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Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 26, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Seeds Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 26, 1971 from the East Asia and Pacific Department, entitled "Indonesia - Seeds Project" (LC/O/71-45).

2. Comments, if any, should be sent to reach Mr. John Foster (ext. 2555) by 5:00 p.m. on Wednesday, March 31.

3. It is planned then, if the Committee approves, to inform the Government that the Association is prepared to begin negotiations for the proposed credit on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
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Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-45

March 26, 1971

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

INDONESIA: Seeds Project

1. There is attached for the consideration of the Committee an Appraisal Report "Indonesia - Seeds Project" (PA-85) dated March 19, 1971. The report recommends that an IDA credit of US$7.5 million equivalent be made to Indonesia to finance the foreign exchange cost of a seeds project.

The Economy

2. The last full report (EAP-19a) on the current economic position and prospects of the economy was issued on November 27, 1970. An Economic Mission has just returned from Indonesia, and its preliminary findings bear evidence to the continued economic improvement described in my Area Memorandum to the Loan Committee (LC/O/71-32) dated March 10, 1971, for the tea project.

The Lending Program

3. The Country Program Paper was approved on January 25, and the latest tabulation of our lending program is attached as Annex 1. Since the Association started operations in Indonesia, it has given emphasis to physical rehabilitation of infrastructure and of agricultural production capacity. It has made 13 credits in Indonesia to help finance three projects for irrigation rehabilitation, two each for estates and for technical assistance, and one each for fisheries, fertiliser production, telecommunications, technical education, power and highways. As of February 28, the amount of these credits held by IDA was US$170.9 million; there have as yet been no cancellations or repayment of principal.

4. During the remaining part of FY 1971, we are preparing three projects for presentation to the Executive Directors, namely this seeds project, the tea project referred to in paragraph 2, and a second highways project. Including these three projects, operations for FY 1971 would amount to US$90.9 million, against the present allocation of US$60 million. The timing of presentation of these projects depends therefore on the availability in the current fiscal year of additional IDA funds for Indonesia.

The Agriculture Sector

5. The Government's development program (1969-1974) gives highest priority to agriculture, with particular emphasis on rice production as rice imports are a severe foreign exchange drain. The Association's

lending program is providing substantial assistance towards Indonesia's drive towards food self-sufficiency. In addition to organising a consortium of lenders to finance a major expansion of the PUSRI fertiliser plant, the Association has extended three credits to assist projects to rehabilitate irrigation systems covering about one-third of Indonesia's irrigated riceland. In the interests of more systematic planning and policy, we are also financing a national fertiliser study, an evaluation of the rice production and intensification program and studies of groundwater availability and potential uses for irrigation. An agriculture sector survey mission to assess further needs in the sector in coordination with the resident staff has been scheduled for the second half of FY 1972. In coordination with the resident staff, U.S. AID is studying agricultural research needs and is financing a study of rice marketing and storage; and U.K. technical assistance is being provided for a study of rice milling requirements.

The Project

6. The proposed project would help increase rice yields throughout Indonesia by establishing a seed multiplication program for high yielding rice varieties. It would establish a modern seed industry, mainly for rice, which at full output would produce about 22,000 tons yearly of high yielding varieties, which would make possible an increase in rice production in Indonesia by about 320,000 tons yearly. The project would principally consist of (i) the establishment of a National Seeds Corporation (NSC) which would develop a mechanised and irrigated seed farm on part of the Government-owned Sukamandi estate in West Java and be responsible for production, processing and marketing of seed, and (ii) the creation of a semi-autonomous Plant Breeding Station on another part of the Sukamandi estate, as part of the Central Research Institute of Agriculture (CRIA) to ensure an adequate flow of high yielding plant varieties to support the NSC's seed production program and to be responsible for seed certification. Appropriate seeds legislation would be promulgated to establish standards for seed purity and certification, and a small Government seeds law enforcement organisation would be set up to administer the law. NSC would establish three production districts in East and Central Java where farmers in selected villages would produce seed on contract. Staff and farmer training facilities would also be developed. NSC would administer the remaining land on the Sukamandi estate as a rental farm until the land were needed for eventual extension of the research and seed-growing facilities.

7. The Sukamandi estate lies within the Djatiluhur irrigation system whose rehabilitation is being planned and implemented by the Djatiluhur Authority and financed by Credit 195-IND (Second Irrigation Rehabilitation Project). To enable seed breeding and farming to start at Sukamandi in the 1971/72 season, a maximum of US$377,000 would be disbursed out of Credit 195-IND to help finance irrigation works on about 750 ha there during the first year of the proposed seeds project, including consulting services to assist the Djatiluhur Authority in planning and implementing the proposed project. Sufficient Credit funds are available for this purpose. The Credit Agreement for 195-IND would need very slight amendment.

8. The Minister of Agriculture would be responsible for the project. The Minister would be advised by a National Seeds Board (NSB), concerned with planning and formulating policies for development and operation of a national seeds industry. A draft Government regulation to set up the NSC and the draft Presidential decree to establish seeds regulations have been submitted to the Secretary of the Cabinet for approval, and draft ministerial decisions to set up the NSB and the Government seeds law enforcement organisation have been prepared for submission to the Minister of Agriculture for approval. The above drafts would be discussed during negotiation, and their coming into effect would be conditions of effectiveness.

9. There are two other conditions of effectiveness. First, satisfactory development of Sukamandi estate is impossible while squatters, amounting to 860 families, remain farming there. Many of the families could be employed on the seed farm, plant breeding station and rental farm; and the Government is confident that the other families could be resettled. It would be a condition of presentation of the proposed credit that the Government had drawn up a firm plan satisfactory to IDA for resettlement (estimated cost of resettlement about US$40,000 equivalent). The Appraisal Report further recommends as a condition of effectiveness that plan implementation should have started, and notice to quit have been given to those squatters on land needed for the seed farm and plant breeding station. However, the rental farm will also be needed in the future for extension of the research and seed growing facilities, and should also be unencumbered. It would be preferable therefore that the condition of effectiveness of notice to quit be extended to those quatters on the land proposed for the rental farm.

10. Second, because of the lack of experience in Indonesia in processing and marketing improved rice seed varieties, agents would be engaged to run NSC for a period of five years under the policy direction of NSC's Board. The agents would provide qualified and experienced staff, from abroad if necessary, to fill executive positions below the level of policy management which under Law 19 must be held by Indonesian nationals. The employment of these agents would be a condition of effectiveness.

11. The total cost of the project is estimated at about US$11.5 million equivalent. The Association would finance US$7.9 million or 69% of total cost, of which almost US$400,000 (including US$100,000 local costs) would be financed from Credit 195-IND and US$7.5 million (covering the remaining foreign exchange costs) from the proposed credit. The Government would provide US$3.6 million, being the balance towards total project costs. For administrative convenience, no disbursement would be made for the foreign exchange cost (estimated at US$282,000) of minor items such as buildings, workshops and office equipment. In compensation, disbursement against the cost of irrigation infrastructure (estimated to cost US$895,000) would be raised to 54%, although the computed foreign exchange component of this item amounts to 33% of the total cost.

12. The Government plans to channel US$1.3 million of the proposed credit into the plant breeding station and the seeds law regulatory organisation as a grant. Of the amount of US$6.2 million to be passed on to the NSC, US$1.8 million, technical assistance, would be in the form of a grant and the balance of US$4.3 million as an investment in the equity of NSC. The Government would make an additional equity contribution of US$2.3 million, bringing NSC's total equity up to US$6.6 million equivalent. This is net of unencumbered assets to be transferred to NSC from the agency now running the Sukamandi estate, P.T. Sang Hjang Seri. The Appraisal Report recommends this arrangement because of the uncertainties inherent in establishing an entirely new industry, and because cash flow projections indicate that during the first five years the NSC would not be able to service debt on the usual Government terms for onlending IDA funds (interest at 12% per year and principal repayable over the life of the project) without jeopardising its financial position. However, after the fifth year the projected cash surpluses begin to build up and I propose therefore that we should explore with the negotiators the possibility of having a part of the US$4.3 million of IDA funds onlent to NSC with interest at 12% per annum and amortization of principal to start after the fifth year. Such an arrangement would be in line with the Indonesian Government's desire to impose financial discipline on its agencies and with our past practice in existing credits for fertiliser production, estates, telecommunications and in the proposed tea project, where the IDA funds are relent to the beneficiary at 12% per annum interest, repayable over the life of the project; in the power project the credit was passed to the beneficiary as equity.

13. Procurement of goods and services would be in accordance with the Association's guidelines. Under a decree of the Minister of Finance, imports of materials, components and finished goods, which are specifically procured for projects financed from project aid, are exempt from customs duty. It is, however, Government policy to encourage manufacturing industry in Indonesia. Therefore, where a local bid is received for goods manufactured in Indonesia to a substantial extent (to be determined by the Association), the bid would be given a margin of preference of 15% or the customs duty*, whichever the lower. Where an award is made to a local bidder, we would include disbursement against the local currency component (US$200,000 at most) net of duties and taxes; the case for local currency financing has already been made in the Country Program Paper approved on January 25. Contracts for new buildings and the renovation of existing buildings, estimated at US$460,000 equivalent, are small and diversified and would be awarded after local advertisement only, though they would be open to international competition.

14. Procurement of some essential project items to meet the 1971/72 program and of technical assistance in preparing the seeds regulations may be needed as from March 1 and the proposed credit would allow retroactive financing of such items.

*duty which would apply to non-exempt imports.

15. The existing plant breeding program is conducted by the Central Research Institute of Agriculture (CRIA), mainly at Bogor near Djakarta. This program operates under severe constraints, including limited land for research, soils not typical of the rice-growing areas of Java, old and poor facilities, inadequate staff salary levels and conditions of service, and an inadequate budget. The new plant breeding station proposed under the Project would be established as a sub-station of CRIA at Sukamandi with adequate land, typical soils and good facilities. The Appraisal Report recommends an assurance that staff employed by the sub-station and other project organisations be paid reasonable salaries, the levels to be agreed with the Association. There could be difficulty during negotiations in reaching agreement on what levels are reasonable in Indonesian circumstances, and some flexibility during negotiations may be necessary.

16. The plant breeding station would employ seven specialists, and it is unlikely that local staff with the requisite qualifications would be available to fill these posts. The Appraisal Report recommends an assurance that appointment of the plant breeding station's Director and the Specialist be subject to the Association's approval. However, I believe that we should modify this right to one only of consultation.

17. Revenues accruing to the plant breeding station from stock seed sales and seed certification services would have to be credited to the Government's general funds from which provision for payment of operating costs would have to be made. During the development period up to 1975/76 the above revenues would not be enough to meet the cost of technical assistance counterpart staff, training and overheads. The Appraisal Report (paragraph 7.04) recommends an assurance that the Government would meet these costs, estimated at about US$80,000 equivalent. I believe that this would be covered by the usual undertaking that the Government provide all funds required for the project, and I do not propose to seek a separate assurance on this point.

Recommendation

18. The amount of US$7.5 million for the proposed project is included in the lending program for FY 1971. Subject to the qualifications in paragraphs 12, 16 and 17 above, I agree with the Conclusion and Recommendations of the Appraisal Report and recommend that we invite the Government of Indonesia to send representatives here to negotiate an IDA credit equivalent to US$7.5 million.

