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PRIME MINISTER

2nd Bosphorus Bridge
(EX(85)1 and 2)

BACKGROUND

Cleveland Bridge (CB), a Trafalgar House subsidiary, are bidding to construct the Second Bosphorus Bridge in Istanbul. The United Kingdom (UK) content of the contract, which involves steel, cable fabrication and management work amounts to some £40 million. CB built the first bridge in 1973, and have a worldwide reputation for long-span bridge construction. But the main Japanese competition, anxious to break into the international market, are offering soft finance which amounts to a price subsidy of around 50 per cent. To help counter this, CB have sought Aid and Trade Provision (ATP) support of about £10 million. A decision is needed urgently.

2. The Minister for Overseas Development has approved ATP of 25.1 per cent of the UK content up to a maximum of £10.4 million, on a conditional matching basis, provided that Export Credits Guarantee Department (ECGD) cover for the deal can be agreed. The Chief Secretary is opposed to granting ATP. A further problem is that, following the British Aerospace (BAe) Airbus deal, present ECGD credit cover for Turkey is almost exhausted. The Chief Secretary has agreed that the present £200 million ceiling may be increased by £6 million to accommodate the Bosphorus Bridge order, but other projects, including a promising order for Norther Engineering (NEI) for turbines for a nuclear power plant at Akkuyu risk being squeezed out.

Canadians

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3. A similar issue has arisen over cover for Talbot's car assembly contract with Iran. A separate note is annexed to this brief.

Proposals

4. The Secretary of State for Trade and Industry proposes in EX(85)1:

a. ATP of £10 million for the CB project;

b. increasing the ceiling for ECGD cover by £47 million to £253 million, in order to accommodate both the CB and NEI projects.

5. The Chief Secretary's main concern is the overall state of ECGD's finances. EX(85)2 proposes:

a. holding the ECGD ceiling for Turkey at "about £200 million" (we understand this includes the £6 million increase to £206 million already tentatively agreed in respect of the CB project);

b. a tough line on ad hoc increases in cover for risky markets;

c. consideration of spending Ministers sharing the risks of any increased cover;

d. discussions between the Chief Secretary and the Minister for Trade on steps to improve ECGD's financial position.

MAIN ISSUES

6. The main issues are:

i. ATP for the 2nd Bosphorus Bridge;

ii. the appropriate level of ECGD cover for Turkey (and hence the fate of the NEI project);

iii. ECGD's overall financial position.

2nd Bosphorus Bridge

7. You have discussed the employment implications for the North East project with Messrs. Fallon and Hickmet, the MPs for Darlington and Scunthorpe. The details are set out in paragraph 8i of EX(85)1. CB argue that losing this contract will put at risk other potential business of over £250 million in the next 5-10 years. Against this, the Treasury have pointed out that the reason for the loss of the contract - the size of the Japanese subsidy - will be generally known, and need not undermine CB's reputation. CB could reduce their bid to a project management function, and source overseas with foreign subsidised materials. Mr Tebbit argues that to do this would be sensitive in terms of employment, and undermine the attraction of the contract in respect of our diplomatic and longer term commercial relations with Turkey.

8. The Foreign Office support the project as a symbol of Anglo-Turkish co-operation, and an opportunity to demonstrate British technology. They are concerned about the political impact of failure to support it, following on from the refusal of ECGD cover for the Tornado contract in November last year.

ECGD Cover for Turkey

9. ECGD cover for Turkey was only resumed in 1983, following the 1978 financial crisis. The limit £200 million was fixed in April 1984. When the Government decided to accept the Airbus order in December, this was in the knowledge that BAe would take up a high proportion (£169 million), leaving little flexibility to accommodate

other projects. The Chief Secretary argues that the Turkish economic outlook does not justify a further increase in ECGD's exposure, and that the limited cover remaining should be taken up by business on more commercial terms such as the prospective NEI order. The latest Joint Intelligence Committee (JIC) assessment suggests that there is a risk of further rescheduling.

NEI Akkuyu Project

10. The NEI project is at an advanced stage of negotiation, and, the Department of Trade and Industry (DTI) judge, has similar industrial and commercial merits to CB's. Some 2,000 man years work would flow from the contract, also with a bias towards hard-pressed plant in the North East. Withdrawal would jeopardise NEI's chances of winning a £40 million contract in Canada and weaken other, more distant, prospects of business in partnership with the Canadians. In order to go ahead with their present bid, NEI need ECGD cover of about £42 million; this would necessitate an increase in the country limit whether or not the CB order is also covered.

