR, VICE MINISTER OF FINANCE,
SAUDI ARABIA, BETWEEN SUNDAY 22 MAY AND THURSDAY 26 MAY**

The Chancellor has seen Mr P J Edwards' minute of 30 March.

2. He would prefer to leave Dr Omair to the Economic Secretary.

A handwritten signature in black ink, appearing to be 'J M G Taylor'.

J M G TAYLOR



FROM: S I M KOSKY
DATE: 13 April 1988

Sup

MR P J EDWARDS

cc P^S/Chancellor
PS/Economic Secretary
Mr Scholar
Mr Bush

VISIT TO LONDON OF DR AL OMAIR, VICE MINISTER OF FINANCE, SAUDI ARABIA, BETWEEN SUNDAY, 22 MAY AND THURSDAY 26 MAY

The Chief Secretary has read your submission of 30 March to the Economic Secretary and regrets that owing to other commitments he will be unable to host a lunch in honour of the Saudi Minister of Finance during his visit to this country.

S I M Kosky

S I M KOSKY

PWP

From: P J Edwards
Date: 13 April 1988

PS/ECONOMIC SECRETARY

cc PS/Chancellor
PS/Chief Secretary
Mr Scholar
Mr Bush

Mr Humphries (COI)

VISIT TO THE TREASURY OF DR AL OMAIR, VICE MINISTER OF
FINANCE, SAUDI ARABIA, ON MONDAY 23 MAY 1988.

The Economic Secretary and Mr Scholar have both very kindly agreed to receive Dr Omair on the afternoon of Monday 23 May in order to discuss the structure and formulation of the Budget. The Chancellor and Chief Secretary will not be available in order to meet Dr Omair on this occasion.

Timing of the visit: 3.30pm to 4.00pm - Economic Secretary

4.00pm to 4.30pm - Mr Scholar

P. J. Edwards

P J Edwards



FROM: P J WALES
DATE: 14 April 1988

Paul

MR P G F DAVIS

cc PS/Chancellor
PS/Chief Secretary
Mr Scholar
Mr Evans
Mr Matthews
Mr Bush

VISIT TO THE TREASURY OF DR AL OMAIR, VICE MINISTER OF FINANCE
SAUDI ARABIA, ON MONDAY 23 MAY 1988

The Economic Secretary will be meeting Dr Omair on the afternoon of Monday 23 May. I would be grateful if you could arrange for the necessary briefing to reach this office by close of play on Friday 20 May, and also attend a short pre-meeting at 3.15pm on Monday 23 May.

Peter Wales

P J WALES
Diary Secretary

FROM: MS S E BURTON

DATE: 20 May 1988

mp

1. MR J MAY

2. MR P G F DAVIS

Seen in draft

[Handwritten initials and marks]

cc PS/Chancellor
PS/Chief Secretary

Mr M C Scholar
Mr H P Evans
Ms C E C Sinclair
Mr S W Matthews

ECONOMIC SECRETARY

VISIT OF DR AL OMAIR, VICE MINISTER OF FINANCE, SAUDI ARABIA, ON
MONDAY 23 MAY 1988

You are to meet the Saudi Vice Minister of Finance, Dr Al Omair, on Monday 23 May at 3.30 pm to discuss the structure and formulation of the Budget. Dr Al Omair will be accompanied by two officials, Dr Al Jasser (Director of Financial and Economic Unit, Central Budget Dept.) and Mr Al Harbi (Private Secretary). Mr Lyscom (1st Secretary (Economic) British Embassy) will attend with Mr Phillips (COI). Mr May will support you.

2. Dr Al Omair is here at the invitation of the FCO. He will be dining with David Mellor on Monday. The visit was originally planned to coincide with the Budget, but was postponed at his request. The broad objective of the visit is for Dr Al Omair to get to know British financial and economic experts and to increase his understanding of the UK financial system. To this end a very varied three day programme has been arranged which includes visits to the Bank of England and the Stock Exchange. His purpose in visiting the Treasury is to be briefed on the preparation of the Budget in Britain, sources of government finance, and the financing of government expenditure. His call on you will be brief, followed by a short call on Michael Scholar for further discussions on the Budget.

3. There are no bilateral issues of any significance which you need raise. Nor do we expect Dr Al Omair to raise any with you.

4. I attach supporting background briefs for the meeting covering Saudi internal and external affairs; the economic implications of the 1988 Saudi budget; bilateral trade; and a biographical note on Dr Al Omair.

S E Burton

MS S E BURTON

AL OMAIR, DR SALIH ABDUL AZIZ

Vice Minister for Finance

Born Qassim

Graduated from King Saud University in 1968. Studied Economics at Wisconsin and Texas Universities, obtaining his PhD from the latter, 1976. Director General of Public Administration in Institute of Public Relations before joining the Ministry of Finance as Assistant Deputy Minister. Became Deputy Minister for Budget and Organisation Affairs, 1979. Promoted to Vice Minister (the first non-Royal Vice Minister) October 1986.

Chairman of the Board of Directors of: Saudi-Bahraini Causeway Company; Saudi Industrial Development Fund; Arab Company for the Manufacture of Medicine and Medical Requisites; National Plastics Company.

Very able and forthcoming, he appears to have a good deal of authority over the preparation of the annual budget and is prepared to speak fairly frankly and often in greater detail than his Minister. Has a very heavy programme which he runs efficiently.

