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Staff Loan Committee - 1962 - (January)

STAFF LOAN COMMITTEE

1962
(Jan)



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Staff Loan Committee - 1962 - (January)

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SLC/M/62-3

Rough Notes of Staff Loan Committee Meeting held on Wednesday,
January 31, 1962, at 11:00 a.m. in the Board Room

CYPRUS

Mr. Knapp - This is an interesting report. Why didn't the Thorp mission end up with recommendations for a development program?

Mr. Kamarck - The Thorp mission provided general guidelines and suggested various elements for a development program.

Mr. Knapp - The report should be adjusted to avoid giving the impression that the Thorp mission didn't leave even a ripple.

Do I understand correctly that the Staff Economic Committee concluded that although there were weaknesses in the economic situation of Cyprus, the country was nevertheless creditworthy for some Bank loans?

Mr. Avramovic - Yes.

Mr. Wilson - I question the implications of para. 36; I doubt whether anyone can know the consequences to Cyprus of the United Kingdom joining the Common Market.

Mr. Avramovic - The mission's report is convincing on the potential growth of Cyprus. However, out of £35 million of imports, two-thirds are balanced by special non-trade export items, such as military expenditures of foreign governments and grants. The development program and the Bank program must be adjusted to the possibility that there may be a drastic decline in such items in the future.

Mr. Kamarck - Foreign government expenditures in Cyprus are broader than military alone. For instance, both the U.S. and the U.K. maintain radio stations there. I agree these are risky components on the export side.

Mr. Knapp - Obviously the situation requires constant attention. If political or economic collapse should occur we would have to re-examine our whole Cyprus operation.

Mr. Cope - We have recommended only an initial operation.

Mr. Kheradjou - Should we examine the whole prospective lending program to Cyprus or just that of the Bank?

Mr. Knapp - We must consider the whole lending program.

I suggest that para. 4 of the Transportation Annex be changed so that the statistics are expressed as vehicles per person rather than persons per vehicle. Also, in para. 8 of the Area Memorandum, in line 5, the "to" should be changed to "of"

Why are the German loans, which are mentioned in para. 8, tied?

Mr. Cope - The £1.8 million referred to is offered by Germany industry, whose loans are, of course, tied.

Mr. Knapp - Is this covered in the bilateral assistance study?

Mr. Avramovic - I will see.

Mr. Aldewereld - Are the conclusions in para. 8 those of the mission?

Mr. Kamarck - No, they are based on consultants' studies.

Mr. Knapp - Cyprus is probably not the place for a "consultative group." Use the idea of "informal consultations among lenders."

Mr. Cope - I agree.

Mr. Schmidt - I agree. We should avoid a practice that might become too general.

Mr. Knapp - In the case of Cyprus I would hope that consultations would be a transitional thing.

Mr. Cope - However, the Area Department contemplates a rather continuous relationship between the Bank and Cyprus economic development.

Mr. Wilson - The Bank should avoid being drawn deeply into a situation which after all is not too exceptional. We should also keep our eye on the effect of our active interest in Cyprus on Greece and Turkey where the Bank is not at present making loans. In other words the Bank should play down its leadership in the development of Cyprus.

Mr. Knapp - With respect to the recommendation in para. 16(b) of the Area Memorandum, we should not take on too much and should not spread our funds too thin. After a power project, what else could we do other than roads?

Mr. Kamarck - In addition to power there are possible projects in roads, ports and an airport. One appraisal mission could do them all.

Mr. Aldewereld - I have doubts about an airport project.

Mr. Knapp - Yes. Why should we do an airport?

Mr. Cope - We will play down the recommendation in 16(b).

Mr. Knapp - 16(c) is all right, and 16(d) is satisfactory provided we understand that we are going to play down our leadership and participation.

Mr. Iverson - Is there a role for technical assistance in the case of Cyprus?

Mr. Cope - That is a normal part of the Bank's operations and may arise.

Mr. Knapp - The figure of £5 million equivalent is acceptable but it should be committed slowly.

Mr. Cope - We are going to try to work with the British and Germans in financing the power project.

