NUCLEAR POWER: I.B.R.D. LOAN

MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

On 31st October, 1957, my predecessor as Chancellor of the Exchequer was invited to examine the possibility of revising, on the lines indicated by the Prime Minister, the terms on which a loan might be obtained from the International Bank for Reconstruction and Development (I.B.R.D.) for the United Kingdom nuclear power programme (C.C. (57) 77th Conclusions, Minute 5).

2. With the agreement of the Minister of Power, exploratory discussions have now been held between officials and representatives of the I.B.R.D. An agreed report by officials on these discussions is annexed.

3. It will be seen that the nature of the proposed loan would correspond closely with the concept outlined by the Prime Minister, and that officials have found in the arrangements no particular feature which by itself constitutes a major obstacle to the taking of a loan. While I fully appreciate that, taken together, all the procedures involved present a certain amount of inconvenience, I am strongly of the opinion that this does not outweight the economic advantages which would accrue.

4. As my predecessor pointed out in C. (57) 253 this I.B.R.D. lending in conjunction with the New York market represents the only real chance we have of getting any new direct fortifications for the reserves. Since then the indications have become all the stronger that we are in no position to forgo this addition to our resources. Although the immediate prospects for the balance of trade of the United Kingdom itself are good, partly because of the fall in commodity prices, nevertheless, for that same reason, which stems from the recession in the United States, the prospects for the rest of the sterling area are serious. The net result is likely to be a loss to our gold and dollar reserves before the end of the year. We cannot afford to dispense with any potential source of gold and dollars which may strengthen the United Kingdom and the sterling area in weathering the effect on world trade of the United States recession, and if this round went smoothly there is a good prospect that we should be able to raise further sums in the same way.

5. It is quite certain that we cannot hope to effect any change in the major features of the proposed arrangements by further exploratory discussions, and it is only reasonable to expect that we may lose the opportunity once and for all unless we now open firm negotiations.

6. The loan from the I.B.R.D. would have to be applied specifically to the nuclear power programme. This means in my view that it must be a loan from the I.B.R.D. direct to the nationalised industry, since I regard as overwhelming the objections to borrowing by the Treasury earmarked for specific purposes. As regards the market loan, if our expectation that this can be a general-purpose loan is fulfilled, the same objection to Treasury borrowing does not arise. But there are also over-riding reasons of Budget policy for deciding that the industry should borrow direct from I.B.R.D. and indeed from the New York market as well if that is technically possible.

CABINET

25th February, 1958
7. The industry are due to raise some £140 millions of capital next year. Under present arrangements this sum will be provided by capital advances from the Exchequer below the line. The more the industry borrow direct from I.B.R.D. and the New York market, the less will be the amount that has to be issued to them from the Exchequer and the better will be my prospects of reducing the overall Budgetary deficit in the next year or so. This is not just a presentational Budget advantage, though the presentation of the Budget has its importance, and the nearer we can get to an overall balance the better will be the effect created abroad. The borrowing in the United States will be a genuine gain to the economy, since to that extent public investment here will be financed without calling on domestic resources, and it is fully justifiable to reflect that gain in the Budget accounts.

8. I therefore recommend that authority be given for the opening of firm negotiations without delay with the International Bank for Reconstruction and Development, with a view to obtaining a loan of $50 millions to the nationalised electricity supply industry towards their nuclear power programme. I also recommend that in conjunction with this negotiations should be opened for a further loan of $50 millions from the New York market. In this case too the borrower should preferably be the nationalised industry. But if, on technical grounds, this course is not feasible, the loan should be a general purpose loan to Her Majesty's Government.

D. H. A.

Treasury Chambers, S.W. 1,
NUCLEAR POWER: I.B.R.D. LOAN

REPORT BY OFFICIALS

Summary

United Kingdom officials have had detailed talks with representatives of the International Bank for Reconstruction and Development (I.B.R.D.) about what would be involved in a loan from the Bank (in conjunction with a loan from the New York market) for the United Kingdom nuclear power programme. The Appendix to this report sets out the position on various aspects of the matter which do not call for detailed decisions by Ministers. The report itself summarises below the background to the discussions, and sets out the principal considerations affecting the three main issues for decision by Ministers, which are as follows:

(a) Whether the United Kingdom should now proceed with a view to a loan from the I.B.R.D. in conjunction with a loan from the New York market.
(b) Whether the loan from the I.B.R.D. should be taken by the nationalised electricity industry direct, or whether it should be taken by the Government for lending to the industry.
(c) Whether the loan from the New York market should be raised by the industry or by the Government.