ECGD's financial position and procedures

11. We understand that the Chief Secretary is more concerned about ECGD's overall financial position, and about the way in which cases come up for decision, than about either the CB or NEI projects. At best, ECGD's deficits will add £377 million to the Public Sector Borrowing Requirement (PSBR) in 1985/86, with cumulative borrowing reaching £1100 million by 1988. The Comptroller and Auditor General qualified ECGD's last two sets of accounts because of insufficient provision for possible future losses. Further cover for Turkey can only worsen ECGD's exposure; there are other cases in the pipeline in addition to CB and NEI.

12. On procedure, the Chief Secretary wants to get away from the present system of setting a country ceiling and then taking projects largely on a "first-come, first-served" basis. This inevitably leads to pressure on the ceiling at the year-end. Ad hoc increases are than conceded on what are generally worthy projects, with the result that ECGD's overall position is made more risky. He would prefer to protect ceilings by better phasing of commitments, achieved through greater selectivity in accepting projects. Where, exceptionally, the limits were eased, he would like to see spending Ministers sharing some of the risks. (Talbot's Iranian contract is an example of how this might work in practice; see the Annex to this brief).

13. The Chief Secretary and Mr Channon are due to discuss such questions shortly and the Sub-Committee will not wish to pre-empt this detailed examination. They might however wish to offer some general guidance on the conduct of the review.

HANDLING

14. Although it is the Chief Secretary's general disquiet about ECGD's finances which has dictated his stance on the specific cases before the Sub-Committee, and which are his main concern, it is unlikely that there will be time for more than a preliminary discussion of this. The CB, NEI (and to a lesser extent Talbot) cases require urgent decisions. With this in mind you will want to invite the Secretary of State for Trade and Industry and the Chief Secretary, Treasury to introduce their papers. The Foreign and Commonwealth Secretary has just returned from Turkey, and can comment on the impact on our relations with Turkey. The Minister for Overseas Development can advise on the ATP aspects.

CONCLUSIONS

15. You will wish the Sub-Committee to reach conclusions on the following matters:

i. whether to grant ATP for the 2nd Bosphorus Bridge;

ii. the level of ECGD cover for Turkey;

iii. whether to offer guidance on:

a. the handling of similar future cases;
b. revision of ECGD's procedures generally; and

iv. (if there is time) whether to grant increased cover for Talbot's Iranian contract, and if so on what basis.

PG

P L GREGSON

12 February 1985

ANNEX

TALBOT'S IRANIAN CONTRACT

If there is time it may be convenient to deal with another ECGD case involving disagreement between the Treasury and Department of Trade and Industry, the details of which are set out in paragraphs 5 and 6 of the Chief Secretary's paper.

Proposals

2. Talbot have asked for a temporary increase in cover of £15 million, to £50 million while new payment arrangements are made with the Iranians. The Chief Secretary is prepared to agree this temporary increase, but only on condition that the Department of Trade and Industry bear part of the risk (£15 million over 2 years) of the guarantee being called on their Public Expenditure Survey (PES) programme. Mr Tebbit has refused, and the workforce has been laid off.

Main Issues

3. We understand that the Chief Secretary is more concerned with improving procedures for the handling of ECGD cases than with the details of this particular case. He wishes to establish, through this example, that where increases in country limits are agreed, he can ask other Ministers to share the risks of increased cover. The main advantage, from his point of view, would be that spending Ministers would be likely to exercise greater caution in putting forward additional candidates. There may be some scope for an agreement with Mr Tebbit which established this principle, but on the basis of a figure lower than £15 million. On the other hand Mr Tebbit is unlikely to concede what could be an expensive precedent easily, and it may be that this general concept will have to be remitted for further study by the Chief Secretary and Mr Channon.

ECGD FINANCES

ECGD's surpluses or deficits are treated as notional deposits or borrowings from the Consolidated Fund. The table in paragraph 2 of EX(85)2 shows forecast deficits (notional borrowings) from the Consolidated Fund as at 31 March each year, after receipts are netted off and including notional interest payments. It thus shows the balance rather than cash flows.