The meeting adjourned at 11:35 a.m.

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SLC/M/62-2

Rough Notes of Staff Loan Committee Meeting held on
Friday, January 26, 1962, at 3:00 p.m. in the Board Room

COLOMBIA

Mr. Knapp - Colombia's creditworthiness has been discussed previously and agreed upon. The updating in Appendix I indicates there has been a general improvement in economic conditions. Has any commitment been made for IDA financing in Colombia?

Mr. Schmidt - No.

Mr. Knapp - Let's not make one.

Mr. Schmidt - Okay. We are waiting for the return of the mission studying the development plan and in the meantime the only other project that might be ready would be a loan for CVC power.

Bogota Power Project

Mr. Knapp - What about rate increases?

Mr. de Vries - We have asked for a rate increase of 33% and have been notified that such an increase will be announced on February 1.

Mr. Cope - Is Annex 8 based on the anticipated new rates?

Mr. Knapp - Yes, so the report says somewhere. It appears to be a good power project at a wonderful natural site.

Mr. Aldewereld - They are selling power too cheaply.

Mr. Knapp - There seems to be no question about the project or the report.

Mr. Wilson - What about the proposal in para. 5 of the memorandum that the loan include the peso cost of employing local consulting engineers?

Mr. Knapp - This is an extension of the principle adopted, for example, in the case of Mexico, that the Bank will finance some local purchases if the goods are produced locally at prices which are internationally competitive. In the present case the engineering services are analogous to locally produced goods.

Mr. Demuth - This would make the foreign exchange financing (the Bank's loan) 52% of the total cost of the project, which for a hydroelectric project is high. Since the proportion is so high we should try to reduce any other financing, such as for local currency purchases.

Mr. Aldewereld - The foreign exchange component is a high percentage in this case because the local cost of civil works in Colombia is low.

Mr. Cope - The two TOD reports (Bogota Power and Paz del Rio) are not consistent in handling foreign exchange. The two reports should be made consistent.

Mr. Arnold - Local currency costs in the Bogota power project were converted at the official rate.

Mr. Knapp - I suppose we may assume that steel prices adjust to changes in the exchange rate whereas power rates are much stickier.

Mr. Aldewereld - We have checked the reports for consistency.

Mr. Schmidt - The extension of the transmission lines for CAR, which would add to the amount of the loan, will have to be negotiated (para. 6 of the memorandum). It would be preferable to have the Bogota Power Co. do this, but detailed arrangements will have to be worked out.

Mr. Piccagli - The studies for this part of the project wouldn't be done for some time.

Mr. Knapp - As a matter of convenience we should negotiate it now rather than later. They will need to find peso financing, and special provisions for disbursement of funds for the distribution facility will be necessary.

Mr. Cope - Let satisfactory arrangements for this be a condition of effectiveness of the loan rather than a condition of disbursement.

Mr. Schmidt - No, that would involve too much delay.

Mr. Knapp - Para. 82 and 83 of the report should be clarified. Will the Bank have to give a waiver of provisions in earlier Loan Agreements dealing with increases in debt? Make it clear that we are giving a waiver to the extent necessary to obtain local finance for this project.

Paz del Rio

Mr. Knapp - The report on Paz del Rio underplays our role in salvaging this project. A historical section showing how bad the financial situation was in the past. Many of the peso values stated in the report are out of date.

(At this point Mr. Knapp read a cable just received from Mr. Eugene Webb, who was in Colombia, which stated that the Inspector General had decided that steel was a necessity and hence had imposed a fine on the Company for not observing price control regulations.)

Mr. Armstrong - Book value is used in the financial statements.

Mr. Knapp - Book value is not at all accurate in this case. There are sunk costs that will never be recovered.

Mr. Aldewereld - The depreciation charges will not be sufficient to reconstruct the steel mill.

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Mr. Knapp - Insert an historical section. In para. 17 you need to state the par value and book value per share. People are paying 10 pesos (against their surtaxes) for a share which has a market price of 1.71 pesos. Is there much of market for the shares?

