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CABINET
MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

FIXED CROSS-CHANNEL LINK

Memorandum by the Chief Secretary, Treasury

The Secretary of State for Transport's paper (E(81)121) covers a lot of ground in setting out the choices we face in relation to a possible fixed link. Before we discuss it, I would like to draw attention to the basic economic and financing issues involved, as I see them.

2. Our policy is that any fixed links should be financed entirely with private risk capital. But it looks increasingly doubtful whether that will be possible. The promoters want through-put agreements which will effectively guarantee their return. The French require us to provide a completion guarantee which, while not necessarily absolving the promoter from risk, will ultimately place the risks on the Government. The French also wish to retain in Government hands control of tariffs and schedules which would be difficult to reconcile with genuine private finance.

3. A "hybrid" scheme (ie a public sector project financed directly by capital raised from the market) of the sort identified by the recent NEDC Working Party on Nationalised Industries Investment remains a possibility. Setting up acceptable financing arrangements of this kind, involving an appropriate degree of risk for investors, will be difficult. The important point is that whether financed

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conventionally or direct from the market, the project now seems likely in effect to be administered by the public sector and it is as a public sector project that we shall have to reach our decisions on it.

4. This means above all that our final decision should be taken on the basis of an economic assessment of the scheme. Further work on an economic appraisal remains to be done but it is already clear that this project is at best a marginal one. On the promoters' own central assumptions, some of which are optimistic, returns from bored tunnels range between 5.6 per cent and 7.3 per cent. This barely exceeds the minimum 5 per cent return we look for from public sector investment and we would normally look for at least 7 per cent in this sort of project to allow for the risk that returns will be lower than forecast.

5. So I am very doubtful that this scheme will prove good enough to justify making the investment. I am not suggesting we should take final decisions until work on a comprehensive economic assessment has been completed. But I am concerned that the process of talking with the French may lead us into a position of semi-commitment before we have formed a considered view on the merits of the project. David Howell's paper proposes (paragraph 9) that he should lead the next stage of discussions with the French towards clarification of three fundamental questions, the first of which is whether to make a quick start with a rail tunnel, clearly that is not a question which can be answered in the discussions with the French. One may hope that the talks with the French will throw some more light on the issues involved. But the important point is that we must form our own view on the economics of the project and, if it is to proceed, what form of finance we are prepared to approve; and we must do this soon.

6. I therefore suggest:-

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- a. that independently of the talks with the French, David Howell should be invited to bring the subject back to E Committee as soon as the economic appraisal is complete and at the same time to provide a detailed note on the prospects for private financing; and
- b. that it should be made clear to the French, to avoid possible misunderstandings later, that in view of our preliminary work on the economics of the project, we are uncertain whether a fixed link will prove to be justifiable

HM Treasury

L.B.

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