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Foreign and Commonwealth Office

London SW1A 2AH

*Prime Minister  
This suggests that we  
sign off the dispute  
on the bridge, by a  
stiff interview between the*

24 June, 1985

*Dear Charles, Foreign Secretary & the Japanese  
Ambassador.  
Bosphorus Bridge*

I enclose a commentary on Mr Nakasone's latest letter to the Prime Minister as you requested in your letter of 5 June to Colin Budd. This has been cleared with the DTI and HM Treasury. As you will see, it is our intention to pursue the question of associated financing in OECD.

*CDP  
24/6*

The analysis supports the conclusion in the Secretary of State for Trade and Industry's minute of 17 June to the Prime Minister, that we should find a way to terminate exchanges with the Japanese Government (particularly at Prime Ministerial level) but in a way which leaves them in no doubt of our strong feelings. Unfortunately, the method which the Prime Minister agreed to (your letter of 18 June to John Mogg) is no longer open to us as the Chancellor of the Exchequer has had to cancel his visit to Tokyo.

*Amend  
ms*

Sir Geoffrey Howe agrees with Mr Tebbit that the arguments for and against summoning the Japanese Ambassador here to round off the affair are finely balanced, the more so since the Japanese are showing considerable concern at reports that the UK is leading the EC towards a strong condemnation of Japan in the Milan European Council. During his visit to Tokyo, Sir Antony Acland was forcefully told of these concerns by his opposite number in the Japanese MFA on 19 June. However, the Ambassador has himself now asked to call on the Foreign Secretary this week to discuss EC/Japan trade issues in advance of the Milan Summit.

Sir Geoffrey has arranged to see the Ambassador on 26 June. I understand that Mr Tebbit would have no objection to Sir Geoffrey taking this opportunity to draw a line under the Bosphorus Bridge episode. If the Prime Minister is also content, Sir Geoffrey will do so.

He would propose to make our concerns clear with some straight speaking. Although we have little to gain (and more than most to lose) by standing out alone in criticism of Japan, or by appearing to the Japanese to be leading the pack against them, the 19 June Foreign Affairs Council declaration, (copy attached) will have shown clearly that our EC partners are just as concerned as we are.

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I am copying this letter to John Mogg (DTI) and  
Richard Broadbent (HM Treasury).

*Yours ever,  
Peter Ricketts*

(P F Ricketts)  
Private Secretary

C D Powell Esq  
10 Downing Street

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## SECOND BOSPHORUS BRIDGE: COMMENT ON MR NAKASONE'S LETTER OF 1 JUNE

1. Japanese aid to be seen as part of OECD's efforts to assist Turkey because of the importance of Turkey to world peace and stability.

It is true that Japan was encouraged to provide special assistance to Turkey in the early 1980's. Britain also provided exceptional amounts of aid at that time to assist economic adjustment in Turkey.

But the Japanese soft loan offer of \$200M which exceeds the amount of special assistance they provided in the early 1980's, was made specifically in respect of the Section 2 contract of the project which included the bridge. Had the project not been awarded to a Japanese consortium the loan would not have been available for other projects in Turkey. To that extent even if a Japanese consortium had not offered the lowest price there would have been a strong financial inducement to the Turkish authorities to award the business to Japan unless another country could match the Japanese aid offer. The nature of the Japanese offer was therefore potentially trade distorting.

2. The terms of the Yen loan were not exceptionally concessional.

Japan has a large bilateral aid programme, about three times the size of the British bilateral aid programme. The poorer countries generally receive grant aid. Grants in 1983 amounted to \$1 billion or 41% of Japanese bilateral aid. Where Japan provides aid to stronger developing countries for political and commercial reasons, primarily in the Far East, it does so on loan terms. For example in 1983 Japan disbursed some \$560 million of loans in Thailand, Malaysia and Indonesia and a further \$300 million in China. The yen loan to Turkey had a grant element of 37%: this is common for countries with similar income per head levels. Japan makes soft loans to Indonesia on more concessional terms: the interest rate is normally  $3\frac{1}{2}\%$ , giving a grant element as calculated by OECD of about 50%.



3. Turkish Government decision to divide project into 4 contracts and to include road component in Section 2 with the bridge.

This is supported by the note prepared by Mr Brown of Freeman Fox circulated by Mr Powell. We have little doubt that Japan would have offered a soft loan for the bridge alone had it been the subject of a separate contract. It was the bridge that was commercially attractive, not the roads.

4. Japanese Consortium made lowest bid.

This is correct both for the project as a whole and for the Section 2 Contract. Within the Section 2 contract the Cleveland cost figure for the bridge was marginally lower than the Japanese. But contracts have substantial mobilisation and overhead costs: the division of these between different components of a contract is somewhat arbitrary and tenderers may allocate them differently. The only real test of Cleveland's price competitiveness for the bridge would have been a separate tender.

5. Associated Financing : Yen loan was development assistance and not credit offered for export promotion.

The implication of Mr Nakasone's letter is that the loan was not part of an associated financing transaction. According to OECD Development Assistance Committee Guidelines, transactions which associate aid, in law or in fact, with other officially supported funds (notably export credits) are regarded as Associated Financing.

In respect of the Section 2 contract only we believe that the yen loan covers the Japanese content of this contract and that therefore taken alone it was not associated Financing.

Official Japanese representations have been made arguing that in terms of the project as a whole their overall financial package was not Associated Financing on the grounds that :-



i. the soft loan offer on Section 2 contract was not conditional upon a Japanese consortium winning the other contracts: this may be true but given the Turkish authorities' intention to let the whole project to one consortium this was the practical effect.

ii. Japanese commercial finance was not officially supported export credit: on a strict interpretation of the DAC Guidelines this point is valid. But where aid is used in association with private banking loans which also finance a country's exports it has been agreed that for the sake of transparency each transaction should be reported to the DAC.

These issues will be pursued within the OECD. If the Japanese financial package is interpreted as Associated Financing they can be criticised for initiating such a large offer but they have not broken the DAC rules governing its use.

6. Interest rates on Commercial loans not under regulation of OECD Consensus.

The commercial loans which formed part of the overall Japanese financial package for the project are not officially supported export credits i.e they are not insured by Japanese export credit agency (EXIM Bank). Japanese banks extending loans presumably guaranteed by Turkish government can be expected to charge higher interest rate than that for an export credit guaranteed by EXIM Bank. It is believed that these loans will largely finance non-Japanese goods and services including costs incurred in Turkey.



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*From the Private Secretary*

27 June 1985

**BOSPHORUS BRIDGE**

Thank you for your letter of 24 June. Although it is now after the event, I should record that the Prime Minister was content for the Foreign Secretary to bring to an end the rather unsatisfactory exchanges over the Bosphorus Bridge at his meeting with the Japanese Ambassador yesterday.

I am copying this letter to John Mogg (Department of Trade and Industry) and Richard Broadbent (H M Treasury).

C D POWELL

Peter Ricketts, Esq.,  
Foreign and Commonwealth Office

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