Mr. Armstrong - The market is active, about 10,000 shares are traded per day.

Mr. Knapp - In para. 29 the report gives good marks to the quality of Paz del Rio steel. I have heard, however, that the railroads prefer to import from abroad.

Mr. Armstrong - The railroads buy abroad because they can get seven-year credits. The Company now makes nails of adequate quality; formerly it couldn't. The present project is intended to improve quality.

Mr. Knapp - With reference to para. 31 on, this enterprise may seem to be competitive only because so much of the original investment has been written off. Does the 12% mentioned in para. 34 include depreciation?

Mr. Armstrong - It contains depreciation on present book values.

Mr. Avramovic - With regard to para. 34, it's very unfortunate that the cost accounting system is so inadequate. Does this paragraph mean that every price must exceed cost?

Mr. Armstrong - The management of the Company tries to maximize profit. Some of the products, however, may have high costs and shouldn't be produced.

Mr. Aldewereld - Para. 34 is simply trying to make the point that cost accounting is a tool of management and this Company doesn't have it.

Mr. Knapp - This section on the competitive position of the Company is reassuring.

Mr. Cope - With regard to para. 31 and Annex 3, we should obtain assurances that the Government will not give undue tariff protection to this Company. The Executive Directors would protest against such a protectionist policy.

Mr. Aldewereld - We asked ourselves the question "can this Company survive without tariff protection?" and our answer is that it can.

Mr. Knapp - I disagree with Mr. Cope.

Mr. Aldewereld - Para. 32 explains the position of TOD.

Mr. Armstrong - Perhaps para. 97 bothers Mr. Cope. The assurance sought there is intended to prevent the Government from holding down local steel prices.

Mr. de Vries - Colombia has a protectionist policy; moreover the present exchange rate is unrealistic.

Mr. Knapp - Insert a paragraph before para. 31 saying that because of the protective tariff policy the Bank checked the economics of the steel market carefully.

The situation described in para. 40 should be clarified and nailed down.

Mr. Cavanaugh - Para 35 should be revised in the light of Mr. Webb's cable.

Mr. Knapp - The sentence beginning "Moreover" in para. 49 on the value of assets should be deleted.

Mr. Demuth - What is the meaning of the last sentence in para. 49?

Mr. Armstrong - It means that if assets were revalued at replacement cost, the value would be 50% to 100% higher; but at such valuation, depreciation charges would be so high that the company could not show a profit.

Mr. Demuth - Then the only thing that makes this investment attractive is that existing assets are there and have a lower value. In other words, a new mill today would not be economic and could not earn its replacement cost.

Mr. Knapp - That para. should be revised and should be more frank.

Mr. Cope - What does para. 50 mean?

Mr. Knapp - Revise para. 50 to show what is meant by "depreciation rates are satisfactory."

Mr. Avramovic - Section III on the market for steel seriously understates the future growth of the market. There will be a greater percentage growth in the future than in the past, and, therefore, the question arises: is the projected plant expansion to 200,000 tons capacity sufficient and economic (para. 53)?

Mr. Aldwereld - The market estimates are intentionally conservative. They had to be conservative for the purpose of financial projection.

Mr. Armstrong - Expansion ^ebeyond 200,000 tons would require a major step-up to 400,000 or 500,000 tons. It would involve a new blast furnace and new rolling mills. The Management couldn't handle this and funds are not available. Market growth may be largely in flat products.

Mr. Knapp - What is the Barranquilla project?

Mr. de Vries - A prominent group in Colombia is promoting that venture. They plan to import scrap and produce skelp and flat rolled steel (hot and cold strip). The proposal is to invest \$11 million and to borrow about \$35 million from the Eximbank. However, the market may not support both skelp mills.

Mr. Armstrong - The Barranquilla venture raises the question whether the skelp mill included in the Paz del Rio project should be built and also whether Barranquilla should also have a wide strip mill. The Barranquilla venture would depend on the importation of scrap.

Mr. Aldewereld - Two questions arise here: (1) Can Colombia economically go into two steel mill projects at the same time? (2) Will a big new investment at Barranquilla at present costs pay off with the resulting high depreciation charges or will the Government eventually have to bail out the Barranquilla venture?