Raymond J. Goodman
Director
East Asia and Pacific Department

Attachment

Population: 121.1m
Per Cap Inc: $80

INDONESIA - ACTUAL AND PROPOSED LENDING THROUGH FY 1976

Attachment 1

($ millions)

		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	Totals 1964-1968	Totals 1969-1973	Totals 1972-1976
								Fiscal Years										
Irrigation Rehabilitation I	IDA							5.0										
Irrigation Rehabilitation II (Djatiluhur)	IDA								18.5									
Irrigation Rehabilitation III	IDA									14.5								
Irrigation Rehabilitation IV	IDA										15.0							
Irrigation Rehabilitation V (Djatiluhur Ext)	IDA											15.0						
Estates I	IDA							16.0										
Estates II	IDA								17.0									
Estates III (Tea)	IDA									15.0								
Estates IV (Rubber & Oil Palm)	IDA										12.0							
Estates V	IDA											10.0						
Fisheries	IDA									3.5								
Rice Seeds Production	IDA									5.1								
Smallholder Rubber	IDA										4.0							
Livestock	IDA											5.0						
Sugar Industry Rehabilitation	IDA											11.0						
Forestry	IDA											9.0						
Agriculture Unidentified I	IDA											10.0						
Agriculture Unidentified II	IDA												35.0					
Agriculture Unidentified III	IDA													35.0				
Agriculture Unidentified IV	IDA														35.0			
Telecommunications I	IDA									12.8								
Telecommunications II	IDA											10.0						
Telecommunications III	IDA														10.0			
DFC I	IDA										10.0							
DFC II	IDA											10.0						
DFC III	IDA													20.0				
Education - Technical	IDA									4.6								
Education - Agriculture	IDA										7.0							
Education Unidentified I	IDA											5.0						
Education Unidentified II	IDA													10.0				
PUSRI Fertilizer Project	IDA								30.0									
Industry - Ombilin Coal Project	IDA											25.0						
Industry Unidentified I	IDA													30.0				
Industry Unidentified II	IDA														30.0			
Industrial Estates I	IDA										5.0							
Industrial Estates II	IDA												5.0					
Industrial Estates III	IDA														5.0			
Family Planning I	IDA										3.0							
Family Planning II	IDA												10.0					
Family Planning III	IDA														10.0			
Djakarta Power Distribution	IDA								15.0									
West Java Thermal Power Plant	IDA										30.0							
Power - Asahan	IDA												30.0					
Power Unidentified I	IDA												30.0					
Power Unidentified II	IDA														30.0			
Tourism - Bali	IDA										5.0							
Tourism Unidentified I	IDA												10.0					
Tourism Unidentified II	IDA														10.0			
Highways I	IDA							28.0										
Highways II	IDA									29.0								
Highways III	IDA										40.0							
Highways IV	IDA											30.0						
Highways V	IDA													30.0				
Marine Transport I	IDA										15.0							
Marine Transport II	IDA												30.0					
Transportation Unidentified I	IDA													30.0				
Transportation Unidentified II	IDA														45.0			
Water Supply I	IDA											5.0						
Water Supply II	IDA													10.0				
Technical Assistance I	IDA							2.0										
Technical Assistance II	IDA									4.0								
Technical Assistance III	IDA										4.0							
Technical Assistance IV	IDA												4.0					
Gross Total (all IDA) a/										88.5	150.0	145.0	154.0	165.0	175.0		515.0	789.0
No.										8	12	12	8b/	7b/	8b/		40b/	47b/
Net Total								51.0	80.5	60.0	90.0	90.0	90.0	126.0	126.0		371.5	522.0
No.								4	4	6	8	8	7	7	7		30	37
IDA Credits Outstanding																		
- including undisbursed								51.0	131.5	191.5	281.5	371.5	461.5	587.5	713.5			
- excluding undisbursed c/								0.3	2.9	13.4	53.5	130.5	224.4	318.6	416.8			
ADB								-	13.4	23.0	25.0	n.a.	n.a.	n.a.	n.a.			

a/ Gross total excludes program lending contingency item of $40-$50 million in 1972 and 1973 combined (see text, Section D)
b/ Will increase depending on project split-up of unidentified items
c/ Based on project lending only; the effect of program lending on the disbursement pattern is discussed in Section D of the text.

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 26, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Trinidad and Tobago - Population Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 26, 1971 from the Central America and Caribbean Department, entitled "Trinidad and Tobago - Proposed Population Loan" (LC/O/71-44).

2. Comments, if any, should be sent to reach Mr. Moya (ext. 4764) by 5:00 p.m. on Wednesday, March 31.

3. It is planned then, if the Committee approves, to inform the Government that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
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Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-44

March 26, 1971

LOAN COMMITTEE

Memorandum from the Central America and Caribbean Department

TRINIDAD AND TOBAGO - Proposed Population Loan

Introduction

1. Attached for consideration by the Loan Committee is Appraisal Report No. PP-6, entitled "Trinidad and Tobago Population Project," which recommends a Bank loan of $3 million to help finance a first population project.

2. The Bank has so far made five loans to Trinidad totalling $46.4 million, net of cancellations: $21.4 million for a first power loan (1961 - guaranteed by United Kingdom); $5 million for agriculture (1967 - Crown Lands development project); $8.6 million for roads (1967); $9.4 million for education (1968) and $2 million for a second power project (1969). The first power project is completed and the second one is expected to be completed by March 31, 1972. After some initial difficulties, good progress has been made in the Crown Lands development project. There are delays in the highway project, due largely to the unsatisfactory work and collapse of the consultants in 1969. Progress on the education project has been good with work started on 13 out of 20 new schools.

3. The proposed loan is the only project in the FY 1971 program. The Five-Year Operations Program (FY 1971-76) is attached.

Economic Situation

4. The political stability which Trinidad appeared to have achieved under the leadership of Prime Minister Eric Williams, head of the People's National Movement (PNM), was seriously endangered in April 1970, when demonstrations against a student trial in Canada deteriorated into civil disorders. Since early May 1970, Trinidad has been fairly calm and in November the state of emergency, which was imposed in April, was lifted. General elections are due within the next twelve months, and re-election of the present regime appears reasonably certain.

5. The last economic report (August 1969) highlighted the possibility that crude oil reserves might not last more than ten years, and that Trinidad, whose quite high per capita income was generated mainly by the oil sector, could be faced with a severe cutback in its GNP if no alternative sources of income were developed in the meantime. However, the outlook for oil has changed considerably for the better during 1970. Amoco, a subsidiary of Standard Oil of Indiana, has confirmed the existence of an important oil and a very large gas field off the east

coast of Trinidad. Amoco now plans to produce some 50,000 barrels a day by the end of 1971 (about one-third of Trinidad's present production) and probably more in 1972. As to gas, the reserves seem to provide a basis for a liquified natural gas venture oriented to the U. S. market.

6. The promising developments in the petroleum sector have not alleviated the pressing need for diversification for the sake of increasing employment, since the petroleum industry will offer only very limited direct employment opportunities. The disturbances of 1970 have brought to the fore the serious unemployment problems in the country. Unemployment in Trinidad and Tobago is around 14 percent and is concentrated among the young and unskilled. In the wake of last year's events, the Government initiated a number of job-creating activities, mostly of the small public works variety, to reduce unemployment in the short term, and has given additional emphasis to family planning as a means to deal effectively with the long-range unemployment problems.

7. As may be expected, the 1970 events have affected recent economic developments in various ways. Overall economic growth slowed down in 1970 to very slightly more than one percent or about the same as the population increase (net of emigration). However, Trinidad has emerged from a very difficult year with the hope of having new financial resources available in the near to medium-term future to strengthen the economy. External public debt is low and the service on external public debt in 1970 amounted to 2.3 percent of exports of goods and services, net of investment income payments. Therefore, Trinidad and Tobago should be considered creditworthy for further external borrowing on conventional terms.

The Project

8. The population of Trinidad and Tobago, which was 275,000 persons at the turn of the century, doubled in the next 46 years and doubled again in the next 23 years to reach 1.03 million in 1969. This demographic trend has resulted in unemployment, emigration of skilled personnel and eventually in serious social unrest. Becoming aware of these problems in 1967 the Government initiated a policy of population planning. Initial achievements under the program have been quite impressive. However, the efforts slackened after a couple of years. In 1969 over 16,000 women accepted family planning services, while in 1970 the number of new acceptors was reduced to about 10,000 (or 50 percent of the Government's target). When the Bank was asked for assistance in this sector, family planning efforts had therefore reached a low ebb. The main factors which have adversely affected the program are its organizational structure, insufficient numbers of the medical and paramedical personnel engaged in and committed to family planning, inadequate facilities and insufficient emphasis on post-partum motivation. However, the Government's commitment to family planning has not changed. A new thrust in these efforts therefore is now needed.

9. The project is designed to enhance the effectiveness of the Government's program and to increase its capacity. It provides for (a) the design, construction and equipment of:

(i) Medical facilities consisting of:
- a new 100-bed maternity hospital with teaching facilities at Mount Hope, including a family planning clinic;
- seven new health centers where family planning and maternal and child health services will be provided, of which four would have a four-bed delivery unit attached to them; and one delivery unit added to an existing health center;
- a family planning clinic attached to the San Fernando Hospital to replace the present inadequate clinic;

(ii) Training facilities to improve training of nurses for family planning and of other family planning workers, consisting of:
- extension of existing facilities of the Port-of-Spain Nursing School to increase teaching and supporting facilities from 200 to 500 students and dormitories for 100 additional students;
- a new rural community health center at Arima to train medical, nursing and other personnel in rural public health work with emphasis on family planning;
- building a Family Planning Institute for training of family planning workers, community leaders and for administrative officers.

(b) a technical assistance component of the project to include the following:

(i) Management advisor to streamline the administrative procedures of family planning service;

(ii) Development of a system of continuous internal evaluation of the program and to measure its effects on fertility;

(iii) Introduction of sex education in schools by 1972;

(iv) Integration of family planning in the basic curriculum of nurses and improvement of the training of family planning workers;

(v) Study of the functions of family planning personnel to secure their optimum use;

(vi) An architect to head the population project unit;

(vii) Provision is also made for an external review mission in 1973 staffed by international consultants who would evaluate the overall program and make appropriate recommendations.

10. The construction element of the project contains three new health centers where family planning and maternal and child health services will be provided, but which do not have delivery units. These therefore do not offer post-partum family planning services. It is worth noting that in Tunisia we financed this kind of health centers whereas in Jamaica we did not. In the present case, the inclusion of three such centers appears justified in view of the population density in general, and the number of expected visitors in particular, serviced by these centers.

11. In addition to the foregoing construction/equipment and software elements, the project includes certain institutional and administrative reforms. The most important ones are:

(i) Family planning should be integrated with maternal child health (MCH) and the level of this combined service should involve the top echelons of the Ministry of Health. The present Principal Medical Officer (PMO) of Integrated Services, a highly respected doctor and able administrator, should devote at least half of her time to the family planning program instead of the present 10-15 percent. During negotiations we plan to discuss two alternatives under which this objective will be achieved:
(a) creation of an additional Principal Medical Officer (PMO) post, or
(b) creation of a post of Senior Medical Officer to deal with non-MCH family planning work and an administrative officer, both under the present PMO.

(ii) The existing Bank education project implementation unit will be reorganized and contain a new Population Project Section, to be headed by a full-time architect. This architect would be hired on a contract basis and would probably be a local architect. The project implementation unit will be strengthened. The specific functions of the Population Project Section within the unit are to be agreed to during negotiations.

(iii) Two measures will be taken to slow down emigration of nurses of whom there is a critical shortage. The Government will enact a proposal under which nurses would be bonded for two years after internship; should they decide to leave the Government services before the two years, they will have to pay the entire cost of training. Also, the Nursing Council agreed in principle to a year of internship after the three years' nurse training. Assurance from the Government will be obtained during negotiations that the bonding proposal will be enacted before the loan is presented to the Executive Directors.

12. During negotiations the detailed functions of the new posts in the Ministry of Health will be agreed and the appointment of these officers will be a condition of effectiveness. Agreement has been reached with the Government on the individual to be appointed to the position of PMO. We will seek to secure agreement that any proposed replacement of the PMO during the project implementation period will be done by the Borrower with prior consultation of the Bank. The green cover appraisal report recommends Bank approval or as a minimum prior consultation for this appointment. Subsequent discussions with government indicate sensitivity to the question of approval. Consequently, Projects and Area Departments do not propose to press the issue of approval.

13. The total project cost, including contingencies but excluding interest and other charges on the proposed loan during construction, is estimated at $4.6 million. The proposed loan of $3 million - 66 percent of total project cost - would cover the estimated foreign exchange component ($2.6 million), plus interest and commitment charges on the Bank loan during construction. As in the case of Jamaica - the only country to which we have lent Bank money for a population project - the terms given in the preceding education project are proposed. Therefore, it is recommended that the same terms as the ones extended in the 1968 education loan be given, i.e., 25 years, including a ten years' grace period.