Dr Al-Omair is one of the few Saudi Vice-Ministers holding Cabinet rank. Architect of the controversial 1988 budget, he also has responsibility for Ministeries' allocations. His sacking was predicted by some observers when the attempt to reintroduce income tax on expatriates provoked a public outcry that embarrassed the King, forcing him to postpone the proposal. That danger has receded: King Fahd values loyal technocrat Ministers and dislikes change.

Speaks good English.

VISIT TO UK OF DR AL-OMAIR, SAUDI VICE-MINISTER OF FINANCE
(23-25 MAY 1988): BACKGROUND BRIEFS

BRIEF NO 2: SAUDI ARABIA: POLITICAL BACKGROUND

Essential Facts

1. Saudi Arabia (formerly Hejaz-Nejd) was formed in the 1920s and 1930s when Abdul Aziz bin Saudi of Nejd conquered the Hejaz and consolidated his Kingdom by a process of tribal conquest.
2. Saudi Arabia possesses some 27% of the world's proven oil reserves and is of enormous importance to the industrialised world. It plays a major role in OPEC and in Middle East politics. Its financial reserves make it a major force in world money markets. It has the incomparable prestige in the Muslim world of being the guardian of the holy places of Medina and Mecca: King Fahd stipulated in November 1986 that he should in future be known as 'The Custodian of the Two Holy Mosques' instead of 'His Majesty'.
3. The Kingdom has a native population of 5 or 6 million, augmented by perhaps 2 or 3 million foreigners. The number of these has decreased in the last three years because of the economic downturn. Most of the population is concentrated in the main centres of Jedda/Mecca (approx 1.2 million) in the west, Riyadh (approx 1.3 million) in the centre, and Dammam/Al Khobar/Dhahran in the east. The oil fields centre on Dammam. Even in the past, the image of Saudi Arabia as a country populated entirely by nomadic Arabs (Bedouin) was misleading: now settlement in the towns has reduced their numbers of less than 15% of the population.

Political and Religious Structure

4. There is no formal constitution: the Saudis would say that the Koran is their constitution. King Fahd is also Prime Minister, and nominates the Council of Ministers. Key decisions are usually taken by the Minister or Ministers most closely involved, usually subject to the concurrence of the King. Within the Council of Ministers senior Princes hold great sway. There has in the past been talk of

the introduction of a consultative assembly, but nothing has yet materialised. The regime is authoritarian and by Western standards undemocratic. But it is indigenous to Saudi Arabia, not an artificial creation of the post-colonial era. The Ottomans never held the interior of Saudi Arabia.

5. The overwhelming majority of Saudis are Sunni Wahhabis, but there is a significant Shia minority in the key oil-producing Eastern Province. The Saudi authorities are scrupulous in their attempts to maintain the strictest possible application of conservative Islamic customs. The King and the Government pay great attention to the religious leaders ('Ulema'). The Islamic Sharia legal code is applied rigorously.

Middle East Department
Foreign and Commonwealth Office
May 1988

VISIT TO UK OF DR AL-OMAIR, SAUDI VICE-MINISTER OF FINANCE
(23-25 MAY 1988) BACKGROUND BRIEFS

BRIEF NO 3: SAUDI EXTERNAL RELATIONS

General

1. Saudi foreign policy (made by the King, not the Foreign Minister) aims to preserve the security of the Kingdom in the peninsula, to maintain as far as possible an Arab consensus and to restrain Soviet influence in the region.

The Gulf Conflict

2. The main current Saudi foreign policy concern is the situation in the Gulf. Historically, Saudi Arabia fears both Iran and Iraq as potential predators in the Arabian Peninsula. However, Saudi policy has generally been to shore up Iraq with considerable financial and other support in order to prevent an Iranian victory. The Saudis support work at the UN to achieve a negotiated settlement in accordance with SCR 598, and have consistently highlighted Iraq's willingness and Iran's reluctance to accept the Resolution. However their belief that an arms embargo against Iran would not be effective colours their support for work on a draft Resolution.

3. Saudi concerns focus in particular on Iranian attacks on Saudi flagged vessels and those carrying Saudi cargo to and from Saudi ports. This has led them to ask some of the Western countries with naval forces in the Gulf, including Britain and in particular the USA, to extend their protective role to such vessels. We have declined the Saudi request on the grounds of a lack of resources. The Saudis have not expressed so far an opinion on the recent US initiative of "distress assistance", but are likely to welcome it.

Iran

4. The Gulf Conflict has been the root cause of the sharp deterioration in Saudi/Iranian relations which culminated on 3 May with Saudi Arabia finally breaking diplomatic relations with Iran. The most serious incident to affect Saudi/Iranian relations was the Mecca Incident during the Hajj (pilgrimage) in July 1987 in which

402 people were killed, (275 of them Iranians) when Iranian pilgrims clashed with Saudi security forces. Since then, there has been an intense war of words, with Tehran seeking to discredit the Saudi role as custodians of the Holy Cities of Mecca and Medina. The final straw which led to the break with Iran was probably the Iranian refusal to agree on the new quota set by the Saudis for the number of Iranian pilgrims for the 1988 Hajj (reduced from 156,000 to 45,000).

5. Despite the open hostility, both countries have shown a reluctance to get into direct military confrontation. However, the Saudis have lately shown much stronger resolve to stand up for themselves. They see the purchase and deployment of intermediate range Chinese CSS2 missiles as a significant deterrent to Iranian aggression. Nevertheless, the Saudis will continue to worry about how to handle this populous and troublesome neighbour.