2. The PSBR impact of ECGD deficits is the difference between the Year 1 deficit and the Year 2 deficit, less notional interest. Thus:

		£m
1985/86 cash balance		885.4
1984/85 cash balance (not shown in the paper)	-	451.6
		433.8
less notional interest	-	56.9
		376.9
rounded		377

3. Mercifully there is no dispute between Departments about these figures, which originate from ECGD.

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EX(85)1
12 February 1985

COPY NO 2

CABINET

MINISTERIAL COMMITTEE ON EXPORTS

PROJECTS IN TURKEY : SECOND BOSPHOROS BRIDGE
AKKUYU 1 NUCLEAR POWER STATION

Memorandum by the Secretary of State for Trade and Industry

SUMMARY

Present ECGD credit cover for Turkey is limited, and insufficient to support the bids of UK companies on two major projects. These are:

(a) construction of the second Bosphoros Bridge - Cleveland Bridge (a Trafalgar House subsidiary) are bidding for leadership of the contract. This would involve £40m UK content. The bid is up against international competition, notably the Japanese who are offering aid-finance (Case summary an Annex A); and

(b) turbine generators for a nuclear power station, Akkuyu I. Parsons (an NEI subsidiary) are collaborating with Atomic Energy of Canada Ltd (AECL) for a contract with a UK content of £30 million. This is one of the two chosen tenders for final evaluation. The othr is from KWU of West Germany (Case Summary at Annex B).

Cleveland Bridge, having lost the chance of a negotiated contract because cover was not agreed, must respond to the Turkish tender by March; Parsons must confirm their participation to AECL shortly.

BACKGROUND

2 Turkey has in recent years had a poor credit rating. ECGD went off cover following rescheduling of debts in 1978. Prospects were sufficiently improved for ECGD to restore cover, albeit on limited terms, in 1983, even though further rescheduling cannot be ruled out at this stage.

3 In view of uncertainties over Turkey's investment priorities and resources, both companies were allowed to pursue their bids on a "first-come first-served" basis within a restricted availability of medium-term ECGD country cover and on condition that they shared some of the risk with ECGD. Accordingly, both bids have been pared down to a minimum UK content.

4 Of the total £206 million ECGD medium-term cover for Turkey, only £24 million remains. Both ECGD's share of the face value of the contracts sought and the associated interest payments over the periods of the loans would need to be met. As a result, the remaining credit cover of £24 million is not enough for the UK element of either bid, particularly that of Parson's which has a longer loan period.

5 As regard the Bridge, it is proposed to match the aid offer from the Japanese with £10 million ATP. The remaining £30 million of the total £40m UK contract value would be shared equally with the private sector. The remaining liabilities for ECGD - taking account of interest payments over the period of the loan - would therefore virtually be containable within the remaining ECGD limit. After our failure to agree this package, which lost Cleveland Bridge the opportunity to gain a negotiated contract, it is now a question of putting together a bid against aid-assisted Japanese competition.

6 The Turkish Government, after a long period of relative inactivity, have now indicated that they wish to pursue final negotiations on the Akkuyu I nuclear station. Parson's bid, as part of the Canadian consortium, has been pared down to a UK content of £30 million, again with liability shared with ECGD on a 40 per cent private sector, 60 per cent ECGD basis. But, largely because of the longer loan period, there is insufficient ECGD cover available for the company to take advantage of their short-listed position.

7 The increase in ECGD's credit limit which would be necessary to allow both companies to pursue their bids would be a further £47 million, as shown by the table below:

	Face value of Contract to be covered by ECGD	Total potential ECGD Liability, including interest payments over loan periods.	*Assumes £10m ATP
Cleveland Bridge	£15m*	£27m	
Parsons	£18m	£44m	
(a) Total ECGD Liability		£71m	
(b) Currently available ECGD cover		£24m	
(c) Increase sought in ECGD cover		£47m	

ISSUES

8 (a) Industrial and Commercial Aspects. Each bid would:

(i) involve some 2,000 man years of work in areas of high unemployment, particularly the North East;

(ii) be important to sustain modern production plants; and

(iii) reflect major efforts undertaken by both companies to advance their sales opportunities.