14. Contracts for civil works, equipment and furniture will be let on the basis of international competitive bidding. Bids would be invited in packages likely to encourage both international and local contractors. A preference of 15 percent or the existing import duty, whichever is lower, is proposed for evaluating bids from local manufacturers of furniture or equipment.

15. The project is estimated to increase new acceptors from 10,000 in 1970 to 22,000 per year from 1980 onwards. Of this total, 7,000 women would become acceptors in maternity hospitals and over 5,000 in the project's health centers and family planning clinics. In addition, 10,000 women are estimated to accept services in other facilities partly as a result of the training and technical assistance components of the project as well as the general measures that will accompany the project. As a result of this, the birth rate is estimated to decrease from 27/1,000 in 1969 to 15.5/1,000 in 1980. The natural rate of population growth will be reduced from the current level at 2.0 percent per year to 0.9 percent in 1980. By the year 2000 the population would be smaller by 97,300 or by 6.2 percent than otherwise and the labor force would be smaller by 37,000 or by 5.2 percent. These demographic trends will improve living standards and alleviate the long-term unemployment problem. The project will also improve the conditions under which deliveries are performed and the health and welfare of mothers and children. The project will improve the management capability of the Ministry of Health and in particular the family planning program. Finally, the nursing school element of the project is justified in terms of manpower needs, in good part linked directly to the family planning program and the hospital and health center components of the proposed project.

Recommendation

16. I recommend that the Government of Trinidad and Tobago be invited to negotiate a loan of $3.0 million for the proposed population project, on the terms and conditions set forth in the appraisal report.

E. Peter Wright
Deputy Director

Attachments

Population: 1.0 m
GNP Per Cap: $790

IVa. TRINIDAD - 5 YEAR OPERATIONS PROGRAM
(By Fiscal Year - Amounts in $ millions)

			1971	1972	1973	1974	1975	1976
3-TRI-AF-01	Fisheries	IBRD		3.0				
3-TRI-DD-01	DFC I	IBRD		2.0				
3-TRI-DD-02	DFC II	IBRD			2.0			
3-TRI-DD-03	DFC III	IBRD				3.0		
3-TRI-EE-02	Education II	IBRD			8.0			
3-TRI-NN-01	Family Planning	IBRD	3.0					
3-TRI-PP-01	Power III	IBRD				14.0		
3-TRI-TP-01	Port Development	IBRD		5.0				
3-TRI-TH-02	Highways II	IBRD			9.0			
3-TRI-TH-03	Highways III	IBRD					8.0	
		IBRD	3.0	10.0	19.0	17.0	8.0	
		No.	1	3	3	2	1	

	Total 1964-68	1969-73	1972-76
IBRD	13.6	43.4	54.0
No.	2	9	9

P & B 3/10/71

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 25, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Botswana - Shashe Infrastructure Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 25, 1971 from the Eastern Africa Department, entitled "Botswana - Shashe Infrastructure Project (LC/O/71-43).

2. Comments, if any, should be sent to reach Mr. Dean (ext. 3565) by 4:00 p.m. on Monday, March 29.

3. It is planned then, if the Committee approves, to inform the Government of Botswana and representatives of the parties concerned that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

Copies for Information:

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The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-43

March 25, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

BOTSWANA: Shashe Infrastructure Project

I. INTRODUCTION

1. The Shashe project in northeastern Botswana is a complex operation. It comprises copper/nickel mines at Selebi-Pikwe and associated smelter, to be owned and operated by Bamangwato Concessions Limited (BCL), a private mining company in which Botswana will have a 15% participation, and the necessary infrastructure, to be provided by the Botswana Government and Government-owned corporations, consisting of power and water supplies, a mining township (which would include a health centre), road construction and two branch railway lines, one to the mining area and one to a coal mine to supply the power plant. The coal mine would be opened up and operated by a subsidiary of Anglo-American Corporation of South Africa. The copper/nickel matte produced by the smelter would be refined in the United States under arrangements with American Metal Climax (Amax), which is directly and indirectly the principal shareholder in BCL. The major part of the metals would be sold under long-term contract to Metallgesellschaft (MG) in Germany. The sulphur by-product of the smelter would be sold under long-term contract in South Africa.

2. The complexities of the operation arise in the first place because of the need to integrate the public and private components of the project, and in the second place because the financial arrangements for the mine and the infrastructure require integrated security and payment arrangements. The financing plan for BCL itself involves a loan from Kreditanstalt für Wiederaufbau (KfW) together with a banking consortium in Germany, a loan from the Industrial Development Corporation of South Africa (IDC) under guarantee arrangements with the Credit Guarantee Insurance Corporation of South Africa (CGIC), short-term financing secured by pledging the matte and metal in transit, and an increase in equity capital to be raised through a rights issue, some by a public offering in the United States. The various components of the infrastructure would be financed by loans to Botswana

on concessionary terms from the Canadian International Development Agency (CIDA) and USAID, the proceeds to be passed on to power and water corporations on commercial terms. On country grounds, the balance of the financing should be provided on IDA terms, but the amount required, $30 million, can be met only by a Bank loan. This introduced the need for special security arrangements involving financial guarantees from BCL, certain of its shareholders and MG, and arrangements to coordinate the payment and security arrangements with the other commercial creditors. The principal agreements between and among the various parties concerned will number about 40.

3. The Bank's involvement with the Shashe project began in 1967 as Executing Agency for the UNDP-financed feasibility study of infrastructure requirements. That study was based on studies of the mining operation carried out by BCL and their consultants. Completion of the feasibility study and preliminary engineering for the infrastructure was delayed by changes in the mining project, the most important of which was the decision by BCL not to build a refinery in Botswana. Both the mining company and Botswana were nevertheless anxious to proceed with the project as rapidly as possible, hoping to start mining in 1972, but it became clear in the summer of 1969 that, unless final engineering could proceed while various key agreements between BCL and the Government and arrangements for financing the mine and infrastructure were being worked out, the start of mining operations would be seriously delayed.

4. To keep the operation moving forward, the shareholders of BCL undertook to continue to provide the company with interim financing (which by the end of 1970 amounted to about $21 million including exploration costs) and the Association in January 1970 provided a credit to Botswana of $2.5 million (No. 172-BT) to finance the cost of engineering design for various elements of the infrastructure and certain preliminary works including site clearance, advance housing and associated services. Under a Reimbursement Agreement with the Association, BCL is obligated to reimburse 50% of the funds disbursed under the IDA credit should BCL not proceed with the mining project.

5. For the last 15 months the Bank has been involved in intensive discussions with other agencies that had expressed an interest in joining in financing the infrastructure; with the Botswana Government on the contractual, organizational, financial and economic aspects of the infrastructure project including the agreements to be reached between the Government and BCL; and with the institutions considering financing BCL. The Bank has thus been acting at various times as counsellor of the Botswana Government and its prospective creditor, organizer of the parallel financing arrangements for the infrastructure and, with KfW, proponent of substantial revisions of the BCL financing plan necessary in the interest of the viability of the project as a whole. Informally, Bank staff have also been concerned with the equity of the

tax agreement between BCL and Botswana and the proposed commercial arrangements between BCL and MG.

6. In putting together financing plans for the infrastructure at a time when the costs were estimated at about $50 million, we began with the hope that Sweden and Canada, and possibly Norway, would together provide about $20 million to cover the costs of the township, hospital, road and rail spurs, leaving the proposed Bank loan to finance the commercial parts of the infrastructure, that is the power and water facilities. Following a change in Swedish foreign aid policy towards Botswana in 1969, Sweden withdrew support from the Shashe project. Canada, however, offered to provide finance on concessional terms for the power station and transmission and USAID funds became available for part of the water supply component. Denmark agreed to provide a loan of D.Kr.20 million (US$2.7 million) to finance a new hospital at Francistown, the present hospital being decrepit, and a health center at the Selebi-Pikwe mining township. Danish procurement requirements, however, which are primarily designed for the purpose of financing exports, made it impossible for their loan to be applied to 100% of the hospital costs. The loan is now proposed to be used to finance the import of medical supplies and equipment. Finance to build the new hospital at Francistown has still not been found but to avoid delaying the project as a whole, financing the hospital will be pursued by Botswana as a separate matter. To ensure that the essential medical needs of the project are met however, the health center has been included in the township.

7. The shift in the availability of parallel finance makes it necessary for the proposed Bank loan to be applied to the costs of the township, transport items and that part of the water supply not financed by USAID. The attached Bank Appraisal Report, however, covers in detail all aspects of the mining operation and infrastructure and, as noted above, the Bank has been heavily engaged in working out satisfactory arrangements for all parts of the project.

8. The present status of the project is that, with exceptions noted below, substantial agreement has been reached on the institutional arrangements, including the establishment of power and water corporations; the contractual arrangements between BCL and Botswana for the provision of and payment for infrastructure services; the BCL financing plan; the related commercial arrangements; the arrangements for refining; and the shape of the security and payments arrangements among the Bank, KfW and IDC. There now remains to be negotiated the Bank Loan and Guarantee Agreements for which the authorization of the Loan Committee is now being sought. Depending on the agreement of the Committee to the proposed recommendations set out in chapter 7 of the attached Appraisal Report and discussed in the rest of this memorandum, negotiations can also be

completed on various agreements to which the Bank is not directly a party. The timetable for those negotiations has been, and remains extremely tight, since if the present target date for mining to commence in August/September 1973 is to be met, certain critical contracts would need to be placed no later than the end of May. Within the next three months, BRST has to complete the arrangement, including obtaining SEC approval for the public issue. This requires that the other arrangements for the mining and infrastructure have been substantially completed.

II. MINING

Ownership

9. The mines will be constructed and operated by Bamangwato Concessions Limited (BCL), a Botswana company owned by Botswana RST (BRST) (51.8%), Foseco Minsep, Inc. (Foseco) (19.6%), the Botswana Government (15%)*, Kalahari Investments Limited (a subsidiary of Anglo-American Corporation group in South Africa) (13.5%) and two minor shareholders (0.1%). BRST is, in turn, owned 43% by American Metal Climax, Inc. (Amax) and its wholly owned subsidiary RST International, Inc. This means that Amax through BRST, has the largest (23%) share interest in BCL and the mining project. There is a proposal, currently being considered by the shareholders of BCL, for an exchange of shares of BCL for shares of BRST, which would leave BRST (85%) and the Botswana Government (15%) as the only shareholders of BCL.

Mining Project

10. The mining project is designed to produce an average of 35,000 metric tons per year of an impure mixture (matte) of copper and nickel and, as a by-product of the smelting process, 103,000 metric tons per year of pure sulphur, over the estimated 25-year life of the project. The development will involve two underground mines at Selebi and Pikwe, located 9 miles apart, a crusher, a concentrator and a smelter. The matte produced in Botswana will be transported to an Amax refinery in the USA for refining to pure copper and nickel (14,400 and 12,000 metric tons average per year respectively); during refining some 90 tons of cobalt annually will also be recovered.

Financing

11. The mining operations are estimated to require the investment of US$121 million. Of this, $42 million will be equity. By the end of 1970 about half had already been provided by shareholders, about $4 million in paid up shares and the rest through loans convertible to equity. The balance of the equity will be raised by BCL from existing shareholders; BRST will provide its part through a public rights issue to its own shareholders in June or July. The main direct and indirect shareholders of BCL and BRST (Amax, Anglo, Zamanglo and Foseco) have agreed to finance any capital costs in excess of present estimates. KfW is making, together with a consortium of ten German banks, a loan to BCL of DM220 million (US$60 million) repayable after 5 years of grace, over 10 years. The rate of interest is not yet determined, but, including a guarantee fee, it is likely to be about 9-3/4%. There are no restrictions as to procurement on the use of the KfW loan. IDC is lending R13.5 (US$20

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* The Botswana Government will receive its 15% shareholding in BCL without payment when BCL becomes a mining company, in return for the granting of the concession to BCL.

million)to BCL at 8-1/2% repayable over 10 years, to finance the export to Botswana of South African goods and services for the mining project. The interest charge covers the cost of the guarantee provided by CGIC. Both these loans will rank equally and each will be secured by a mortgage on the rights, title and interest in BCL's mining lease and on BCL's housing in Selebi-Pikwe; the Bank will also have a mortgage on these assets ranking equally with the KfW and IDC mortgages (see para 29 below). The coordination of the construction of the mining facilities will be carried out by Brown and Root, a U.S. management contractor of international repute, with a small team of BCL engineers in overall control, who will maintain close liaison with the Government's management unit, which will perform a similar function for the infrastructure project (see para 17 below).

