

PRIME MINISTER

FIXED CROSS CHANNEL LINK

Prime Minister

May I suggest that - because this is so cogent - Alan be invited to speak at the meeting on these lines?

- (I think I shall need an oral briefing on this.)
- CONFIDENTIAL
1. In essence the DoT (memorandum 27 April E(82)40) argues that a fixed channel link would be justified, and since the French would only stand for a rail-only link, then Britain should agree to go ahead with the rail-tunnel option. DoT also believe that we should accede to the French requirement for a guarantee against political cancellation. MLCs 30/4
 2. The DoT case has a number of flaws, many serious, some fatal.

The Economic Case

3. Using their chosen rate-of-return criterion, the preferred option is not the rail-tunnel but the road bridge (Annex D). Even under the different risk scenarios (Annex D) the road bridge has an expected rate of return greater than alternatives. The report rejects the road bridge, in spite of its economic superiority, ostensibly on two grounds; first there are more "risks" and secondly the French wouldn't tolerate it. The former argument seems to me beside the point, since the risks are already incorporated in contingencies in the cost estimates, and in any case private capital is taking on these risks and will pay for these contingent liabilities. The second point, that the French will not have it, may be construed as a first claim in order to get what the French railways prefer.
4. But in any case the report uses a fallacious criterion for choosing the preferred option. The rate of return is both irrelevant and misleading in judging between mutually exclusive investment programmes. The only criterion is the size of the net present value*. If we re-calculate using the net present value criterion, we find that the road bridge is far superior to the twin tunnel and furthermore the road-bridge-with-rail-tunnel is also superior to the rail-only tunnel. (I believe even the Euroroute would be superior, but I would have to carry out detailed calculations to establish that point.) This implies that by forgoing the road bridge and building rail-only tunnels, we are sacrificing a substantial, even handsome, financial return which could be earned on the additional capital involved.

* Any book on project analysis establishes this point. See, for example, Layard and Walters "Microeconomic Theory" page 335 et seq.

CONFIDENTIAL

5. Another major flaw in the economic case is that there is no evaluation of the case of "no fixed link", that is to say the developed ferry system. I was impressed by the case put by the Dover Harbour Board, and it is at least remarkable that the DoT has not seen fit to evaluate that case. Yet that is one of the main options and should clearly be evaluated before any decision is made. This is all the more important since the DoT memorandum refers in paragraph 8 to employment in the politically very sensitive area of Pas de Calais being a very important consideration on the part of the French. Ferries and ports are labour intensive.
6. DoT suggests that the tunnel is better than the road bridge because inter alia it will not be so superior and so cheap a link that it will eliminate ferry competition, as would the road bridge. This is, of course, standing the normal efficiency criterion on its head! It argues that we should not build the road bridge because it is too efficient an option and will eliminate competition! The subsidiary argument is that the ferries will restrain monopoly pricing on railways, whereas no such restraint will be imposed on the road bridge operator. This is without foundation: if there is potential competition from incipient entrants into the ferry business this will always be a constraint on road bridge monopoly.

The Guarantee Problem

7. At a previous meeting of E it was pointed out that we would not give a guarantee against political cancellation. There were insurmountable difficulties in defining what would be meant by "political cancellation". Clearly withdrawal for good commercial reasons may well be influenced by political events, and a guarantee might well be subject to acrimonious and lengthy disputation.
8. From the memorandum, one gets the impression that DoT have moved forward and found an appropriate definition of political guarantee. But I cannot see any further progress in Annex E, (which is devoted to the organisation and legal structure.) In para 6 of Annex E the company would have the statutory duty to construct and operate a link - "this duty could only be rescinded by agreement between the two Governments". This provision clearly does not deal with the political guarantee issue.

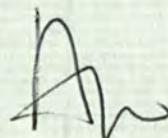
Pre-emption of Rail Policies

9. The report does not consider the implications of possible changes in the status of the railways, especially in Britain, and the consequences of a rail monopoly of the fixed link. Clearly the rail tunnel will be a considerable advantage to French railways and British Rail. The rail tunnel would pre-empt at least some of the decisions that are due to be made on the future of British Rail. The rail-only option is also clearly more advantageous to French Railways than to BR or the UK. French Railways are markedly more efficient than BR and likely to remain ahead. French railways would also benefit at the expense of our relatively efficient road haulage industry. One can understand French enthusiasm, indeed intransigence, for the rail-only option. I would have thought it would have been worthwhile to examine the split in net benefits between the UK and France.

Conclusion

10. (a) The initial objection to a government guarantee still stands. DoT have not indicated how we can satisfy the French requirement of a political guarantee without involving an open government commitment. It would be unwise to allow the fixed link to gather any more steam until there is at least a feasible solution to the political guarantee problem. I can see none.
- (b) DoT's recommendation of proceeding with a rail-only tunnel is not warranted by the evidence. The alternative road bridge projects are best for the Fixed-Link Authority and probably for Britain. DoT has used an inappropriate and misleading criterion of choice. I would recommend that, granted a settlement of the guarantee problem, that we indicate to France our interest in the road bridge, and our rejection of the rail-only tunnel.

30 April 1982



ALAN WALTERS