Apart from their readiness to share country risk, both companies have spent substantial sums preparing proposals, establishing co-operative arrangements, and presenting their bids. Cleveland Bridge's credentials for major structural steel projects are high, and Parson's last turbine orders overseas were won against the Japanese in Singapore and Iraq.

A choice between the two is extremely difficult. As things stand both companies draw the conclusion that we are not prepared to give them the same support as their competitors receive from their Governments. It should be noted that there are other companies with current indications of ECGD cover for Turkey. They, together with any newcomers, would have to be told that ECGD cover had been exhausted for the present and would be bound to complain about what they would describe as preferential treatment for the two companies.

(b) Diplomatic Aspects.
Coming so soon after the public controversy surrounding Tornado and Airbus, the apparent UK reluctance to support Turkey at a time when their Government has taken realistic economic steps is bound to weaken our position across the field of commercial and political relations.

CONCLUSION

9 Increased ECGD exposure of £47 million in the market must be weighed against the industrial/commercial and political benefits of these two potential contracts. I consider that both bids are of sufficient importance to justify acceptance of the risk involved in providing the support proposed. The Secretaries of State for Employment and Environment have also underlined the employment aspects in adding their support for these proposals.

The Committee is, therefore, asked to approve:

(a) provision of £10 million ATP against Cleveland Bridge's bid; and

(b) an increase in the present ECGD cover for Turkey of some £47 million sufficient to accommodate both bids.

N T

Department of Trade and Industry
12 February 1985

ANNEX A

SECOND BOSPHOROS BRIDGE

BACKGROUND

Cleveland Bridge are bidding with a local Turkish firm, ENKA, for construction of this bridge and some 37-300 kilometres of associated roadwork. While, in another market, Cleveland might have gone for a higher UK value contract, in view of the credit limit, they have reduced the scope of their package to some £40 million and relied upon foreign sub-contractors for some of the basic bridge, and all of the road-related, work.

Normally Cleveland would be well-placed, having an unsurpassed reputation world-wide for long-span bridge work and having successfully completed the first Bosphoros bridge in 1973. But the main Japanese competition, determined to break into the international market, are offering concessionary finance equivalent to some 40+ per cent of their price, i.e loan of up to US$200 million over 25 years at 4.25-4.75 per cent annual interest. (A copy of the Japanese offer obtained from confidential sources is at Appendix I).

To help counter this, Cleveland Bridge have sought the minimum ATP support of £10 million on the £40 million UK content (including steel, cable, fabrication and management). The company, to reduce further the liability on ECGD, have - with their banks - agreed to take a seven and half year horizon of risk without ECGD cover on 50 per cent of the contract value, after ATP has been allowed for. They are, in addition, raising £500 million for the civil construction.

IMPLICATIONS

Cleveland Bridge hold a technological lead in long-span bridge construction over the Japanese, who are their most formidable potential competitors. If Cleveland Bridge were forced to withdraw from the bidding for the second bridge the Japanese would develop and apply new techniques and exploit their success over Cleveland in bidding for future business around the world. Future business is currently valued at over £250 million in the next 5/10 years.

As one of the main gateways to Turkey, the second bridge will be a prominent example of UK design and engineering skills. In employment terms, some 2000 man years in the UK would flow from the contract, notably at Cleveland's modernised Darlington plant where capacity is now seriously under-utilised and redundancies are already taking place.

Cleveland Bridge could - in the absence of ATP - reduce the UK content to a project management role for other countries' supply of the hardware. But, even if they were successful in this, the UK would gain little employment or diplomatic and commercial advantages with Turkey.

Department of Trade and Industry
12 February 1985

APPENDIX 1

PRE-QUALIFICATION FORM

PROPOSALS

Please state any proposals about the construction technique, finance and duration of the work with regard to the realization of the project, otherwise state "not applicable".

We are submitting below our proposal on the subject of the financing required for realizing the project :

Our group would like to undertake the construction of the whole four lots, which are:

1) Kınalı - Mahmutbey Motorway section of the Kınalı - Adapazarı Motorway (Thracian Motorway),
2) 2nd Bosphorus Bridge and Crossing,
3) Çamlıca - Gebze Motorway (Anatolian Motorway),
4) İzmit - Adapazarı - Kazancı Motorway (Anatolian Motorway)

and secure their financing.

Our group is in position to secure financing covering the whole value of our tender, under favorable payment conditions.