III. INFRASTRUCTURE

12. The Infrastructure Project consists of power, water and transport facilities and a township, provided by the Government and Government corporations.

Power

13. The power facilities include a 60 MW conventional steam power station with a related transmission line. The power station and transmission line will be owned and operated by the Shashe Division of the newly established Botswana Power Corporation (BPC), a semi-autonomous statutory corporation. The coal for the power station will be supplied from a new coal field in Botswana at Morupule, 69 miles south of Pikwe. The coal mine will not be part of the Bank/CIDA/USAID Project, but will be owned and operated by Morupule Collieries, a subsidiary of Anglo, which has agreed to supply BPC's total requirements of coal under a 25-year cost-plus contract. The price to be paid by BPC will be designed to give Morupule Collieries an after-tax return on its capital investment of 10% (increasing to 15% in certain circumstances).

Water

14. The Project includes a dam on the Shashe river, a pipeline, a treatment plant and a distribution system to serve the mining complex, power station and township, and a separate water supply to serve the coal mine. The facilities will be owned and operated by the newly created national water authority, the Water Utilities Corporation (WUC).

Township

15. The township facilities will include housing, roads, drainage, sewerage, schools, administration, health service and fire station facilities. The Botswana Government and BCL have agreed that 75% of the common costs of the township should be charged to BCL, who would repay these costs to the Government. Upon completion, the township facilities will be turned over to the relevant government authorities for operation and maintenance.

Roads

16. The project will include an access road from the present main north-south road to the mining area, the upgrading of a part of the main road subject to increased traffic from the mining project and a road maintenance study. After completion, the roads will be the responsibility of the appropriate branch of the Botswana Government for operation and maintenance.

Railways

17. Two branch lines will be constructed from the present north-south line operated by Rhodesia Railways. One spur will go to the mining area (40 miles) and the other to the coal mine (10 miles). The road bed will be owned by the Government which will hire the track and other recoverable items of equipment from Rhodesia Railways, who will maintain and operate the service on the spur lines.

Project Coordination

18. In order to coordinate the various aspects of the Project until the completion of construction, the Botswana Government has established a Shashe Project Management Unit in the Ministry of Finance and Development Planning and intends to establish various technical and construction coordinating committees. The Unit is headed by a Chief Executive Engineer (already appointed), and the Bank is also being consulted with respect to the appointment of other senior staff. The Bank has seconded a Project Coordinator to Botswana to be the link between the various ministries and departments of Government and the Management Unit, during the construction period.

Financing Plan

19. Since Botswana is still a budget supported country, the project capital has to be financed directly or indirectly 100% externally. The Botswana contribution of $1.0 million to the cost of the township, shown in the financing plan below, will come from grant funds available to Botswana under U.K. aid.

20. The power station, transmission line and distribution will be financed under a CIDA loan of Can.$20.0 million signed on November 16, 1970, of which 75% is tied to Canadian procurement and the balance available for local costs. Although Canadian procurement results in higher costs than international competitive bidding, the cost difference is more than offset for Botswana by the extremely favorable loan terms. There is no interest, commitment or service charge. The loan is repayable over 40 years after 10 years of grace.

21. The pipe for the bulk water main will be financed by USAID. Loan negotiations are not yet completed but agreement has been reached on a loan of US$6.5 million, with interest at 2% per annum during the 10-year grace period and 3% per annum over the subsequent 30-year repayment period. Fifty percent of the loan is tied to U.S. procurement or up to 100% in "low income" countries. Again, the concessional terms of the financing more than offset the higher cost to Botswana of U.S. procurement compared to international bidding. The proposed Bank loan would finance the rest of the water supply component, that is the Shashe dam, pumping stations, pipe laying, civil works, miscellaneous equipment and township distribution, as well as the township, roads and rail spurs. The Appraisal Report recommends that the proposed Bank loan be for 25 years including a 3-year period of grace. As noted in paragraph 33 below, we are now recommending the grace period be extended to 4 years.

22. The total infrastructure project cost of $60.5 million, including the $0.9 million of Credit 172-BT to be refinanced, and assuming interest on the proposed Bank loan during a 4-year grace period, would be financed as follows:

(U.S.$ million)

	Cost as estimated by Bank	Financing	
Power	21.9	21.9	CIDA loan 1/
Water - trunk main	7.6	7.6	USAID loan 1/
- other	9.0)		
Roads and railway	4.6)		
Township	8.9)	30.0	Bank loan
Engineering and administration	4.2)	1.0	Government grant for Township
Interest on Bank loan during construction	4.3)		
	60.5	60.5	

1/ The amounts shown above for the CIDA and USAID loans are still under discussion and exceed the amounts presently negotiated (see paragraph 32 below).

IV. CONTRACTUAL ARRANGEMENTS

23. To establish the status of BCL with respect to Botswana, to create the necessary links between the mining operation and the various elements of the infrastructure, and coordinate the financing plans for mine and infrastructure requires a network of agreements between and among the various parties. A full list of legal documents is annexed to this memorandum. The following paragraphs in this section identify the principal contractual links of primary concern to the Bank, classified according to the parties to each agreement. The remaining issues to be resolved with respect to any of these agreements are discussed in Section V.

A. The Bank, USAID, CIDA, Botswana Government and its Agencies

24. The CIDA, AID and proposed Bank loans, would all be made to the Botswana government. The proceeds of the CIDA loan will be relent to the BPC under the Power Subsidiary Loan Agreement. The proceeds of the USAID loan and of part of the Bank loan will be relent to the WUC under the Water Subsidiary Loan Agreement. The subsidiary loans would be for the same grace and repayment period as the proposed Bank loan; the interest rate would be 7¼%.

25. Although the proceeds of the proposed Bank loan would be applied to only part of the infrastructure project, the Bank loan Agreement with Botswana would contain virtually all the covenants that we would require if we were financing the whole of the project. The Project Description embraces all items in the infrastructure. Performance, consultation on appointment, information, accounting and tariff covenants extend as appropriate equally to the BPC, which the Bank is not financing at all, to the WUC, which it is financing in part, as to those parts of the project to be carried out by Government departments and wholly financed by the Bank.

B. BCL and Botswana Government or Government Corporations

26. A Master Agreement between BCL and the Government sets out the basic rights and obligations of the two parties to one another, in particular the obligation to construct and operate the mining project and infrastructure facilities respectively; failure to observe the terms of the Master Agreement would be an event of default under the Bank's loan agreement.

C. The Bank, BCL and Certain Shareholders and MG

27. The Bank loan to Botswana will be guaranteed (i) 100% by BCL, and (ii) by MG, the purchaser, as to 40% of the Bank loan, up to a maximum of $12 million, for the duration (18 years) of the sales agreement, and (iii) as to 60% of the Bank loan while MG is a

guarantor, and, when it is not,as to 100% by Amax, Anglo, Zamanglo and Foseco in proportion to their direct and indirect shareholding in BCL. The obligations of guarantors would be suspended or terminated upon occurrence of certain events of a political nature, such as war, revolution or expropriation (see paragraph 35 below).

D. BCL, KfW, IDC, Botswana and Bank

28. A Trust Deed will be created, under the terms of which BCL will assign the payment of revenues under all sales contracts to a Trustee (Barclays DCO) in London, who will make payments due by BCL to KfW, IDC, BPC, WUC and the Botswana Government. BPC and WUC will also assign the proceeds under the Power and Water Contracts, to secure the debt service to Government under the Power and Water Subsidiary Loan Agreements. Botswana will instruct the Trustee to pay directly to the Bank debt service and other charges on the Bank loan out of Government accounts in the Trust. After these payments to creditors have been made, the Trustee will pay any balance to BCL.

29. The Taxation Agreement and provision for royalties (incorporated in the Mining Lease) fix the liabilities of BCL for taxes and royalties for a 25 year period. Royalties vary with profits, subject to a minimum payment of R750,000 ($1,050,000) a year. The Township Contribution Agreement between the Government and BCL provides for the payment by BCL of its share (agreed at 75%) of the costs of common services (i.e. excluding housing and private facilities). The payment is being spread over a period of 25 years, with provision for acceleration in case other loans to BCL or the Government are accelerated. The Power Contract is a 25-year agreement between BPC and BCL for the sale of energy to BCL (initially 90% of total output). The power tariff would provide a rate of return on gross fixed assets of at least 7.5% at the start of operations and 8% by FY-1978. However, the contract provides for a minimum monthly charge to be paid by BCL, whether it takes power or not, starting on the date power is provided, or six months before debt service payments begin by BPC to Government under the Power Subsidiary Loan Agreement. The minimum monthly charge covers fixed operating costs and debt service payments. The Water Contract is a 25-year agreement between WUC and BCL for the sale of water to BCL (initially about 63% of total output; BPC will take another 16%). The water tariff will provide a 7% rate of return on gross fixed assets at the outset, rising to 7.5% by FY-1976 and 8% by FY-1978. A monthly minimum charge is payable, whether water is taken or not, which will cover fixed operating costs and debt service payments under the Water Subsidiary Loan Agreement between the Government and WUC.

E. KfW, IDC and the Bank

30. KfW and IDC require a mortgage on the rights of BCL under the mining lease and on its houses in the mining township, as a security for their loan to BCL. Since BCL will be a guarantor of the Bank loan, in order to maintain a pari passu position between the Bank, KfW and IDC, the Bank will also share the security under the mortgage. The Bank would take a pari passu position. A Lender's Agreement between the three ensures coordination of the exercise by the parties of their rights under their resepctive loan agreements.

V. ISSUES

(i) Adequacy of Available Financing

31. When the Engineering Credit was under discussion by the Committee it was accepted that Botswana could not give any meaningful commitment to finance cost overruns on the infrastructure. It was therefore decided that the cost estimates on which the financing plan should be based would contain ample provision for contingencies and that the Bank should accept the possibility that further lending might be required. To make possible additional Bank lending if no other suitable financing were available, the guarantors of the Bank loan have undertaken to extend their guarantees to cover an additional amount up to the equivalent of 20% of the initial Bank lending, on the same terms and conditions as the original guarantee.

32. On the basis of bids received, the Appraisal Report estimates the costs of the power facilities including escalation and contingencies will exceed the CIDA loan of Can $20 million by Can $1.9 million. Bank estimates of the costs of the water trunk main under U.S. procurement exceed the USAID loan of US $6.5 million by about $1.1 million; USAID do not agree and consider their loan to be fully adequate. We shall not know who is right until bids are received and analyzed in June, that is to say probably after presentation to the Executive Directors. I consider that we need to be assured prior to presentation that both CIDA and USAID stand ready to provide loans in the amounts actually required. We have already raised the matter with both agencies and Botswana has already submitted a formal request to CIDA.

(ii) Retroactive Financing

33. The target date for the beginning of production at the mine is August/September 1973. In order to meet this date, the CIDA-financed contracts to construct the power stations* should be let by

* Bids have already been received; their validity has already been extended once, to the end of March.

April 1, the Bank-financed contract for the dam by June 1, and the USAID-financed water pipe by July 1. If the dam contract were not let by June, six months could be lost, because dam construction would not be sufficiently advanced to impound the first season's rains. These dates precede the likely dates of effectiveness of the Canadian and U.S. loans and of approval of the proposed Bank loan. The Government is not willing to let such contracts in the absence of firm arrangements for financing, unless BCL agrees to underwrite the financial commitments involved, i.e. cancellation charges and amounts actually spent. BCL and its major shareholders are not willing to consider such underwriting unless they are reasonably satisfied (a) that major outstanding issues on connection with the project are likely soon to be resolved, and (b) that CIDA, USAID and the Bank have indicated their willingness to finance any expenditures committed or made before their loans were signed. Provided we are satisfied that Botswana is in a position to enter into the dam contract, I propose that the Bank indicate, with the customary reservations, that we would have no objection to the contract being let on June 1.