Mr. Schmidt - We know we have a problem here that must be settled before negotiations on a loan to Paz del Rio. We couldn't go into the problem with the Colombians before the Bank had made a general decision on such a loan.

Mr. Knapp - Okay. They^{ry} explore and settle this problem before negotiations on a possible loan.

On the financing plan, the contents of paras. 91 and 92 should be stated at the beginning of the section. In para. 89, the sentence beginning "nevertheless" should be deleted.

The protective arrangements in para. 96 seem pretty extensive.

Mr. Clark - Many of these are severe. Moreover, it may not be possible under Colombian law to include some of them as covenants; they might have to be stated as events of default.

Mr. Knapp - Regarding items (e), (h), and (i), (e) is a good provision, but with (e) in, why are (h) and (i) necessary?

Mr. Armstrong - (h) and (i) are a double check on (e). They would give the Bank extra protection.

Mr. Demuth - I suggest that item (f) be incorporated into (g) by deleting the phrase in (g), "after the completion of the project."

Mr. Knapp - Instead of (i), obtain a statement from the Government that it will not renew the plan for the purchase of the Company's shares by credit against surtaxes.

In para. 101 delete the middle sentence.

Mr. Avramovic - Para. 102 could be substantially strengthened by pointing out such things as additional training of labor and management, improvement of social services and many others.

The meeting adjourned at 5:00 p.m.

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SLC/M/62-1

Rough Notes of Staff Loan Committee Meeting held on
Tuesday, January 16, 1962, at 3:00 p.m. in the Board Room

KOREA

Mr. Cargill - An application from Korea for an IDA credit was received today. It requested \$20 million for rolling stock, half to be bought in Japan and the rest under international competitive bidding. It suggested a 15-year term at 3% interest plus service charge.

Since the Germans are becoming active in Korea and the U.S. mission is being reorganized, and both will be sending development advisors to Korea, it is desirable to give the economic report to both Governments. After revision it should be distributed to the Executive Directors as the most practical method of reaching the German and U.S. Governments without raising other questions.

(All agreed.)

Mr. Lutolf - The report doesn't mention North Korea because not much is known about the present situation there. It is reported to have developed well and of course it has a better resource base than South Korea.

The terms of reference of the economic mission did not call for detailed sector analysis. The priorities stated in the report are tentative but are based on an analysis of the Government's five-year plan which is now being revised. It is expected that the revised five-year plan will incorporate many of the mission's priorities.

There is a great need for additional financial assistance to Korea, especially in the next two or three years, when investments in power and railways as well as agriculture are very great.

Relations between South Korea and Japan since 1945 have been strained, and the issues of reparations and claims prevented normalization of relations. Relations between the United States Operations Mission (USOM) and the Government have not been good but are now improving. The contemplated reorganization of USOM should improve its coordination and over-all planning work.

The Government has emphasized that receipt of IDA credits would be a sign of confidence in the area and would reduce the feeling of total dependence on the U.S.

Sir William Iliff - Are there any questions about the report?

Mr. Cope - The parts on historical background and relations with North Korea were done too lightly, almost laconically.

Mr. Cargill - He agreed; the revised report would expand the section on history and the description of the prewar economy of the Korean peninsula.

Mr. de Wilde - The report would be improved if the judgments and conclusions of the mission were explained more fully. The report's criticism of the development program needed more detailed justification, particularly the judgment that the program was too big.

Sir William - He thought that the mission justified its conclusions simply on the ground that funds were not available to finance the development plan. The mission's position seemed well taken.

Mr. Schmidt - In its discussion of development possibilities and financial needs, the report was more precise than was possible, given the shortage of accurate data.

Mr. Lutolf - The power program was handled precisely in the report because the Koreans who were concerned with it knew the facts and were precise. However, he did plan to tone down the discussion of prospects and generally make it less precise.

Sir William - Does the Committee wish to see the revised report?

All - No.