We would like to draw your attention to the following two points which will enable obtaining financing under favorable conditions :

1) We are in position to obtain a Japanese Yen Credit of $ 200 Million U.S.Dollars equivalent value, which will be used exclusively for financing the 2nd Bosphorus Crossing lot of work, covering the Bridge and the related crossing motorways. In case your Administration agrees to, the subject Yen Credit can be realized upon request of the Turkish Government.

   Terms and conditions can be as follows :

   - Yearly interest rate 4,25 - 4,75 %
   - Back payment period 25 years including 7 years grace period
   - Amount : up to $ 200 million

2) The financing we are going to secure for the 1st, 3rd and 4th lots and possibly for the motorway part of lot 2 can be as follows :

   - 15 % by Italian Government credit under conditions indicated below,
   - Another 15 % as an export credit loan.

PROPOSALS

Please state any proposals about the construction technique, finance and du of the work with regard to the realization of the project, otherwise state "not applicable".

The U.S.Dollar based Italian Government Credit can be obtained under the following conditions, in case this is requested by the Turkish Government from the Italian Government.

- Yearly interest rate 2 % - 2,5 %
- Back payment period 17 years including grace period
- Amount 15 % of the tender value for the subject lots.

The export credit loan will be under the current consensus agreement terms and its amount will also be the 15 % of the tender value of the same lots.

It is planned to complement the rest of the financing requirement from commercial credits.

We are submitting to your kind attention the above scheme which for the whole of four lots meets your credit requirements under most favorable terms and conditions to your Administration regarding interest rates, back-payment periods and grace periods.

We have set up our programs with the goal of completing the whole project by July 1988.

In setting up this Association, the combined strength of the partners,

- In their strong staffs of skilled personnel,
- In extensive plants and equipments in their ownership,
- In their financial strength,
- In their deep experience in the construction and manufacturing fields for similar works,
- In their use of the latest and most actual technical means and in the additional support which will be brought in by their associated companies anc subcontractors,

will insure the reliable and perfect realization of this most important project.

Our Turkish Partner is entitled to contact your Administration on behalf of our Association, in case any information or clarification is required regarding our prequalification application.

Yours respectfully,

Sezai Türkeş Feyzi Akkaya Construction Co.

Ishikawajima-Harima Heavy Industries Co. Ltd.

Mitsubishi Heavy Industries Ltd.

T. Ukawa

Nippon Kokan K.K.

Impregilo S.p.A. (Impresit Girola-Lodigiani)

ANNEX B

AKKUYU I

Background

Parsons are in a consortium led by AECL of Canada for the Akkuyu I nuclear power plant which has a total value of £1 billion. KWU of Germany are the principal competitors. Within the consortium Parsons has responsibility for the turbine element worth £150 million in total. Because of the credit restraint they have arranged to source as much as possible overseas. They have retained only the turbine generators supplied from this country, worth some £30 million. Further scaling down of the UK content is impossible.

Negotiations on this contract are now at an advanced stage following tenders in early 1984. Both KWU and AECL have had to offer to operate the plant and to put up equity for an operating company. The money to pay the companies for equipment supplied by them will be raised by electricity sales. Parsons' equity contribution would be about $3.3 million and, with their banks, they have agreed to take a 12 year horizon of risk on 40% of the contract value without ECGD cover.

Implications

Parsons' contract for turbine supply would provide about 2,000 man years of work, mainly in the North East, where the company is facing redundancies through shortage of orders. Collaboration with AECL in the nuclear field is one of the company's principal commercial strategies. This would be undermined if they were to withdraw at this late stage. A £40 million bid to collaborate with AECL for the next nuclear

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station in Canada would immediately be jeopardised and other prospects in Portugal, Korea and Yugoslavia would also be affected. Moreover, as GEC previously withdrew from a larger share of the AECL bid for Akkuyu for lack of UK credit support, the Canadians would become reluctant to consider turbine generator supply from the UK again. To date the UK has supplied the majority of AECL's turbines. The loss of this customer in present very competitive market conditions would be serious.

On the wider political front the Canadian government have consistently pressed us to support their Anglo/Canadian power sector ventures. Parsons' withdrawal, particularly if it handed the Turkish contract to KWU, would be likely to affect Anglo/Canadian industrial collaboration more generally.

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