Previous Developments

2. On 31st October, 1957, the Cabinet invited the Chancellor of the Exchequer to explore further the terms and conditions on which a loan might be obtained from the I.B.R.D. for the United Kingdom nuclear power programme. During the following week both the then Chancellor of the Exchequer and the Minister of Power met the President of the I.B.R.D., and these meetings served to confirm the following points:

(a) The I.B.R.D. could not make a dollar loan to finance expenditure in the United Kingdom except in conjunction with a loan raised on the New York market, which would render the I.B.R.D.'s own loan justifiable as a gap-bridging operation.
(b) The probable amounts were $50 millions from the I.B.R.D. and $50 millions from the market, though the I.B.R.D. would step up the amount when the time came if that proved possible.
(c) We could take it that these might be the first of a series of loans from the I.B.R.D. (and the New York market) over the next few years.
(d) Neither the I.B.R.D. nor the market loan would involve any equity holding; both would be bond issues. Neither would require anything in the nature of a mortgage on the assets of the industry.

3. The then Chancellor of the Exchequer and the Minister of Power then agreed to a suggestion by the President of the I.B.R.D. that representatives of the Bank might visit the United Kingdom to discuss with interested authorities here what would be involved in an I.B.R.D. and a market loan, without prejudice to the decision whether Her Majesty's Government would wish to go ahead with such an arrangement. A decision would have to be taken by Ministers in the light of the outcome of the discussions. This visit was to take place, and has in fact taken place, without any publicity or any disclosure that discussions were proceeding. The I.B.R.D. sent a team of four, led by Mr. Davidson Sommers, one of their Vice-Presidents who is also the Bank's General Counsel, and including the Bank's Atomic Energy Adviser. During the week commencing 9th December, 1957, the I.B.R.D. representatives had a series of meetings with representatives of the Treasury, the Ministry of Power, the Electricity Council and the Central Electricity Generating Board. Other Departments have been kept informed.
I.B.R.D. Procedures

4. There are various requirements and procedures which have to be satisfied before the I.B.R.D. makes a loan to any country or organisation. These are dealt with in some detail in the Appendix. On none of the points dealt with in the Appendix, taken individually, have difficulties been encountered so far which appear to constitute a major obstacle to arrangements for a loan.

5. There is a further point, not arising so directly from the discussions with the I.B.R.D. to which it is desirable to draw the attention of Ministers. This is the likelihood that at a later stage in their enquiries the I.B.R.D. would become seized of the degree of economic risk involved in the United Kingdom's nuclear programme. It is public knowledge that on present forecasts power from the United Kingdom nuclear stations is expected to be 10 per cent. dearer than power from conventional stations in the United Kingdom. This assumes no increase in the cost of coal and oil for conventional stations; a 5 per cent. rate of interest on capital for the nuclear stations; and a given net price for the Generating Board's nuclear fuel after allowing for repurchase of irradiated material by the Atomic Energy Authority. What has not hitherto been known is that this estimate also assumes that, as a result of technical progress postulated between now and, say, 1960, a certain "burn-up" of fuel elements will be achieved although so far there has been no practical experience to demonstrate this as attainable.

6. It is suggested that this uncertainty about the fuel element performance need not by itself be regarded as an insuperable obstacle in the way of an application for a loan. As the inherent risk in the nuclear power programme does not invalidate the programme itself it need not invalidate the case for seeking a loan. If Ministers were to decide to seek a loan it could be put to the I.B.R.D. that we did not claim to be able to show that each item in our electricity development programme would in the short run yield a profit by the test of commercial accountancy. Taking all items together—the manpower situation for coal mining, the insecurity of our oil supplies and the prospect of further scientific development in the field of nuclear energy—we regarded our nuclear power programme as justified on broad grounds. From the purely financial angle I.B.R.D. would have their guarantee from Her Majesty's Government whether the nuclear power stations make a profit or not.

I.B.R.D. Loan—Who should be the Borrower?

7. The Electricity Council and the Generating Board would prefer that any loan should be through the medium of the Treasury. This would avoid further complications in general procedure for financing the industry, and would relieve the industry of any exchange risk. The Treasury, however, consider that there are over-riding objections to any departure from the principle that the Exchequer does not borrow for specific purposes. This principle has so far been rigorously observed in spite of pressure. The I.B.R.D. would be prepared to make the loan either to the industry (with a Government guarantee) or to the Government itself, but in the latter case the loan proceeds would definitely have to be allocated for finance of the nuclear power programme, and thus would be an earmarked loan for a specific purpose. Even if the Treasury were to take the loan for lending to the industry this would not dispose of the question of legislation, which would be needed, whether to provide for a lending operation of this kind, or for direct borrowing from the I.B.R.D. by the industry. The Treasury therefore consider that the loan from the I.B.R.D. should be taken by the industry—whether by the Electricity Council or by the Generating Board would have to be further considered.