Arab League

6. Since the suspension of Egypt from the Arab League, Saudi Arabia has regarded itself as the leading State in the Arab world, largely because of its oil wealth and its guardianship of the Islamic Holy Places. But it lacks the population and the political weight to play this rôle with confidence, and on most Arab issues Saudi Arabia waits for a consensus to emerge before taking up a public stance. The Saudis attach a great importance to maintaining a reasonable relationship even with radical Arab States such as Syria and Libya, whom they are nervous not to antagonise. Saudi Arabia has played a part in patching up Arab differences; for example the reconciliation between Syria and Jordan at the end of 1985 and sponsoring the secret meeting between President Assad of Syria and President Saddam Hussein of Iraq earlier in 1987. The Arab/Israel dispute remains a major concern to the Saudis because of its implications for intra-Arab relations. Saudi Arabia restored full diplomatic relations with Egypt soon after the 9 November Amman Summit gave member states leave to do so. This opens the way for Egypt to provide more overt military assistance to Saudi Arabia and other Gulf States (but Egypt has made it clear that it will not send troops to Saudi Arabia to replace the 10,000 Pakistanis currently being withdrawn).

Gulf Cooperation Council

7. Saudi Arabia is the dominant force in the Gulf Cooperation Council (GCC). This causes some resentment among the smaller Gulf states, who have rejected Saudi proposals in the past that all future GCC Summits should be held in Riyadh (the GCC Secretariat is in Riyadh). Saudi Arabia took over from the UAE as Chairman of the GCC for 1987/88 at the GCC Summit in Riyadh in December 1987.

USA

8. Saudi relations with the United States have been very close and broadly-based, ever since in the thirties and forties the United States and US oil companies, displaced Britain as the predominant influence. Most Saudis would recognise that the United States represents the best guarantor of the security of a nation which, for all its size and wealth, has a tiny indigenous population. But the Saudis are critical of what they see as the United States' failure to understand Arab sensitivities (eg over the bombing of Libya). Congressional opposition to the sale of sophisticated defence equipment to Saudi Arabia has not helped the relationship. This probably contributed to the Saudi decision to buy Chinese missiles, the revelation of which led to a temporary weakening in Saudi/US relations. One victim of the affair was the US Ambassador to Saudi Arabia whose recall was requested by the King. However, Saudi Arabia has since made a vigorous effort to restore relations.

USSR

9. Soviet/Saudi diplomatic relations were suspended in 1938 and have not been resumed since. Saudi Arabia was displeased by the Omani decision in September 1985 to establish diplomatic relations with the Soviet Union without prior consultation: the UAE followed suit two months later. However, the Saudis have had discreet contacts with the Russians in the past two years and some of the younger Princes would like to see diplomatic relations re-established. This had seemed unlikely to happen so long as Fahd was King, but recent contacts may indicate that Saudi policy is changing. Prince Saud Al Faisal, Saudi Foreign Minister, visited

Moscow in early February 1988 to deliver messages from King Fahd (as GCC President) calling for Soviet support for a UN arms embargo Resolution against Iran and for action to end the violence in the Occupied Territories. The visit will undoubtedly have been used to discuss bilateral relations. On 20/21 February the Head of the Soviet Near East and North African Department was given red carpet treatment during a brief visit to Riyadh.

10. Saudi disillusionment with the USA over e.g. arms sales and US policy in the Middle East and an acknowledgement that the USSR has a role to play has led to this apparent warming of relations. But the Saudis will probably approach the question of restoring full diplomatic relations with caution. A minimum requirement will be the full withdrawal of Soviet troops from Afghanistan. The Saudis also want the Soviets to play a more active role in bringing the Iran/Iraq conflict to an end. The Saudis have so far not bought Soviet arms (unlike the UAE), but an improvement of relations coupled with frustration of US deals may make them look at the possibility more closely.

People's Republic of China (PRC)