34. Both USAID and CIDA are willing retroactively to finance expenditures on the contracts for the works under their loans which are let prior to effectiveness. If the contract for the dam were let on June 1, no payments would be due for reimbursement prior to July 1, the assumed date of signature of the Bank loan. However, there would by that date be about $250,000 in engineering costs for the infrastructure project which cannot be covered out of the funds remaining under the engineering credit. I recommend that these expenditures should be eligible for reimbursement under the proposed Bank loan.

(iii) Terms of Bank Loan

35. The Appraisal Report recommends a Bank loan of $29 million, with a term of 25 years including 3 years of grace. It is requested by the Government, supported by BCL, that we should provide a longer grace period to take account of the possibility of delays in completion of the power and water facilities, resulting in repayments beginning before production starts, not only by Botswana to the Bank and the corporations to Botswana, but also by BCL to the corporations. The Projects Departments concerned consider the construction schedule to be tight. I therefore recommend that we be willing to make the grace period four years. This would require the loan to be increased to $30 million, to take account of the additional interest.

(iv) Guarantee Agreement

36. An important problem concerns the definition of the events of force majeure upon the occurrence of which the obligations of the guarantors would be suspended or terminated. According to the present practice of the Bank expropriation by the government with the agreement

of the company or the guarantors would not be one of the events. Both Amax and MG argue from recent experience that situations can arise in which a company and its shareholders in fact have no option but to agree to a takeover when the only alternative is known to be compulsory acquisition. They have requested that the Bank provide a letter of interpretation on the wording of the relevant clauses of the Guarantee Agreement, to say in effect that we would treat as an event of force majeure an agreement made under coercion to sell the company to the Government. We have not so far agreed, but the Legal Department considers, and I agree, that we should be willing to give the guarantor-shareholders a side letter (Annex 2) defining narrowly the circumstances, in the Bank's judgment, in which we would grant a waiver.

37. There are other points on the guarantee still outstanding. Under the terms of their agreements with KfW, IDC and ourselves, the shareholders undertake to make advances to BCL to finance any cost overrun on the mining project. We and KfW proposed that BCL should not be required to repay such advances before 5 years and that repayment thereafter should be spread over at least 10 years. Amax has suggested that, without other limitation, funds otherwise available as dividends should, at BCL's option, be applied to the repayment of advances. Amax's proposal would be detrimental to the Government's interest as a 15% shareholder, and I recommend that we should not agree to it.

38. We are not yet satisfied that Foseco Minsep would be acceptable as a guarantor-shareholder, as its assets are mainly shareholdings spread over a large number of small companies and the grouping of three of these companies proposed by Foseco Minsep has quite inadequate assets. We have asked Foseco Minsep to propose a combination of companies that would have assets adequate to meet its potential liability under the guarantee, which would, at a maximum, be $8 million. If the company cannot offer a satisfactory solution, we propose to inform the other guanantor-shareholders, Amax, Anglo-American and Zamanglo, that they will have to take on the Foseco share.

39. Despite strong pressure from the Bank on Anglo-American Corporation to take on the whole of the share of the guarantee to the Bank corresponding to the 14% shareholding in BCL of Kalahari Investments Limited, a Botswana holding company, we have not succeeded. They have proposed that this share of the guarantee be given partly (54%) by Anglo and partly (46%) by Zamanglo* on a several basis, stating that this reflects the shareholding of .

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* A holding company for the Anglo-American group's interests in Zambian copper mining with total assets of £148.5 million, established in Bermuda in 1970.

Anglo and Zamanglo in Kalahari Investments. Anglo moreover states that the Reserve Bank of South Africa would not give exchange control permission for Anglo, a South African company, to take on the obligation of Zamanglo. The concentration of Zamanglo's assets in Zambian copper mining weakens her attractiveness as a guarantor. I therefore propose that the Bank ask the Reserve Bank in Pretoria to give exchange control permission to Anglo to take over the Zamanglo share of the guarantee.

40. Amax requested that the Bank agree that its guarantee rank behind Amax's unsubordinated debt, presently about $60 million. In view of the relatively small size of the guarantee obligation, about $21 million, compared to shareholders' equity of the order of $600 million, we have indicated that we would accept this provided that Amax gave to the Bank a satisfactory written undertaking that at all times the total of such "senior" debt ranking ahead of the guarantee obligation to the Bank would be covered at least 250% by net tangible assets.

(v) Nickel Sales

41. In the KfW loan agreement there was a requirement, said to be imposed at the insistence of the German Government, that all metal should be sold in Germany. The sales agreement to be concluded between BCL and MG provides for 2/3 of the nickel to be taken by MG at INCO prices, the balance being sold under other arrangements by BCL. The Bank has suggested that the requirement that the 1/3 of the nickel not sold to MG nevertheless be sold only in Germany should be waived in the event that BCL could obtain better prices for all or part of it outside Germany. To do so would make the sales arrangements fairer by allowing some part of the benefit of the difference in INCO prices and the market price, at times when the latter exceeds the former, to go to Botswana rather than all the benefits to remain with Germany. In the present draft of the KfW loan agreement, BCL would be allowed to sell the 1/3 nickel not going to MG outside Germany only if the price outside were higher than that obtainable in Germany and if the price were below the INCO price. I am not certain that the KfW requirement is a German Government requirement. In any case, I propose that we inform KfW that the Bank considers it to be inequitable and that we consider that BCL should be free to sell outside Germany the 1/3, if the price is higher.

(vi) Trust Arrangements

42. There are two problems on the Trust Agreement. One concerns the priority for tax in the disposal of funds held by the Trustee in the general account at a time of liquidation of BCL. The Government argues that since the Trust is a payment mechanism designed only to give protection against exchange control in Botswana, tax should have the same first priority in liquidation as

it would in the absence of the Trust. IDC and KfW argue that the Trust is for them a security, that it does alter the situation in that the funds belong to the Trustee, not to BCL (though BCL is the beneficiary of those in general account) and that the Trust is outside Botswana, and priority for tax only applies within the country in which the tax liability is incurred. Since our loan repayments are made from Government funds in the Trust, we have supported the Government's position on this point and I recommend that we continue to do so.

43. The other issue concerns the pledging of the pipeline of matte and metal between African port and Germany as security for short-term borrowing by BCL and the discounting of sales invoices issued by MG on receipt of nickel, for which payment is made 45 days later. Without prior consultation with the Bank, KfW and IDC agreed with BCL that until the end of 1975 up to $11 million could be borrowed against the security of pipeline, the total value of which would be between $15-18 million* provided that an amount equal to the aggregate of the next semi-annual debt service payments on the IDC, KfW and Bank loans was also covered by the value of the pipeline and the invoices. We reserved our position on this point. I recommend we accept the proposal; the arrangement admittedly reduces the security value of the Trust, but it is KfW and IDC who regard it in this light, whereas we have considered the Trust primarily as a payments mechanism.

(vii) Pollution Control

44. The Government of Botswana engaged a consultant to advise on necessary technical and legislative measures to control air pollution by the power station and smelter, in order to protect the health and welfare of the population. His recommendations were accepted by the Government and legislative action has been taken. The Bank's consultant on air pollution control, Dr. Katz, agreed with all the recommendations of the Government's consultant except one - the height of the chimneys carrying effluent gases. Dr. Katz recommended increasing the heights of the stacks from 152m to 200m. A third expert on air pollution, who was also consulted by the Government, recommended stack heights of 160m.

45. Public Utilities Projects Department and Mr. Lee have given further consideration to the impact of implementing Dr. Katz's proposal on (i) the timing, (ii) the engineering and (iii) the additional initial cost to the project, and consider that a stack height of 160 meters (525 ft) for the smelter and 74 meters (250 ft)

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* depending on whether Bank or BCL assumptions as to metal prices are used.

for the power station would be acceptable. It is proposed however, that the Bank should require Botswana to implement the monitoring and enforcement measures provided in the legislation and to make all relevant data on the effectiveness of these measures available to the Bank. Should the SO_2 ground level concentration at any time exceed the limits to be agreed with the Government, the Government would be obligated to require BCL to take the necessary corrective action.

(viii) UN Sanctions Matters

46. The rail spurs will be maintained and operated by Rhodesia Railways, who own and operate the main line which runs from Southern Rhodesia and links up with South African Railways on the southern border of Botswana. Botswana has already made representations to the Security Council explaining its inability to comply fully with the sanctions resolutions prohibiting the use of the transport facilities of Rhodesia. No objection to such representations was raised by the members of the Security Council. The import of equipment and supplies and export of matte over Rhodesia Railways would not therefore create difficulties for Botswana in the UN.

47. Another problem arising from UN sanctions and the need to avoid giving recognition to the Smith regime in Southern Rhodesia was the question of obtaining an agreement with Rhodesia Railways for the provision of the recoverable items for the rail spurs and their operation and maintenance. Under Botswana law, the General Manager of Rhodesia Railways has now been recognized as the legal authority for Rhodesia Railways' operations in Botswana. The agreement between Botswana and the General Manager for the operation and maintenance of the spurs in the project will therefore be a legally valid and binding obligation on both parties, without involving Botswana in violating the sanctions resolutions or conferring recognition on the illegal regime in Southern Rhodesia.

48. We have informed Botswana and the Government has agreed that Rhodesian firms must be specifically excluded from the invitations to tender for work to be financed from the proposed Bank loan. Strictly speaking, we should also refuse to disburse against freight costs incurred on Rhodesia Railways in Rhodesia. Not much is expected to be imported by this route, and I therefore recommend that eligible disbursements should include any freight costs on Rhodesia Railways, the payment of which by Botswana is implicitly recognized by the UN as the unavoidable consequences of Botswana's location. In connection with the Kariba North loan we have similarly agreed to reimburse freight costs on Rhodesia Railways.

VI. ECONOMIC SITUATION

49. An economic report (AE-4a) on Botswana was distributed to the Executive Directors on October 31, 1969. An up-dating economic memorandum is being prepared and will accompany the President's Report to the Executive Directors.

50. The population of Botswana depends largely on livestock raising. Livestock represents nearly 50% of GDP and provides about 90% of all exports. Agricultural crops - sorghum, maize, and pulses - are produced mainly for subsistance. Given the present land tenure system coupled with low standards of range management, the livestock industry has reached the country's carrying capacity. The government is trying to improve the standards of livestock rearing through modifications in the land tenure system and improvements in the extension services.

51. The Government has in the past been unable to finance its recurrent expenditure through domestic resources. The United Kingdom financed not only the recurrent deficits through grants-in-aid but also most of the development expenditures. Since 1969, the budgetary situation has improved considerably. A new customs agreement with South Africa, Lesotho and Swaziland now gives Botswana customs revenues proportionate to its imports, and imports are increasing rapidly as a result of the development of a mining industry. Total revenue from internal sources in 1971/72/1 is estimated to be about 130% above the 1968/69 level. Assuming mining development takes place as planned, the Government expects to be able to balance its recurrent budget from domestic revenue by 1972/73.

52. Two large-scale mining projects have reached an advanced stage of preparation: the De Beers diamond mine at Orapa, 110 miles west of Francistown, and the Shashe copper/nickel mine. The Orapa diamond mine will come into commercial production in July 1971. Income to Government from royalties and dividends (Government holds 15% of the equity) from Orapa during 1971/72 is estimated at R800,000. This amount is estimated to increase to $2.9 million in 1974/75 (including profit taxes). In addition, a large portion of the expected increase in revenue from customs duties in 1971/72 is the result of imports for the Orapa capital works in 1970/71. Total imports of capital goods for the Orapa mine in 1970 and 1971 have been estimated at $12 million. An even greater impact on Government revenue is expected from the Shashe copper/nickel project. Customs revenues will be affected by imports for Shashe for the first time in 1972/73, and royalty payments are expected to start in 1974/75.

/1 Financial year, April to March.

53. The direct and indirect contribution to GDP by the Orapa and Shashe mines is expected to reach about R40 million per year by 1975 or about 80% of the estimated 1969/70 GDP. Much of the addition to GDP will, however, be transferred abroad as mining profits, interest on loans and expatriate salaries so that the increase in GNP will be much smaller than the increase in GDP. In addition to Orapa and Shashe, a number of new mining prospects are actively being explored which could lead to new mining projects in a few years.