Market Loan—Who should be the Borrower?

8. The Electricity Council and the Generating Board would also prefer that the loan from the New York market should be raised by the Government, and here there are not the same objections from the Treasury's point of view. It is understood that this could be a general-purpose loan, not specifically related to finance for the nuclear power programme, although the prospectus for the market loan would mention that it was being raised in conjunction with the I.B.R.D. loan for the programme. In that case, no fresh legislation would be required to enable the Government to raise the market loan, whereas additional powers would be needed to enable the Electricity Council or the Generating Board to borrow by an issue of bonds in the New York market. Moreover, the I.B.R.D. advise that
a New York loan to the industry (with a Government guarantee) would have some market disadvantages as compared with borrowing on the market by Her Majesty's Government.

Other Points

9. The following two further points, which are dealt with in more detail in the Appendix, should be noted:—

(a) It will be implicit in a decision to proceed with the I.B.R.D. loan project that, if the industry ever raises money in the United Kingdom on the strength of a charge on its assets or revenues (which would probably be a necessary feature of any borrowing by the industry without a Treasury guarantee), the I.B.R.D. should, if necessary, at that stage be given equivalent security (see paragraph 1 (g) of the Appendix).

(b) It would be the United Kingdom's intention that the I.B.R.D. loan should be related to at least a limited sector of the nuclear power programme as possible, but it may well be necessary to relate it to at least two nuclear power stations rather than to a single station.

10. To sum up Ministers are invited to decide:—

(a) Whether the United Kingdom should now proceed with a view to a loan from the I.B.R.D. in conjunction with a loan from the New York market.

(b) Whether the loan from the I.B.R.D. should be taken by the nationalised electricity industry direct, or whether it should be taken by the Government for lending to the industry.

(c) Whether the loan from the New York market should be raised by the industry or by the Government.

February 1958.

APPENDIX

CONDITIONS UNDER I.B.R.D.'S PROCEDURES

The requirements and procedures on which the I.B.R.D. have to be satisfied are partly a matter of their Articles and partly a matter of practice. Although in the present case the I.B.R.D. are prepared to be accommodating in such matters as not requiring competitive tendering and in financing expenditure already incurred, it is clear that they will be very reluctant to forgo any of these requirements or procedures as a concession to the United Kingdom, if to do so would make it difficult to demonstrate to other member countries that the United Kingdom was not being given favoured treatment. The principal steps involved are as follows:—

(a) Report to the I.B.R.D. Board on the financial and economic position of the United Kingdom. This is not expected to present any problem. Such reports have been prepared in the past in connection with United Kingdom guarantees of I.B.R.D. loans to Colonial territories. The last of these reports was in connection with the Kariba loan in 1956. It will be a question of bringing this up-to-date.

(b) Report on the general activities and financial position of the electricity industry. This is not expected to present any problem, so far as it deals with the past and the present. In addition, the I.B.R.D. staff would wish to ask questions on and comment in their report about the probable future financial policies and viability of the industry, so as to be in a position to deal with any comments on this which may be made when the report goes to the I.B.R.D. Board. The Electricity Council do not welcome this prospect, though they do not suggest that this is a serious obstacle to arrangements for a loan.

(c) Technical report on the economics of the nuclear project or projects with which an I.B.R.D. loan would be associated.
This report would be based on documents of a confidential but, for the most part, general character to be made available to the I.B.R.D. staff by the Generating Board. This would then be supplemented by detailed enquiries into particular aspects. The United Kingdom would be given an opportunity to comment on the report in draft before it was put to the I.B.R.D. Board. No information of military value would be supplied, and it is not considered that any leak of information of commercial value would result. The Generating Board do not welcome the obligation to deal with these enquiries or the calls which would be made on its time but the work would not be so heavy as to constitute a serious objection to arrangements for a loan.

(d) I.B.R.D.'s right of inspection during construction.
The I.B.R.D. would expect to send representatives on visits of inspection, lasting one or two weeks each, once or twice a year, during the period of construction. They would also expect to receive progress reports, perhaps once every quarter. The Generating Board would be prepared to accept such arrangements.

(e) Procedure for reimbursement of expenditure.
The I.B.R.D. would make disbursements against evidence that expenditure had been incurred. This would present no difficulty.