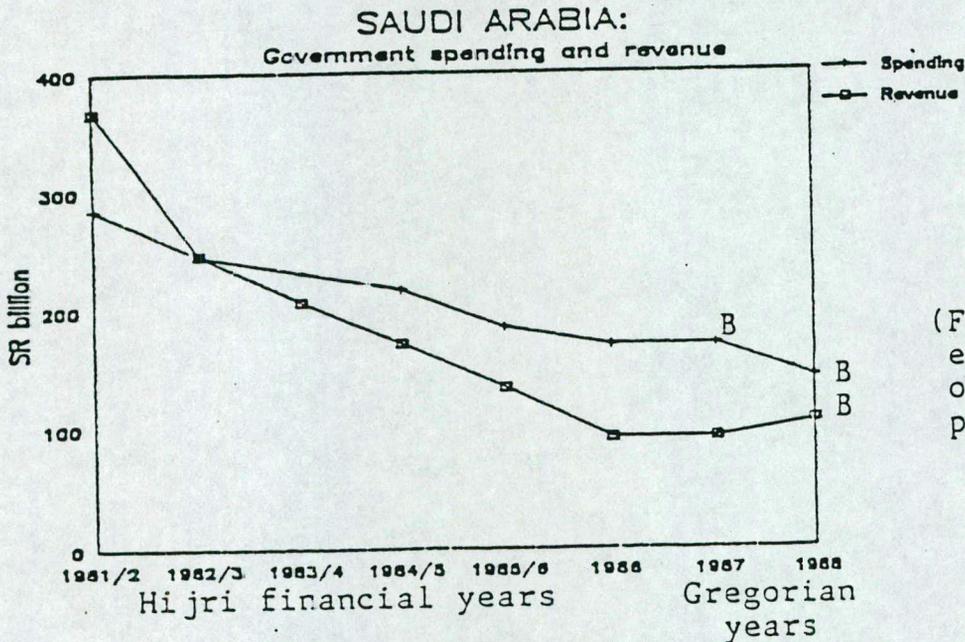
11. The revelations in March 1988 that Saudi Arabia had purchased Chinese nuclear-capable missiles showed that Saudi PRC relations were much thicker than anyone had realised. Visible contacts with the PRC up to 1988 had been through businessmen and trade delegations, the most recent one being from PRC led by the Chairman of the China Council for the Promotion of International Trade. In 1988, the Saudi Minister of Agriculture visited Peking (probably to deliver a GCC message from King Fahd), and, after the missile revelation the Chinese Deputy Minister for Foreign Affairs visited Riyadh (theoretically to deliver a reply). The Saudis have recently opened a Consulate in Hong Kong. It is considered unlikely, however, that the Saudis will feel able to open full diplomatic relations with PRC given their strong links already with Taiwan.

Middle East Department
Foreign and Commonwealth Officer
May 1988

SAUDI BUDGET FOR 1988: ECONOMIC IMPLICATIONS

Overview

1. With little prospect of much of a recovery in oil revenues, which last year were around a fifth of their peak in the early 1980s, the Saudis have introduced another austerity budget. Government spending, the major influence on the pace of domestic economic development, has been declining since 1981-82. The new budget allows for a further 17% fall in spending (relative to last year's target, which may however have been undershot), to a level only half that of the peak in 1981-82.



2. The intention in making further spending cuts must be to reduce the budget deficit (which has been around SR40-50 bn or \$11-14 bn, over 1984-86 and perhaps more last year). This should allow the authorities to limit the amount of drawing on their overseas assets. This same aim is being furthered by the proposed issue of Government bonds to help finance the budget.

3. Successive budgets have sought to insulate ordinary Saudis from the effects of retrenchment: the sort of current spending which directly affects them (wages, subsidies and grants) has not been greatly reduced. But the Government's other spending (on projects, operations and maintenance and loans) has been correspondingly badly hit and the private sector has contracted substantially in the past few years. There was in fact modest growth (less than 1%) in non-oil output last year, but this slight recovery must be in jeopardy if the budget is implemented as planned.

In the medium term oil revenues and economic growth should pick up.

CONFIDENTIAL

/.....

DETAIL

Oil policy

4. Two years after the big fall in oil prices, demand for OPEC's oil is recovering, but only slowly. OPEC countries are still having to hold their production down in order to keep prices at around \$18/barrel. Saudi Arabia has been a leading proponent of the \$18/barrel target. However, it has not made the preparation or execution of a budget based largely on oil revenues very easy. The Deputy Minister of Finance told the Ambassador on 10 January that the new budget assumes oil production up to quota and prices at around the \$18/barrel target.

The outturn in 1987

5. As if to illustrate the difficulty of projecting revenues, 1987 receipts were around 20%, or SR25 bn, below the level set out in the budget. On available information it is not clear how much of this shortfall reflects lower than expected oil earnings, though these earnings were certainly low in the first half of the year when oil production was cut substantially to support the \$18 target. Overall earnings from non-oil sources (investments, transfers from parastatals, and domestic taxes) appear to have fallen short, possibly substantially. Spending, by contrast, may have been quite close to the budgeted level. If so the actual budget deficit may have been appreciably larger than the target of SR53 bn (\$14 bn). This would have been financed by drawing on the Government's still very large foreign exchange reserves, but would nevertheless have been a cause for concern.

The strategy in 1988

6. The Saudis, like the rest of OPEC, may well have hoped that the oil market would have strengthened substantially in 1987 and that for 1988 the promise of higher oil revenues would permit higher spending and a lower budget deficit. In the event, faced with a weak oil market and uncertain prospects even of making the \$18/barrel target continue to stick, they have allowed for oil revenues little

higher than last year. Given the size of the deficit last year that probably had to rule out higher spending this year. In fact, the authorities have gone for an even tougher approach, budgeting a sizeable further reduction in spending (from a budgeted SR170 bn to SR141 bn, a fall of 17%) in order to get the deficit down (from a budgeted SR53 bn and possibly higher outturn to SR36 bn, or about \$10 bn).

7. At the same time the authorities have introduced an important innovation - financing a large part of the expected budget deficit not by drawing on their existing assets but by issuing riyal-denominated bonds. The combination of lower spending and a bond issue of up to SR30 bn means that they apparently hope to reduce the extent of drawing on reserves from SR50 bn (\$13 bn) or more last year to as little as SR8 bn (\$2 bn) this year.

8. The budget's attempt to broaden the Government's revenue from non-oil sources is a sensible if belated response to the present overdependence on oil and vulnerability to oil market weakness. Unfortunately for the authorities, it has fallen at the first hurdle with the hurried withdrawal of the proposed income taxes on expatriates. The basic rate of tax envisaged for higher paid (including most western) expatriates was well above 30% once fringe benefits are allowed for. A storm should have been predictable. Increased customs duties survive as a more modest contribution to revenue raising.