Mr. Cope - The report sometimes interprets the facts in too favorable a light, for example in para. 37, the last sentence beginning "1960" should be omitted.

Mr. Schmidt - In Section I on recent political events, it is incorrect to say that the Constitution was patterned after that of the U.S. since Korea had a parliamentary system of Government.

Mr. de Wilde - What are the present relations between the new Government and the private sector, and, in view of the Government's criticism of the past behavior of private business and the penalties levied against it, what will the future relations be? Is this a great uncertainty that hangs over the economy which might handicap future development?

Mr. Cargill - The criticism, fines and suspicion do exist, but the military Government is more aware today of the need for the cooperation of the private sector and there is a tendency for its attitude to soften.

Sir William - Is there any private foreign investment in South Korea?

Mr. Lutolf - No, but the Japanese are contemplating it. Private business is entirely in Korean hands.

Mr. Cargill - Investment by the Japanese would be good for both the Japanese and the South Koreans. The coal industry would be one field of investment.

Mr. Broches - Is there any danger of communism in South Korea?

Mr. Lutolf - Not much.

Mr. Broches - Then the comment about communism should be removed.

Mr. Squire - Para. 55 of the report states that all investment planned in the railroads was of high priority. Since a railway program still has to be appraised, the report should simply say at this time that major investments in this sector had a high priority.

Mr. Cargill - He agreed that the revised report should not consider detailed figures or make precise expert judgments on the priorities of total investment in the railroads.

Mr. de Wilde - Is it a railway problem or a transport problem? How do we know that improved highways are not the greatest need?

Sir William - Is South Korea eligible for Bank loans?

It was unanimously agreed that if anything was to be done in South Korea it would have to be through IDA credits. Korea appeared to qualify for IDA on the basis of its lack of creditworthiness and of its own efforts to help itself.

Mr. Schmidt - Is the present South Korean Government a constitutional Government? Is it legally possible for the present Administration to sign binding agreements?

Mr. Broches - He did not know yet; the question was being examined.

Sir William - It is an important question; we cannot be in the position of making an appraisal and then backing out on constitutional grounds.

Mr. Wilson - Is it indicative of sound financial management for the Koreans to propose such a big development plan that it cannot be implemented?

Mr. Cargill - The planning people know that the plan is too big. One reason for sending the mission report to the German and U.S. Governments is to influence them to press the military Administration in South Korea in the right directions.

Mr. Cope - He would go along with an IDA credit of \$10 million.

Mr. Cargill - The Germans have committed themselves to \$37.5 million and are sending advisors to South Korea. The U.S. advisors are already there. One reason why the South Koreans want IDA is to obtain advice from an objective non-political source.

Mr. Broches - Has technical assistance for South Korea been considered?

Mr. Lutolf - South Korea requested the Bank to send an advisor. Right now Arthur D. Little, Inc. has been hired by the U.S. Government to assist the Korean Government in revising the development plan. We have been waiting to see what the other advisors do.

Mr. Cargill - The U.S. wants the Bank and IDA to add their advice to South Korea. This is an opportune time to begin operations in Korea because of the reorganization of USOM.

Mr. de Wilde - He had heard that Mr. Killen, Chief of USOM, was being transferred to an African country. *

Sir William - The general consensus seems to be that South Korea is eligible for a modest amount of IDA credit. The next question is: "Are the railroads a suitable recipient of IDA aid?"

Mr. Squire - Before we undertake to appraise the railways we should learn more about them, preferably by questionnaire. We don't know such things as earnings, accounting techniques, management, organization or financial standards.

* Subsequently found to be unfounded.

Mr. Cargill - I would prefer to send an expert rather than a questionnaire. The Koreans might not know how to complete the questionnaire, merely delaying any operations.

Mr. Cope - It seemed to him that the type of information needed could be obtained best by an expert on the spot.

Sir William - We had better get on with the appraisal. What amount of credit is contemplated?

Mr. Cargill - \$10 million to finance the foreign exchange costs of rolling stock.

Sir William - The last sentence on p. 21 should be deleted.

The meeting adjourned at 3:55 p.m.

HGHilken/hmf