54. The expected improvement in the budgetary position arising from the two mining projects will not be sufficient for the Government to achieve an appreciable and sustained budgetary surplus. Botswana will therefore continue to require external capital on IDA terms, and for the highest acceptable proportion of project cost. Bank financing can be considered only for self-liquidating projects, such as Shashe, for which special security arrangements can be made.

VII. RECOMMENDATIONS

55. I recommend that we enter into negotiations (a) with representatives of the Botswana Government on a loan of US$30 million for 25 years with 4 years grace substantially on the conditions proposed in Chapter 7 of the attached Appraisal Report and on the terms of the Subsidiary Loan Agreements between Botswana and the Power and Water Utilities Corporations, and (b) with representatives of Metallgesellschaft and the guarantor-shareholders, American Metal Climax, Anglo-American Corporation, Zamanglo and Foseco Minsep on a guarantee agreement for the proposed Bank loan.

Michael L. Lejeune
Director

Attachments

ANNEX 1

LIST OF LEGAL DOCUMENTS

1. Agreements Governing Basic Relations Between Botswana and BCL

1.1 Exploration Agreement between BTA*and RST Exploration dated June 2, 1959.

1.2 Deed of Concession between BTA and RST Exploration, dated November 26, 1959.

1.3 Memorandum of Agreement between BTA and Botswana, dated April 4, 1967.

1.4 Agreement and Deed of Concession between Botswana, BTA, BCL, BRST and RST Exploration, dated November 15, 1967.

1.5 Mining Lease between Botswana and BCL (draft).

1.6 Master Agreement between Botswana and BCL (draft).

1.7 Tax Agreement between Botswana and BCL, dated March 5, 1970.

1.8 Shareholders' Agreement between Botswana, BRST, Minsep and Kalahari Investments (draft).

2. Finance Agreements - Agreements Relating to Finance for the Infrastructure Project

2.1 Credit Agreement between IDA and Botswana, dated January 15, 1970.

2.2 Loan Agreement between IBRD and Botswana (draft).

2.3 Guarantee Agreement between IBRD, Amax, Anglo, BCL, Minsep, MG and Zamanglo (draft).

2.4 Loan Agreement between AID and Botswana (draft).

2.5 Loan Agreement between CIDA and Botswana, dated November 16, 1970.

2.6 Water Subsidiary Loan Agreement between Botswana and WUC (draft).

2.7 Power Subsidiary Loan Agreement between Botswana and BPC (draft).

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* Bamangwato Tribe and Tribal Authority (BTA)

3. Finance Agreements - Agreements Relating to Finance for the Mining Project

3.1 KfW Loan

3.1.1 Loan Agreement between KfW and BCL (draft).

3.1.2 Shareholders' Completion Guarantee between KfW and BRST, Amax, Minsep and Anglo (draft).

3.1.3 Instrument Covering Guarantee by the Federal Republic of Germany of KfW loan to BCL (draft).

3.1.4 Guarantee Agreement between KfW and MG (draft).

3.1.5 Guarantee Indemnity Agreement between MG and BRST, Amax, Minsep and Anglo (draft).

3.2 IDC Loan

3.2.1 Credit Agreement between BCL, IDC and a 100% Subsidiary of IDC (draft).

3.2.2 Shareholders' Completion Guarantee between IDC and Amax, Minsep and Anglo (draft).

3.2.3 Guarantee Agreement between Union Acceptances Limited (UAL) and a 100% IDC Subsidiary (draft).

3.2.4 Services Agreement between UAL Export and BCL (draft).

3.2.5 Insurance Policy (or other instrument) relating to CGIC insurance to IDC (or a 100% IDC subsidiary) (draft).

3.3 BCL Shareholders' Contributions

3.3.1 Shareholders' Contribution Agreement between Amax, Minsep and Anglo (draft).

3.4 Pledge of Copper/Nickel Matte and Metal

3.4.1 Agreement between BCL and Rothschild relating to terms and conditions on which Rothschild would arrange finance for BCL by pledge of matte and metals (draft).

4. Finance Agreements - Payment, Security and Lender's Arrangements

4.1 Trust Deed between Botswana, IBRD, KfW, IDC, BPC, WUC, BCL and Barclays (draft).

4.2 Agreement of Hypothecation (and/or Mortgage Bonds) between BCL and KfW, IDC and IBRD (draft).

4.3 Lender's Agreement between IBRD, KfW and IDC (draft).

5. Infrastructure Agreements

5.1 Water Supply Agreement between WUC and BCL (draft).

5.2 Temporary Water Supply Agreement between Botswana and BCL (draft).

5.3 Power Supply Agreement between BPC and BCL (draft).

5.4 Temporary Power Supply Agreement between BCL and Botswana (draft).

5.5 Township Contribution Agreement between Botswana and BCL (draft).

5.6 Coal Supply Agreement between BPC and Morupule Colliery Limited (draft).

5.7 Railway Agreements between Botswana and Rhodesia Railways (drafts).

5.8 Consultants Agreement between BCL and Sir Alexander Gibb & Partners (draft).

6. Refining and Sales Agreements

6.1 Refinery Agreement between Amax and BCL (draft).

6.2 Copper and Nickel Sales Agreement between BCL and MG (draft).

6.3 Sulphur Sales Agreement between BCL and Triomf (draft).

6.4 Sales Agent Agreement between BCL and Ametalco, dated December 31, 1969.

Annex 2

Draft Side Letter

American Metal Climax, Inc.
Anglo American Corporation of South Africa Limited
Foseco Minsep Limited
Metallgesellschaft AG
Zambia Copper Investments Limited

Dear Sirs:

I refer to the Guarantee Agreement of even date between us and Bamangwato Concessions Limited (BCL). This Agreement provides that under certain conditions the Guarantors (as defined in the Agreement) may be relieved of obligations under the Agreement if the Government of Botswana compulsorily acquires ownership or control of all or substantially all the property and assets of BCL essential for the proper and efficient operation of its business. One of the conditions to such relief is that such compulsory acquisition has not been agreed to expressly or by implication by any of the Guarantors or by BCL. You have pointed out that after threatening to acquire compulsorily the assets of BCL the Government may enter into negotiations for the purchase of such assets with the intention of compulsorily acquiring these assets if such negotiations are not successful. In such a case the Guarantor Shareholders (as defined in the Agreement) may negotiate a sale of such properties to the Government for a price substantially the same as that which they would have received as a settlement if the properties were compulsorily acquired by the Government. In your opinion such a voluntary sale would often add stability to the settlement arrangements, and in these circumstances, you consider it unfair that the Guarantors not be relieved of obligations under the Agreement.

The Bank hereby agrees if, in its opinion, circumstances as outlined above exist in connection with a negotiated sale to the Government of BCL's properties, to waive the provisions of Section 3.02 (iii) of the Guarantee Agreement. Such a waiver would be conditional on the Bank being informed of the negotiations with the Government sufficiently in advance of the execution of an agreement for the sale so that it had adequate opportunity to discuss the matter with the Government of Botswana.

Sincerely yours,

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By ____________________

Authorized Representative

Population: 0.6 m
GNP Per Cap: $90

IVa. BOTSWANA - 5 YEAR OPERATIONS AND LENDING PROGRAMS
(By Fiscal Year - Amounts in $ millions)

OPERATIONS PROGRAM			1971	1972	1973	1974	1975	1976
8-BØT-AL-01	Livestock	IDA		3.3				
8-BØT-AC-01	Agricultural Credit	IDA			2.0			
8-BØT-AX-01	Agriculture Unidentified	IDA					2.0	
8-BØT-AI-01	Irrigation I	IDA						2.0
8-BØT-IM-01	Shashi River Eng.	IDA						
8-BØT-IM-02	Shashi River Power	IBRD	30.0					
8-BØT-IM-03	Mining Unidentified	IDA				1.0		
8-BØT-TH-02	Roads - Gaborone-Lobatse	IDA		2.0				
8-BØT-WU-01	Water Supply - Lobatse	IDA	3.0					

	1964-68	Total 1969-73	1972-76
IBRD		12.0	12.0
IDA	3.7	4.0	19.0
Total	3.7	16.0	31.0
No.	1	6	6

	1971	1972	1973	1974	1975	1976
IBRD	30.0					
IDA	3.0	5.3	2.0	1.0	2.0	2.0
Total	33.0	5.3	2.0	1.0	2.0	2.0
	2	2	1	1	1	1

LENDING PROGRAM (1/27/71)

	1964-68	1969-73	1972-76
IBRD		30.8	
IDA	3.6	10.8	10.3
Total	3.6	41.6	10.3
	1	6	6

	1971	1972	1973	1974	1975	1976
IBRD	30.0					
IDA	3.0	3.3	2.0	1.0	2.0	2.0
Total	33.0	3.3	2.0	1.0	2.0	2.0
	2	2	1	1	1	1

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-17

March 24, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Indonesia - Tea Project" held at 4:30 p.m. on Wednesday, March 17, 1971 in Conference Room A.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

Copies for Information:

President
The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

LM/M/71-17

March 24, 1971

Minutes of Special Loan Meeting to consider "Indonesia - Tea Project" held at 4:30 p.m. on Wednesday, March 17, 1971 in Conference Room A.

1. Present: Messrs. Cope (Chairman), Broches, Baum, Gabriel, Goodman, Fontein, McIvor, Rowe, Asser, Foster, Kaupisch and Pearce (Secretary).

2. Issue: The meeting had been called to consider the East Asia and Pacific Department's memorandum of March 10, 1971 to the Loan Committee entitled "Indonesia - Tea Project" (LC/O/71-32), which recommended a $15 million credit to finance the foreign exchange component of a $25 million project for the rehabilitation and development of tea and cinchona (quinine) on two groups of Government-owned estates in Java, PNPs XII and XIII. The only issue for discussion was the conversion of the two PNPs, i.e. government-owned estates operating under the policy direction and control of the Ministry of Agriculture, into PTs, i.e. autonomous enterprises operating under the Commercial Code.

3. Discussion: The meeting noted that:

(a) The Government had decided in principle to convert all PNPs into PTs as soon as possible. This would meet the need for more commercially-oriented operation of the estates.

(b) However, it was uncertain whether, in view of the time needed to select and appoint appropriate individuals, the Indonesians would be able to convert PNPs XII and XIII formally to PTs before the credit was declared effective or by December 31, 1971, as recommended by the Agriculture Projects Department. If IDA insisted on a commitment to either of these targets during negotiations, the credit's effectiveness might be delayed considerably. Alternatively, IDA could make the appointment of policy-making Boards of Directors and Management Boards to the PNPs or, if necessary, formal conversion to PTs a condition of disbursement separately for each PNP/PT in respect of specific elements of the project, thus permitting disbursements for technical assistance and research to proceed as soon as the credit had been declared effective.

3. The meeting noted that IDA's main concern was the substantive one of ensuring effective operation of the tea estates, an important feature of which would be the adoption by the Indonesians of a management structure along commercial lines. Provided that IDA received satisfactory assurances during negotiations regarding interim arrangements for estate operations, there was no reason to insist on formal conversion to PTs sooner than the Indonesians themselves planned to accomplish this.

4. <u>Decision</u>: The Chairman decided that the Indonesians should be asked during negotiations to submit their proposals on this issue, in the light of which the Association could then determine what PNP/PT arrangements would be appropriate.

David Pearce
Secretary

Cleared by: Messrs. Cope
Fontein
McIvor
Asser

cc: Loan Committee
Participants

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 24, 1971

MEMORANDUM TO THE LOAN COMMITTEE

India - Tamil Nadu Agricultural Credit Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 24, 1971 from the South Asia Department, entitled "India - Tamil Nadu Agricultural Credit Project" (LC/O/71-41).