The economic outlook

9. There is a fair risk of Saudi oil revenues this year falling short of a planning total which assumes production at quota and prices at \$18/barrel. Indeed there are already reports of a Saudi production cut laying behind the modest strengthening of the market (from well below \$13) since Christmas. However, the very low projected drawing on reserves represents a safety valve: the deficit could clearly be allowed to rise if revenues are down. But even if in consequence spending is right up to budgeted levels there is a risk of further contraction in the private sector and further problems of bad debts, unless the authorities are trying to find most of the cuts in their own foreign procurement.

10. The immediate economic outlook is therefore not particularly encouraging. The authorities are giving priority to limiting the call on reserves and - if they hold this line - may not allow steady growth of spending to resume until oil revenues are again on a clear upward trend. When that will be is very uncertain. In the medium term Saudi Arabia can still reasonably expect a substantial increase in its oil production and revenues. Under careful stewardship the market outlook is good, though there remains a difficult challenge of economic diversification.

General Trade

1. Saudi Arabia was our 10th largest market in 1987, our largest outside Europe and USA. Tornado sales contributed significantly to record visible exports of £1,987 million, overlying a strong, broadly-based UK performance. Invisibles are estimated to add up to 50% of this figure. In the last two years our main competitors have lost ground in both volume and market share.

	(£ million)	<u>UK Exports</u>	<u>UK Imports</u>
1985		1,249	496
1986		1,507	436
1987		1,978	383

Market shares of OECD exports to Saudi Arabia in 1986 (latest annual figures available):

1. USA	21.3%	4. FRG	9.5%
2. Japan	17.2%	5. Italy	9%
3. UK	13.6%	6. France	7.4%

UK Prospects

2. Despite (December 1987) budget cuts of 17%, the market still offers good opportunities for UK firms in operations and maintenance, public utilities, health-care, education and training. The economic offset programme associated with the sale of Tornado Aircraft to Saudi Arabia proffers profitable investment opportunities in joint ventures etc.

3. ECGD is discussing with BAE the credit cover which they require for the sale of Tornado aircraft to Saudi Arabia. ECGD cover (currently estimated at £350 million) will be against termination of the contract because of an arms embargo or as a result of complete breakdown in the oil arrangements (economic offset programme). Cover might also be agreed shortly for a Vosper contract for the lease of 2 Minehunters to the Saudis; the ships have been leased from MOD.

Crown Agents/BATC

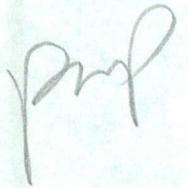
4. British Arabian Technical Cooperation (BATC) implement a UK/Saudi agreement to develop technical cooperation between the two countries. They deal primarily with the Saudi Ministry of Finance and National Economy, reporting monthly to HE Osama Faquih, Deputy Minister for International Economic Affairs. Crown Agents took over the BATC with the support of the DTI and FCO last year.

5. BATC place British experts in posts in the Saudi public sector and provide technical training courses for Saudi officials. They currently have about 10 experts in the Kingdom and have recently completed a first course in Riyadh on maintenance management.

6. The placement of experts can give a donor country commercial and economic influence in the Kingdom and often a direct commercial advantage. The American and West German governments subsidise their equivalent bodies (JECOR and GTZ respectively) and have much larger numbers of their experts in Saudi Ministries.

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FROM: P D P BARNES
DATE: 24 May 1988



NOTE OF A MEETING HELD IN ROOM 51/2, TREASURY CHAMBERS, PARLIAMENT STREET AT 3.30pm ON MONDAY 23 MAY 1988

Those Present

Economic Secretary

Mr May

Dr Al Omair, Saudi Vice-Minister of Finance

Dr Al Jasser, Director of the Financial and Economic Unit,
Central Budget Department, Saudi Arabia

Mr Al Harvi, Private Secretary

Mr Liscom, FCO

Mr Phillips - DOI

Dr Al Omair thanked the Economic Secretary for seeing him.

2. Dr Al Omair explained that the sharp fall in the oil price in 1986 had required Saudi Arabia to reduce its public expenditure substantially. In 1987 receipts had been some 20% below the level projected. Saudi Arabia had achieved the cuts mainly by reducing capital rather than current expenditure. The period up to 1987 had also witnessed a decline of between 5% and 7% in the non-oil sector of the ~~non-oil~~ economy.

3. Since 1987, the non-oil economy had been growing more healthily, with a projection of growth up by between 2 and 5% in the coming year. Since mid 1987 commodity prices had risen slightly, although inflation generally was being kept well under control. Some attempts had been made to introduce new sources of revenue to reduce the dependence on oil and these were on target with budget projections so far. Revenues from the oil sector were also on target, but were governed by the price of oil in the markets. There were indications that expenditure might be held below budget forecasts. Non oil revenue was predicted to grow from 25% to 30% of Government revenues. The outlook for 1988 was good,

M.M.L.K.

RESTRICTED

with public companies reporting profits, and with considerable banking activity and strong growth in consumer spending. Saudi Arabia's GDP was now higher than that of Switzerland or Sweden and its income per head was now the twelfth highest in the World. The economy was a liberal one with no foreign exchange restrictions and Customs tariffs generally no higher than 5%.

