PZ.48

CC ... MHT

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

30 April 1985

D ~~Williamson Esq~~ ?
10 Downing Street
LONDON SW1

Dear David,

ECONOMIC SUMMIT

... We spoke about Charles Powell's letter to Richard Hatfield of 29 April and I agreed to send briefs on items (i) and (ii) via you. I attach suitable briefs.

... On Cleveland Bridge losing the contract for the Second Bosphorus Bridge to Japanese competition, I attach a background note which has been agreed at official level with DTI. I should explain why it does not include a speaking note as such. You will see that the Cleveland Bridge-led consortium was, irrespective of aid, unable to compete with the Japanese on price for the whole project including the approach road and motorway. The Japanese did have the further advantage that the Japanese Government offered a substantially greater aid and credit cover for the project than we did. Our support was necessarily confined to the UK element of the Bridge which represented a relatively small proportion of the overall project. That said, there is no evidence that the Japanese used methods to win the contract which should be challenged under the international rules. The Chancellor therefore feels that if the Prime Minister wishes to mention the matter to Mr Nakasone she should only do so in the context of the need to restrict the use of soft financing for major capital projects abroad.

I am copying this to Richard Hatfield (Cabinet Office), John Mogg (DTI), and Len Appleyard (FCO).

Yours ever
Rachel Lomax

RACHEL LOMAX
Principal Private Secretary

PRESIDENT MITTERRAND'S CURRENCY IDEAS

French Thinking

President Mitterrand is reported (Wall Street Journal, 29 April) to have said "If we could build something on a "tripod" - the dollar, the yen and the ecu - it's possible to determine somewhat more fixed relationships between them". He insisted that he was open-minded about exactly how to overhaul the monetary system.

2. In Group of Ten discussions at official level, the French have espoused the idea of "target zones" for exchange rates, with the major currencies very much in mind. They aim ultimately at fixed relationships, binding on all parties subject only to agreed occasional adjustments. They want as soon as possible to move towards this through stages of notional ranges, indicative ranges, any possible intermediate and gradually more and more binding stages.

3. The French have very little support in the G.10 - Belgium and perhaps Italy. United States, Germany, Japan, Netherlands, Canada and UK opposed, although most countries except the United States are prepared to accept that there is at least some indicative value in some currency movements, and that they could be a signal on occasion for the need to re-examine domestic policies.

4. When challenged in detail, French officials flounder: in particular, they have not even the beginnings of an answer to the question: What target zones would you choose at present?

Line to Take

5. The following points could be made:

- agree that greater stability of exchange rates between major currencies would be welcome - for industrialists, traders, investors as well as governments;

- but very sceptical about any future return to a fixed or nearly-fixed system: flexible movement of exchange rates often has a relevant and valuable contribution to make towards necessary adjustments between countries;

- in any case certain that the time is not ripe now: how would one possibly define the right rates at present?

- the root problem is the achievement of individual domestic policies in major countries which are both sound and compatible: this is what we must work on - as we are trying to do;

- understand that G.10 are likely to explore French ideas as well as the more promising approach of trying to get underlying policies right: best to await their report.

And on a related point:

- agree with President Mitterrand that a greater international reserve role for the yen and the ecu (and its main constituent currencies) would be welcome: one reason for pressing Japan to open up its capital market, and for welcoming growing private use of the ecu (to which London market has made a big contribution).

SECOND BOSPHORUS BRIDGE: ATP: CLEVELAND BRIDGE

BACKGROUND NOTE

The Project

Cleveland Bridge Ltd led an international consortium in a bid for this project which involves a contract for the building of the second Bosphorus Bridge, and immediate approach roads packaged together with three other contracts for some 160 kilometres of related motorway. The main competition was from a Japanese led consortium including the Italians. Cleveland Bridge's particular interest was in the bridge itself. The company applied for ATP support and ECGD cover for the minimum necessary UK content for the bridge only. They recognised that it would be impossible to secure agreement to any further ECGD cover sufficient to have allowed greater UK involvement in either the bridge or the roads.

The Bids

2. Ministers decided at EX that the ECGD cover limit for Turkey should be increased which allowed Cleveland Bridge to bid with an offer of £10 million ATP support and export credit cover of £40 million for the UK content of the bridge. But the Cleveland consortium (including US, West German and Turkish firms) had to put in a bid for the whole project. They did this with commercial finance which included $300 million officially supported US credit for the 90% plus balance of the project.

3. The Japanese competitor's bid for the bridge itself was slightly higher ($114 million against Cleveland's $111 million), but their offer which involved $206 million yen loan at 5% over twenty five years represented a mixed credit subsidy of some 37%. It was therefore agreed to increase ATP for Cleveland's bid to almost £15 million. This matches the subsidy level of the Japanese offer but not of course the overall amount which remained some four times greater.

4. It has to be emphasised that the Japanese led consortium's bid for the whole project, including the road ($550 million) was, irrespective of aid, some 20% cheaper than the Cleveland consortium at $675 million. This pricing together with the inability of Cleveland Bridge to secure US or German government aid support put the Japanese in an unassailable position.

5. In the context of the Japanese offer the Italian official suport was largely marginal but added to the attractiveness of the Japanese/Italian bid.

Japanese Methods

6. The Japanese might very well have won the project on price even without an injection of aid. The OECF aid money that was put in was offered on their usual supposedly 'untied' basis. The Japanese often claim their aid is untied because contractors from LDCs as well as Japanese companies are eligible to compete for it. In practice this results in effectively tying the aid to Japanese companies. However we cannot really complain about more than the pretence of Japanese "untied aid" practices. Their offer is not counter to international rules and indeed our own aid offer was also tied.

7. It is also understood that in making their aid offer the Japanese government made it conditional upon the Japanese consortium winning the whole project thus ensuring that they beat Cleveland on the bridge. But there is no absolute evidence of this, and in any case it is difficult to argue that it is illegitimate as a commercial tactic.