2. Comments, if any, should be sent to reach Mr. David Thomas (ext. 2294) by 4:00 p.m. on Friday, March 26.

3. It is planned then, if the Committee approves, to inform the Government that the Association is prepared to begin negotiations for the proposed credit on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
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President
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Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/0/71-41

March 24, 1971

LOAN COMMITTEE

MEMORANDUM FROM SOUTH ASIA DEPARTMENT

INDIA - TAMIL NADU AGRICULTURAL CREDIT PROJECT

1. Attached is an Appraisal Report (No. PA-81) dated March 11, 1971, recommending that the Association make a credit to India of US$35.0 million equivalent for an agricultural credit project. Also attached is a copy of the gross operating program as of mid-March; revision of this program is under active consideration to ensure a two-year (Fy 71/72) IDA lending program to India of about US$600 million.

2. The proposed project in the State of Tamil Nadu in Southeastern India would assist in financing on-farm investment (e.g. in minor irrigation, land-levelling, drainage and farm mechanization) together with equipment required for project implementation and certain consultancy services. The project would be one of a series aimed at increasing the range and amount of institutional credit available to farmers who wish to take fuller advantage of modern agricultural technology.

Background, including Bank/IDA Lending Program

(Paragraphs 3 - 5, below, are virtually identical with paragraphs 3 - 5 of the Area Memorandum on the Haryana Agricultural Credit project distributed on March 19, 1971.)

3. This would be the fifth agricultural credit project in India; three others, in the States of Gujarat, Punjab and Andhra Pradesh, have already been approved by the Association and a fourth, in the State of Haryana, has been appraised and was recently referred to the Loan Committee. Additional projects (in the States of Maharashtra and Mysore) are currently being appraised with a view to presentation early in FY 72; a third agricultural credit project in either Bihar or Uttar Pradesh is also scheduled for next year.

4. For the current fiscal year India's allocation from IDA is US$245 million, of which US$30.4 million has been approved for two credits (Agro-Aviation US$6 million and Andhra Pradesh Agricultural Credit US$24.4 million). Negotiations on a grain storage project (US$5.0 million) were suspended because of GOI's unwillingness to agree to international tendering for silo construction. Appraisal of the Cauvery Delta Irrigation and Drainage Rehabilitation project (US$26 million) was completed nearly a year ago, but because of an unexpected interstate water dispute could not be brought to negotiation. Appraisal reports are now being completed for the Pochampad Irrigation Project (US$35 million) and Cochin Fertilizer (US$20 million). An appraisal report has been prepared for a second Power Transmission Project (US$ 75 million), which is scheduled for presentation to

the Executive Directors on April 27. Negotiations for a Fourth Telecommunications Project (US$78 million) began on March 17. If all of these credits are negotiated before the end of June, presentation of one or two may have to be deferred to keep within the IDA allocation. Needless to say, appraisal work is proceeding on several other projects which should be ready for negotiation early in FY 72.

5. The latest economic report, "Economic Situation and Prospects of India" (SA-13a, April 29, 1970), indicated that the economy was moving out of the recession brought about primarily by the effect of bad harvests in 1965/66 and 1966/67. It also reported an encouraging improvement in the balance of payments. Despite these favorable developments, India still requires substantial aid on concessionary terms for economic development purposes. I do not expect these conclusions to be altered by the economic report for 1971, which is now being prepared.

The Project

6. As in other agricultural credit projects in India, the Agricultural Refinance Corporation (ARC, the all-India institution which has participated in the three previous projects) would assume the main responsibility for supervising the proposed project. The borrower would be the Government of India. Most of the proceeds of the credit would be lent to farmers through ARC, the Tamil Nadu State Land Development Bank (LDB) and its federated Primary Land Development Banks, and selected commercial banks. As in the Punjab and Andhra Pradesh Credit projects, participating commercial banks would be required to accept the same terms and conditions of lending to farmers as the LDB. In addition, the project would include financing for well-drilling and earth moving machinery and for three types of consultancy services - namely (i) advisers to the State Groundwater Directorate (SGD) to assist primarily in the establishment of new appraisal techniques for groundwater exploitation, (ii) a systems analysis of the Cauvery Delta, and (iii) an aerial survey of a part of Tamil Nadu and the neighboring States of Maharashtra, Mysore and Andhra Pradesh, to provide more adequate information on groundwater resources in those areas.

7. It should be noted that the project includes groundwater development which was originally integrated with the rehabilitation of surface irrigation facilities in the Cauvery Delta Irrigation and Drainage project (referred to in paragraph 4 above). Although the integrated project cannot be negotiated, a section of it is suitable for financing through credit institutions. We understand that other parts of the Cauvery project (i.e. the rehabilitation of the surface irrigation system and improved drainage) are being undertaken by the State using its own resources and without IDA participation. A systems analysis would contribute very useful information to this work. (See paragraph 14 below).

8. **Benefits - The appraisal report estimates that the** proposed investments would lead to an increase in cropped area of 60,000 ha (of which 45,00 ha would be attributable to minor irrigation) and that a further 150,000 ha would benefit from improved farming conditions. In turn, these would result in an estimated increase of 280,000 tons of food crops and an expansion of production of commercial crops, the most important of which would be 400,000 tons of sugar cane (30,000 tons raw sugar equivalent) and 20,000 tons of oil seeds (paragraph 6.01). The economic rate of return is estimated to be 28 percent at present crop prices and using the current exchange rate. Sensitivity tests using a rate of exchange (Rs 9.50 to US$1), which more accurately reflects the effective cost of imports in India, yield a higher rate of return (paragraph 7.02). Benefits to farmers would also be high with the estimated financial rates of return ranging from 27 percent to 30 percent for minor irrigation investments, 46 percent for land levelling and 30 percent for farm mechanization. In addition, increased gross project production, estimated to be worth US$29 million at full production and current prices, should help strengthen India's foreign exchange position.

9. The appraisal report estimates the total cost of the project at US$62.2 million equivalent. The proposed Association credit would finance the total estimated foreign exchange cost of US$12.8 million and approximately one-half of local expenditures.

10. Procurement - (Paragraph 10 is virtually identical with paragraph 9 of the Area Memorandum on the Haryana Agricultural Credit project distributed on March 19, 1971.) Procedures for tractor procurement would follow those established in other Indian agricultural credit projects. Farmers would choose their preferred make of tractor after being apprised of unit prices offered by eligible suppliers for bulk orders at varying quantities. Eligible suppliers would be restricted to those manufacturing or approved to manufacture tractors in India. The Association would disburse only against imported tractors. The number of eligible suppliers is now five (including dealers representing suppliers in the U.S., U.K. and Germany) but seven others (including additional dealers from the countries listed above, plus France, Austria and Japan) may become eligible during the three-year project. This arrangement provides adequate competition along with sufficient specialization to encourage maintenance of proper service facilities. As in the case of the Andhra Pradesh project, we propose to stipulate in the credit documents that if any contract is awarded despite the reasonable objection of the Association, an appropriate amount of the credit may be cancelled.

11. Hard steel components for tractor implements, which are in short supply in India, and well-drilling and earth-moving machinery would also be procured through international competitive bidding. Some well-drilling equipment and earth-moving machinery are manufactured in India, but the supply is inadequate for current needs. Procurement arrangements will be on the basis of international bidding including the usual preference for domestic suppliers at the level of the existing tariff or 15 percent which ever is lower. I do not expect the Government of India to ask that these items be reserved for procurement from domestic suppliers, but if any item were to be so reserved we would reduce the amount of the credit accordingly.

Issues

12. The appraisal report makes a number of recommendations with which I largely agree, although several modifications in our approach are suggested in the following paragraphs. These modifications and the reservations which I express have been discussed with the Agricultural Projects Department, and we are agreed on the tactics outlined and the degree to which we will pursue the various recommendations during negotiations.

13. Expatriate technical consultants are recommended by the appraisal report for the State Groundwater Directorate and it is proposed that SGD be required to obtain such assistance as a condition of effectiveness; an amount of US$200,000 has been allocated for this purpose (paragraph 4.12). Similar provisions were incorporated in the recently approved Andhra Pradesh Agricultural Credit project and were accepted by the Government of India. In other projects, however, the employment of foreign personnel has been resisted, and it is possible that the Government may again argue that in this instance technically qualified personnel can be provided from within India. In view of the overall scarcity of Indian personnel qualified in this field, and because of the particularly difficult problems of groundwater exploitation in Tamil Nadu, for which techniques new to the State must be developed, we believe the employment of qualified hydrology consultants is essential to the success of the project. However, I am not certain that it is necessary or appropriate to make this appointment a condition of effectiveness and during negotiations we will explore questions of timing and other details of the proposed arrangements.

14. Other consultancy services recommended (paragraph 4.13) provide for aerial survey of the crystalline areas of Tamil Nadu and of three neighboring States and for a systems analysis of the Cauvery Delta water resources - both by firms of foreign consultants. The aerial survey would greatly facilitate the appraisal of minor irrigation loans not only in Tamil Nadu and Andhra Pradesh but also in neighboring States, and during negotiations we will seek an assurance that a competent survey be done promptly; however, if the use of an expatriate firm for this work is resisted on security grounds, I do not believe we should insist on it. A systems analysis of the Cauvery Delta would be extremely useful even though it would not be of direct concern in the execution of this project and though there is little likelihood of IDA financing of further surface irrigation development in that area until the water rights dispute between Tamil Nadu and Mysore is resolved. I do not expect strong resistance to the proposed systems analysis by consultants, but if there is such resistance I do not think we should insist on consultants and would be prepared to remove the item from the project.

15. The proliferation of lending institutions is the most difficult issue raised in the report (paragraph 5.01). During its visit to India, the appraisal mission was alarmed at the very rapid rate at which Primary Banks had been established (they had increased in number from 106 to 179 between September 1969 and September 1970), and expressed its concern that this could endanger the efficiency and financial soundness of the LDB itself. As a result, the State Government agreed that, prior to credit negotiations, new Primary Bank openings, over and above those established at that date, would be

restricted to 50 only. Subsequently, this issue was discussed further between ARC and the State Government since officials of ARC were inclined to agree with the mission's findings that a number of newly established (or sub-divided) Primary Banks did not meet minimum standards for organization or staffing; at negotiations I expect ARC and Tamil Nadu jointly to put forward proposals for establishing and maintaining the quality standards of participating banks. Toward this same end, the appraisal report proposes that, as a condition of effectiveness, the ARC, in conjunction with LDB, should present a plan, acceptable to the State Government and to IDA, for itself and its Primary Banks. The appraisal mission also recommends that the suitability of each Primary Bank in project areas be established by ARC before that Primary's lending activities can be included for refinancing under the proposed IDA project. We also expect the ARC plan to include:

(i) arrangements for the distribution and organization of Primary Banks which would ensure the sound management, supervision and financial independence of the LDB system, and

(ii) a list of the Primary Banks and/or branches of commercial banks which would be responsible for project lending and which, wherever possible, would provide participating farmers in each area with a choice of at least two banking institutions.

16. There are, of course, political implications in this question of the Primary Banks' participation in the project and the way in which they are organized. But the problem was explored thoroughly by the mission in India last October. Subsequent visitors to the State (including myself) can confirm that the mission's concern is well understood both at the State level and by ARC and officials in Delhi. As of last fall, the State Government had agreed with ARC on the outlines of a plan for dealing with the problem, and since the same ministers have been returned to power in recent State elections, I am hopeful that ARC is now in a position to make reasonable and detailed proposals. In order to avoid an impasse during negotiations, which are tentatively scheduled to begin on April 26, we have asked the leader of the appraisal mission and the responsible loan officer, both of whom will be in India during the next few weeks on other work, to see whether ARC and LDB have in mind proposals which offer a satisfactory basis for negotiations.

17. I do not consider that it is appropriate to make the acceptance of such a plan a condition of effectiveness of the credit. Preferably, this matter should, and indeed may, be settled during negotiations. However, should the Indian authorities require further time to finalize details of the plan, I would suggest that its acceptance by IDA be made a condition of disbursement of the credit. The Agricultural Projects Department would prefer that the detailed plan be agreed before the project is presented to the Executive Directors, or failing that, that its agreement be made a condition of effectiveness. Perhaps, since we do not yet know how far the ARC, the State Government and the LDB have progressed in the preparation of their plan, a final decision on this tactical question can best be taken during negotiations when more of the facts are known.