4. Dr Al Omair expressed interest in the process of public expenditure control and revenue raising in the UK. The Economic Secretary explained to him how these operated. Dr Al Omair mentioned that his country found it easier to control capital than current expenditure.

h₃

P D P BARNES
Private Secretary

cc PS/Chancellor 2
PS/Chief Secretary
Mr Scholar
Mr Evans
Miss Sinclair
mr Matthews
Mr P G F Davis
Mr May
Ms Burton



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

CH/EXCHEQUER	
REC.	10 AUG 1988
ACTION	Mr MOUNTFIELD
COPIES TO	EST
	Sir G. LITTLER,
	Mr LANKESTER,
	Mr R.G. ALLEN,
	Mr H.P. EVANS

30 July 1988

Dear Bob,

PRIME MINISTER'S MEETING WITH THE CROWN PRINCE OF BAHRAIN

The Prime Minister had a meeting with the Crown Prince of Bahrain in the Gudaiyiba Palace in Bahrain on the morning of Saturday 30 July. The Bahrain Foreign and Defence Ministers were also present, together with HM Ambassador Bahrain.

Introduction -

The Prime Minister enquired after the Amir and the Prime Minister and thanked the Crown Prince for the very kind hospitality extended to her party in Bahrain. The Crown Prince said that the reports of the Prime Minister were good: he was already sitting up following his operation.

The Prime Minister continued that we were very grateful to Bahrain for the facilities granted to our naval vessels in the Gulf. This was part of the traditional friendship between Britain and Bahrain which we greatly prized. The Armilla Patrol was in the Gulf to defend freedom of navigation and would stay as long as necessary to carry out that task. The Bahrainis need not fear a precipitate withdrawal.

Iran/Iraq

The Prime Minister said that we were following the discussions of a ceasefire in the war between Iran and Iraq very closely. Iranian acceptance of SCR 598 had been a very important step. But there were still great difficulties, particularly Iraqi insistence on a face to face meeting with Iran, and she was not optimistic that the target of 1 August for the ceasefire would be met. She quite understood Iraq's suspicions of Iran, but a ceasefire was the essential first step and other issues would have to be explored after that. However, she was confident that Senor Perez de Cuellar would persist.

The Crown Prince and the Foreign Minister agreed that Iranian acceptance of SCR 598 was an important step forward. They recalled that SCR 598 extended to the Gulf as a whole and assumed a comprehensive settlement. It would take time for the Iraqis to accept Iranian sincerity. Moreover, it must be clear that the ceasefire applied to the conflict as a whole and that Iran could not continue to prosecute the war in the air or at sea. The real reason that Iran had been brought to accept a ceasefire was not so much SCR 598 as the very firm position adopted by the United Kingdom and the United States in the Gulf. Their naval presence had been the crucial factor and had given enormous encouragement to the Gulf States.

The Prime Minister agreed that the ceasefire must be only a first step to a comprehensive settlement. But one should not under-estimate the significance of Iranian acceptance of SCR 598. It was in effect a defeat for Iran and a crucial set back for fanaticism in the Middle East. That would have long term consequences. Improved East-West relations were also a factor. The ability of the five Permanent Members of the United Nations Security Council to work together had been an important development. The Crown Prince warmly endorsed this last point which he attributed to the Prime Minister's lead in establishing a good relationship with Mr. Gorbachev.

The Prime Minister continued that we would all need to bring great pressure to bear on Iran to cease its support for terrorism. She was also very concerned about the precedent set by an extensive use of chemical weapons in the Iran/Iraq war, as well as the spread of ballistic missiles throughout the area. The only bright side of that was that it might help convince people, not least in Israel, that it would no longer be possible to win a war in the Middle East without unacceptable loss and sacrifice. If that lesson could be learned, people might come to see that real security could be found only through a peaceful settlement.

The Prime Minister asked if the Crown Prince had any information about the Ayatollah Khomeini's health. The Crown Prince commented that it was very important that Iran had accepted the ceasefire while Khomeini was still alive. The Foreign Minister added that the real power in Iran lay not so much with Rafsanjani, but Ahmed Khomeini, the Ayatollah's son. The Prime Minister asked how Iranian acceptance of SCR 598 had been received by the Shia community in the Gulf. The Foreign Minister said that he believed there was some division and disillusion in Iran. People naturally asked why they had been asked to sacrifice their sons for no gain. He did not believe we had yet seen the last of the effects of this in Iran. As to the rest of the Gulf, the important point was that the Iranians had

not been able to open up divisions between the Shia and Sunni communities in Bahrain and other Gulf States.

The Prime Minister reported subsequently that the Crown Prince had told her in the car on the way to the airport that Bahrain was concerned about the implications for Iraq's future behaviour of its success in the Iran-Iraq war. He did not discount the possibility that they would think they could take on Israel next.

Arab/Israel

The Prime Minister said that Britain had constantly urged the United States to bring pressure to bear on Israel to accept an international conference. Unfortunately it was only realistic to accept that no substantial progress would be made until after the American and Israeli elections. Nonetheless, it was important to keep discussions going in the hope that a new United States Administration would be prepared to take up the problem early in its term of office. The Soviet Union was beginning to show signs of a more co-operative approach, although it would be prudent to remain wary of their intentions.