(f) Guarantee Agreement.
If a loan is made to Her Majesty's Government for lending to the industry, there will be only a Loan Agreement. If it is made direct to the industry, the Loan Agreement would be supplemented by a Guarantee Agreement between the United Kingdom and the I.B.R.D. Either the Loan Agreement or the Guarantee Agreement, or both, would include undertakings to the effect that the project or projects will be carried to completion; this does not appear to present any difficulty. There would also be a "negative pledge" to the effect that, if any assets of the United Kingdom or of the industry are pledged as security to any other overseas lender, then the I.B.R.D. will at the same time be given corresponding security. This is of definite significance only as it concerns Her Majesty's Government, who have already given the "negative pledge" as part of the United Kingdom guarantees for I.B.R.D. loans to Colonies; as a result, having now pledged dollar securities as collateral for an advance from the Export-Import Bank of Washington, the United Kingdom has also been obliged to pledge similar collateral to the I.B.R.D. From this point of view, the effect of taking an I.B.R.D. loan for the nuclear power programme would not involve any further pledge of collateral to the I.B.R.D. in the first instance, but would result in the giving of such collateral if, for instance, there were to be a repeat of the Export-Import Bank Agreement in the future, and the amount which we could borrow on the strength of our dollar portfolio would be correspondingly reduced. However, this is a disadvantage which we must in any case expect to incur when we come to guarantee further I.B.R.D. loans to the Colonies.

(g) Finally, there would be an undertaking that, if the industry ever creates anything in the nature of a mortgage or debenture in favour of any other lender, the I.B.R.D. would be given similar security. As distinct from the form of "negative pledge" just discussed (which is concerned only with overseas borrowing), this final undertaking might conceivably in some circumstances be brought into effect if the industry were to borrow on the United Kingdom market on the strength of a charge on the business. The nationalised electricity industry has never so far given any such security—which has been unnecessary while all its market borrowings have been guaranteed by the Treasury—but the position might be changed if it were decided that any future market borrowings should not have the benefit of the Treasury guarantee.
a loan with the whole programme, on the grounds that this would enlarge the scope
for specific technical enquiries by the I.B.R.D., and would prefer any initial loan to
be related to one particular station, either the Berkeley or the Bradwell project.
The Generating Board would, however, accept that if necessary any initial loan
should be applied to both these stations, and would be ready to consider the selection
of further particular stations in the event of subsequent loans. The I.B.R.D.'s
own attitude on this remains to be further clarified. The indications are that
agreement with them would be possible on the basis of a loan which, within the
nuclear programme, would be directed towards the finance of the Bradwell and
Berkeley projects. The Treasury's concern in this respect is that the sector of
the programme chosen should be large enough to justify receipt of the whole
$50 millions from the I.B.R.D. by, say, 1st January, 1959. Though selection of a
single station might achieve this result if the I.B.R.D. were prepared to relate
disbursements to expenditure on a £ for £ basis, it would be necessary to embrace
both Bradwell and Berkeley to achieve the same rate of disbursements if the latter
were on, say, a basis of 10s. for every £1 spent, as they might well be. The
inclusion of a third and fourth station would not make a very material difference
to the rate of receipt, since progress on other stations will not be so early as on
these two.

Market Issue—Procedures and Terms

3. Whether the bond issue in the New York Market were affected by Her
Majesty's Government or by the industry, it need not be specifically related to the
uclear programme, and would not involve supplying confidential information on
that subject. But it would require a very full prospectus, much bulkier and more
detailed than a prospectus issued in the United Kingdom, giving all relevant
information about the economic and financial position of the United Kingdom
(whether as borrower or guarantor) and of the industry also, if the industry were
the borrower. Representatives of the United States Issuing House will have to
visit the United Kingdom at an early stage to put preparation of this in hand.
These requirements would not arise if the Market loan were to take the form of
a private placing with financial institutions, but Mr. SOMMERS of the I.B.R.D.
has expressed doubts about the prospects for such an operation, and certainly
advises that it would have definite disadvantages from the point of view of securing
a broad market, and, still more, from the point of view of establishing a market
which could be tapped by the United Kingdom in future years. Although the
expenses of a private placing would be somewhat smaller, the amount which could
be raised would be less and the rate of interest would be higher. The indications,
are therefore, that the Market loan would be by means of a public offer. The
expenses of the issue would be met by the spread between the price paid by the
United States public and the price received by the United Kingdom.

4. As regards the yield to be offered to the public, this might have to be
slightly higher if the issue were made by the industry with a guarantee, instead of
by Her Majesty's Government. Moreover, Mr. SOMMERS had advised that a
guaranteed issue would be less advantageous from the point of view of establishing
the credit of the United Kingdom Government itself with a view to subsequent
borrowing in the New York Market.