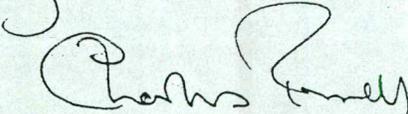
The Foreign Minister commented that there seemed to be new prospects of progress on a number of regional issues: Angola, Afghanistan and Cambodia. It was surely important to give equal priority to the Arab/Israel dispute. But the prognosis was not very bright. If Mr. Shamir won the election in Israel, a Democratic President was elected in the United States and King Hussein persisted with his intention of withdrawing from involvement in the West Bank, it would be a very gloomy outlook. The Crown Prince added that the Arab Summit in Algiers had not been at all successful from the point of view of progress on Arab/Israel issues. Indeed, it had done a lot of harm to King Hussein who, until then, had been very active and constructive. The Prime Minister said that King Hussein felt that he had not been given sufficient credit by other Arab governments for his role. They gave public support to the PLO while he was left to do the work and pay the bills. But the King had emphasised in a recent message to her that his decision to discontinue the development programme on the West Bank and take other steps did not mean any reduction in his commitment to a peaceful solution through an international conference. He would still be prepared to see a confederation between Jordan and the West Bank in the context of a comprehensive settlement. Opinion in Israel was deeply divided and the outlook for Mr. Peres not very bright. But we would go on pressing home the message that territory for peace was the only basis for a long term solution, while continuing to argue for an international conference.

UK/Bahrain relations

The Prime Minister commented that our relations with Bahrain were extremely good and trade was doing well. The Crown Prince said that great credit was due to the Prime Minister. What she had done in Britain was good for Bahrain and good for the whole Gulf region. Above all, they appreciated the strong leadership which she gave.

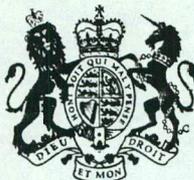
The Prime Minister said that we were very pleased with the first meeting of the United Kingdom/Bahrain Defence Committee. The Crown Prince said that it had indeed been successful and well received in Bahrain. It had established good grounds for co-operation in the military field and there was a full agenda for its next meeting in London. The Prime Minister asked about defence co-operation within the Gulf Co-operation Council. The Crown Prince was rather dismissive of that, commenting that defence relations with the United Kingdom were special. The Prime Minister said that we would always be ready to supply Bahrain's defence equipment needs.

I am copying this letter to Brian Hawtin (Ministry of Defence), Alex Allan (H M Treasury) and Trevor Woolley (Cabinet Office).

Yours sincerely,


C. D. POWELL

R. N. Pierce, Esq.,
Foreign and Commonwealth Office



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

CH/EXCHEQUER	
REC.	28 OCT 1988
COPIES TO	Mr MOUNTFIELD
	EST. G. LITTLER,
	Mr LANKESTER,
	Mr R.I.G. ALLEN
	Mr H.P. EVANS

28 October 1988

Ch. X, overleaf. More
unhelpful remarks.
28/10

Dear Bob,

PRIME MINISTER'S MEETING WITH THE PRIME MINISTER OF BAHRAIN

The Prime Minister had a talk this morning with the Prime Minister of Bahrain. Shaikh Khalifa was accompanied by his son, his brother-in-law and the Bahraini Ambassador.

The Prime Minister said she had been sad to miss Shaikh Khalifa during her visit to Bahrain in the summer but glad to see that he was now fully recovered. She enquired after the Amir. Shaikh Khalifa thanked the Prime Minister for her various messages during his illness and on his arrival in this country. They had been a great comfort. The Amir sent his warm regards.

Iran/Iraq

The Prime Minister recalled that she had had excellent talks, during Bahrain with the Crown Prince and the Foreign Minister in which they had concentrated mainly on Iran/Iraq and the prospects for a ceasefire. That had now been achieved and in her view was irreversible. Nonetheless the negotiations to formalise it were proving difficult. Iran was showing considerably more diplomatic skill than Iraq which had, in consequence, lost some of the advantage gained by its military performance. There was no question of Britain leaving the Gulf. We would want to be sure that the ceasefire was being honoured and the Armilla Patrol would remain so long as there was a threat to shipping, although the pattern of its activity would change our minesweepers would also stay in order to clear the main sea lanes. We were most grateful to Bahrain for the hospitality and support given to our ships. Finally, she wished to mention that we were discussing the restoration of diplomatic representation with Iran. But we were wary of them and would move carefully.

Shaikh Khalifa agreed that the ceasefire was irreversible. He complimented the United Kingdom on its role in achieving it. He fully understood our intention to restore diplomatic representation with Iran. The Iranians were also trying to repair relations with Bahrain. Bahrain was ready for this on a step by step basis. Shaikh Khalifa continued that a strong British presence in the Gulf was essential as a

support for Britain's friends. It was in that context that Bahrain very much welcomed the decision to supply Tornado to Saudi Arabia.

Bilateral Relations

Shaikh Khalifa said that he was grateful for Britain's continuing co-operation with Bahrain on defence and security matters. He attached particular importance to the latter and hoped that the Home Secretary would visit Bahrain in due course for a general discussion. The newly established Defence Committee was doing useful work. Bahrain would also like to see economic and commercial relations strengthened further. The Prime Minister said that she shared these hopes and would ensure a regular flow of senior Ministerial visitors.

Y | Shaikh Khalifa raised Bahrain's misgivings about the Government's Green Paper on residence and domicile. This had caused much anxiety in the Gulf. The Prime Minister said that she was aware that there was widespread unease about it. It was important to understand that the proposal was only a discussion document.

Arab/Israel

The Prime Minister said that the prospects for progress towards a settlement of the Arab/Israel dispute depended very much on the outcome of the forthcoming elections in Israel and the United States. She would be visiting Washington shortly after the Presidential elections and would urge upon the next President the vital importance of an early American initiative towards a settlement. The issue must be brought up the list of priorities and no time lost. It would also be necessary for the PLO to sort themselves out. There were some signs that they were beginning to do so but she was not yet convinced. She had understood the reasons which had led King Hussein to end Jordan's formal ties with the West Bank.

Shaikh Khalifa was gratified by the Prime Minister's determination to raise the matter at a very early stage with the next United States Administration. For the Gulf States, the priority was to restore peace and stability in the Gulf following the Iran/Iraq war, as the basis for being able to help in other areas. That would be the main task of the meeting of the Gulf Co-operation Council in early December.

I am copying this letter to Brian Hawtin (Ministry of Defence), Alex Allan (HM Treasury) and Neil Thornton (Department of Trade and Industry).

you dearh,
C.D. Powell

(C.D. POWELL)

R.N. Peirce, Esq.,
Foreign and Commonwealth Office.

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OF 070820Z NOVEMBER 88

INFO ROUTINE BANK OF ENGLAND, DTI, ODA ECGD

*More good Reasons for not
Subsidising export of Tornados.*

W. K. v.

J.

AMMAN TELNO 459 JORDAN ECONOMY

SUMMARY

1. PACKAGE OF AUSTERITY MEASURES, INCLUDING IMPORT BANS ON LUXURIES AND INCREASED TARIFFS. SOME UTILITY COSTS TO FALL. MAY HELP TO CONVEY THE SERIOUSNESS OF THE SITUATION.

DETAIL

2. AS FORESHADOWED IN TUR, THE JORDANIAN COUNCIL OF MINISTERS ANNOUNCED ON 5 NOVEMBER 1988 SOME NEW MEASURES DESIGNED 'TO BOLSTER THE ECONOMY AND PRESERVE THE COUNTRY'S RESERVES OF FOREIGN EXCHANGE'.

3. THE IMPORT OF CERTAIN GOODS WILL BE BANNED UNTIL 31 DECEMBER 1989, INCLUDING PASSENGER AND GOODS VEHICLES, CERTAIN DOMESTIC ELECTRICAL EQUIPMENT, HOME FURNITURE, CERTAIN HIGH QUALITY CONSTRUCTION AND DECORATIVE MATERIALS AND ORNAMENTS. EXISTING IMPORT LICENCES FOR THESE PRODUCTS WILL BE CANCELLED EXCEPT FOR THOSE WHICH LETTERS OF CREDIT HAVE BEEN OPENED AND THOSE ISSUED FOR THE IMPORTATION OF GOODS SHIPPED BEFORE 6 NOVEMBER 1988. THE FINANCE MINISTER SAID ON 6 NOVEMBER THAT THESE BANS WILL SAVE DOLLARS 200 MILLION IN 1989.

4. CUSTOMS FEES ON NON-ESSENTIAL GOODS, AIRPORT TAX, TAXES ON AIR TICKETS AND HIGH-CLASS RESTAURANTS WILL BE INCREASED.

5. THE COST OF WORK PERMITS FOR ARAB AND FOREIGN WORKERS, OTHER THAN TO THOSE IN AGRICULTURE AND NURSING, WILL BE INCREASED.

6. CHARGES FOR ELECTRICITY WILL BE REDUCED BY 10 PERCENT AND FOR WATER BY FROM 5 PERCENT TO 20 PERCENT.

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7. A STUDY IS TO BE MADE INTO THE REAL COST OF IMPORTED GOODS AND OF LOCAL COMMODITIES WITH A VIEW TO FIXING THEIR PRICES.

COMMENT

8. THESE STEPS FLESH OUT, RATHER BELATEDLY, SOME OF THE BROAD INTENTIONS ANNOUNCED ON 16 OCTOBER (SEE TUR). FURTHER DETAILS WILL NO DOUBT BE REVEALED IN THE 1989 BUDGET DOCUMENT. ALTHOUGH THE IMPORT BANS STAND IN STARK CONTRAST TO THE RECENT DECISION TO DE-REGULATE THE ECONOMY AND TO LIBERALISE TRADE (THOMAS'S T/L OF 21 AUGUST TO RAY, DTI), THEY MAY HELP TO IMPRESS MORE WIDELY UPON THE NATION THE SERIOUSNESS OF THE SITUATION. MEANWHILE, FOLLOWING THE IMMEDIATE DEPRECIATION OF THE DINAR BY ABOUT 20 PERCENT AFTER ITS FLOTATION ON 15 OCTOBER, PRESSURE ON THE DINAR HAS EASED.

9. THE REDUCTION IN THE PRICES OF ELECTRICITY AND WATER, TOGETHER WITH THE PREVIOUS PROMISES TO SUBSIDISE BASIC FOODSTUFFS, ARE NO DOUBT INTENDED TO SOFTEN THE BLOW AND TO EASE INFLATION. IN FACT CHARGES FOR ELECTRICITY HAVE BEEN ARTIFICIALLY HIGH FOR A COUPLE OF YEARS REFLECTING HIGH DOMESTIC FUEL PRICES.

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