18. The need to control groundwater exploitation compounds this problem. There is, of course, no method of achieving complete control over minor irrigation investments without regulatory legislation and an organization to implement such legislation effectively. Pending enactment of regulatory legislation (which is planned but may take a year or two), it is proposed to exert at least partial control through lending institutions operating on criteria developed by the State Groundwater Directorate (paragraphs 4.03 and 4.04). Specifically, it is proposed that minor irrigation investments be forbidden in project areas unless they are part of the project program, and that in other areas of the State, groundwater development be financed only after SGD has certified that it has no objection. It is understood that the LDB will control the lending activities of all its Primary Banks whether they participate in the project or not; it is proposed that control over commercial banks should be achieved by having the Reserve Bank of India (RBI) direct them to conform. Although RBI itself suggested such control informally, we are not at all certain how commercial banks will respond to such restrictions or how RBI will be able to enforce them. Possible alternatives, including SGD control over the State Electricity Board's energization of wells, will also be explored during negotiations.

19. A number of subsidies, which serve to encourage an uneconomic use of groundwater resources, should be removed. The appraisal report (paragraph 4.05) recommends that, as a condition of effectiveness, the State Government should (i) abolish direct well subsidies, (ii) introduce commercial well-drilling charges and (iii) increase charges for mechanized land-levelling. (Similar stipulations were made in the Andhra Pradesh project and rates satisfactory to the Association were implemented before negotiations). I agree that there is also a strong economic case for the removal of these subsidies in Tamil Nadu. But it may be more practical to agree on a schedule of phased action for the removal of subsidies rather than expecting final action before project implementation is started. In any case, I do not think it appropriate for these measures to be conditions of effectiveness.

20. Small farmers are to benefit from smaller downpayments and longer maturities, as in the case of the Andhra Pradesh project, for certain minor irrigation developments and land levelling. In addition, the State Government provides a guarantee for all farmers who are unable to provide sufficient collateral to satisfy the LDB in respect of on-farm investment loans. The appraisal report proposes that this guarantee should be restricted to tenant farmers as a means of discouraging the proliferation of individual wells and encouraging the grouping together of farmers (paragraph 5.10). However, the State may consider our proposal an unacceptable interference in its welfare policies and, if so, I believe we should accept the existing guarantee arrangements after urging that measures be taken to give preference to tenants and to discourage uneconomic proliferation of wells.

Recommendation

21. Subject to the views of the Committee and with reservations expressed above, I recommend that the borrower be invited to negotiate the proposed credit of US$35 million on the basis of the recommendations set out in paragraphs 8.01, 8.02 and 8.03 of the appraisal report.

Gregory B. Votaw
Deputy Director
South Asia Department

Attachments

Population: 556 m
GNP Per Cap: $ 76

INDIA - 5 YEAR LENDING PROGRAM

		($ million)							
		Fiscal Year						Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Agri. Credit - Punjab	IDA	27.5							
Agri. Credit - Gujarat	IDA	35.0							
Agri. Credit - Haryana	IDA		25.0						
Agri. Credit - Tamil Nadu	IDA		35.0						
Agri. Credit - Andhra Pradesh	IDA		24.4						
Agri. Credit - Mysore	IDA			25.0					
Agri. Credit - Maharashtra	IDA			25.0					
Agri. Credit - Unidentified	IDA			25.0					
Irrigation - Kadana	IDA	35.0							
Irrigation - Pochampad	IDA		40.0						
Irrigation - Tawa	IDA			46.0					
Irrigation - Jayakwadi	IDA			20.0					
Irrigation - Unidentified	IDA			20.0					
Agricultural Aviation	IDA		6.0						
Agri. Industry Unident.	IDA			10.0					
Agri. Unident. (7 projects)	IDA				150.0				
Agri. Unident. (7 projects)	IDA					165.0			
Agri. Unident. (7 projects)	IDA						165.0		
Grain Storage	IDA			5.0					
Telecommunications IV	IDA		78.0						
Telecommunications V	IDA				40.0				
Telecommunications VI	IDA					40.0			
Telecommunications VII	IDA						35.0		
DFC - ICICI VIII	IBRD	40.0							
DFC - ICICI IX	IBRD			40.0					
DFC - ICICI X	IBRD						40.0		
Education - Agri. University	IDA			20.0					
Education Unidentified	IDA						20.0		
Fertilizer - Nangal (Public)	IDA			20.0					
Fertilizer - Cochin (Public)	IDA		20.0						
Fertilizer - Debottlenecking	IDA			5.0					
Iron Ore - Marcona	IDA				40.0				
Industry - Tata Fertilizer	IBRD				25.0				
Industrial Imports VI	IDA	75.0							

(Cont'd.)

		($ million) Fiscal Year						Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Family Planning	IDA			15.0					
Power Transmission II	IDA		75.0						
Power Transmission III	IDA			60.0					
Power Unidentified I	IDA				15.0				
Power Unidentified II	IDA					15.0			
Power Unidentified III	IDA						60.0		
Highways II	IDA			30.0					
Railways X	IDA	55.0							
Railways XI	IDA			50.0					
Shipping	IDA			80.0					
Transportation Proj. Unident.	IDA				60.0				
Transportation Proj. Unident.	IDA					50.0			
Water Supply - Bombay	IDA			27.5					
Water Supply Unidentified I	IDA				15.0				
Water Supply Unidentified II	IDA					15.0			
Unallocated I	IDA			16.5					
Unallocated II	IDA				180.0				
Unallocated III	IDA					35.0			
Unallocated IV	IDA						40.0		
	IBRD	40.0		40.0	25.0		40.0	189.0	145.5
	IDA	227.5	303.4	500.0	500.0	320.0	320.0	591.0	1683.4
	Total	267.5	303.4	540.0	525.0	320.0	360.0	780.0	1828.9
	No.	6	8	19	8	6	6	13	44

3/11/71

Note: The IDA lending program is to be adjusted to - 245.0 (1971) 350.0 (1972) 350.0 (1973) 350.0 (1974) 350.0 (1975)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 24, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Yugoslavia - Fifth Highway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 24, 1971 from the Europe, Middle East and North Africa Department, entitled "Yugoslavia - Proposed $35 Million Loan for a Fifth Highway Project" (LC/O/71-42).

2. Comments, if any, should be sent to reach Mr. Kopp (ext. 4711) by 5:00 p.m. on Monday, March 29.

3. It is planned then, if the Committee approves, to inform the Government that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
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The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-42

March 24, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

YUGOSLAVIA - Proposed $35 Million Loan for a Fifth Highway Project

1. Attached for consideration by the Loan Committee is the Appraisal Report (PTR-73) dated March 11, 1971, on the Fifth Highway Project. The Bank has made 16 loans to Yugoslavia totaling $475 million and including four highway loans. Three more projects are under preparation which should lead to lending operations in FY 1971: two tourism projects and a multipurpose water project. The Five-Year Lending Program is attached. A recent economic mission to Yugoslavia is preparing its report; its preliminary findings confirm the priority of the proposed project and Yugoslavia's creditworthiness for Bank lending.

Project

2. The proposed project consists of three parts: (i) construction and supervision of five highway sections, totaling 153 km. in the Socialist Republics of Macedonia and of Slovenia and in the Socialist Autonomous Province of Kosovo; (ii) imported engineering equipment, mainly traffic counters and vehicle weighing scales and (iii) consulting services to assist in improving the standards of project preparation and economic evaluation, traffic engineering, and some aspects of highway design and maintenance. The highway sections constitute the third and last tranche of the highway program submitted by the Government to the Bank in 1968. This would be the first highway project in Yugoslavia financed by the Bank to include engineering equipment and consulting services.

Loan Amount and Possible Local Cost Financing

3. The appraisal mission's estimate of the total project costs has been adjusted to take into account the recent devaluation of the dinar. Total project cost is estimated to be about $87.1 million. However, this estimate is subject to further review with the Government during negotiations, especially as regards equipment purchases and consulting services to be included in the project. The equipment list is still being worked out among the various highway authorities. The detailed requirements, arrangements, and cost estimates for the consulting services also remain to be worked out.

4. The proposed Bank loan of $35.0 million would finance the foreign exchange cost of construction and supervision, of imported equipment and of consulting services. According to the most probable estimate the foreign exchange cost of construction, including supervision and contingencies, would

be \$32.8 million, or 39 percent of these costs (\$84.6 million). The estimate assumes that one of the eight major contracts would be awarded to a foreign firm; this assumption reflects the growing interest of foreign firms in Yugoslav construction and the Government's continuous efforts to attract foreign firms. If all construction contracts were won by Yugoslav firms, Bank loan financing of local currency costs of up to \$2.4 million would be involved. The increase in the foreign exchange component from 15 percent estimated under the Fourth Highway Loan to 37 percent (if all contracts were won by Yugoslav firms) is due to the fact that Yugoslavia has recently become a net importer of major construction materials (asphalt, cement, steel, wood) and that the construction industry is more highly mechanized. The proposed loan tentatively includes \$2.2 million to cover the foreign exchange cost of imported equipment and consulting services, both including contingencies.

Lending Arrangements

5. The loan would be to the Socialist Federal Republic of Yugoslavia which would relend that part allocated to construction to the Republics of Macedonia and Slovenia, and to the Province of Kosovo on substantially the same terms as the Bank loan (25 years including 5 years of grace). The financial and executing arrangements for the purchase of equipment and consulting services are now being considered by the Federal Government and the Republics and Provinces. As for all previous highway projects we expect that the Federal Government will appoint the Yugoslav Investment Bank to administer and coordinate certain aspects of project execution, including international bidding and withdrawal applications.

Procurement

6. Consultants would be selected according to procedures acceptable to the Bank. Most construction contracts would be awarded after international competitive bidding; however, about \$2 million of preparatory construction works in Slovenia (Hoce-Levec section) would be confined to local bidding because they involve numerous small relocations of drainage and irrigation structures which would be unattractive to foreign firms. Furthermore, the equipment purchases (in an amount of about \$1.1 million) would not be subject to international competitive bidding because of standardization for the traffic counters, scales, and office equipment, which would be the same make as those now in use, and because the new type of pavement evaluator is produced by only one manufacturer. Subject to Bank approval, these purchases would be made after receiving and evaluating quotations from suppliers.

Start of Negotiations - Difficulties with the Second Railway Loan (395-YU)

7. In contrast to the satisfactory implementation of all other Bank financed projects in Yugoslavia, the Second Railway Project (395-YU, December 1964) has been seriously delayed, initially due to delays in engineering design and bidding, and later by a shortage of local financing. To expedite execution of the project, the Government and the Bank agreed in May 1970 on a financing plan for that year and the Bank agreed to extend the closing date until March 31, 1973. However, the cash shortage persists. The Government was to

submit by November 30, 1970 a similar plan for 1971, but has not done so until now. The Transportation Projects Department is concerned that lack of progress in the railway project will lead to serious economic dislocations in the transport sector and considers that the financing problem should be surely on its way to solution before any new Bank commitment to the transport sector is made. Therefore, it recommends not to start loan negotiations on the proposed fifth highway project (currently scheduled to start early April 1971) before a Letter of Agreement ensuring adequate local funds in 1971 for the railway project (395-YU) has been agreed upon by the Government and the Bank (cf. paragraphs 6.01 and 1.05 of the Appraisal Report).

8. For the following reasons, I recommend that the Bank not delay negotiations on the proposed highway project, particularly since I believe that this would not help in finding a solution of the railway problems:

(a) In addition to the measures (including a freight rate increase of 9 percent) taken already before the agreement of May 15, 1970, the Yugoslavs took a number of measures during the remainder of 1970 in accordance with this agreement. These included exemption of the railway enterprises from payment of interest to the Business Fund, of contributions payable on income and of interest during construction, refund of taxes, and the prolongation and increase of a loan of the National Bank to the Railway Community. However, it should be noted that the arrangements in the May agreement for covering past deficits have only been partially effective; only about Din 126 million of the Din 332.5 million to be made available in cash in 1970 had been received by November 1970. Also, the proposed reduction of accounts receivable has not been effected.

(b) The fact that the Government has not yet submitted a comprehensive plan to meet the railway deficits in 1971 is not due to lack of cooperation. The Government has already taken some important actions which positively affect the railway position in 1971:

(i) The Railways have been authorized to make a linear freight rate increase of 17 percent effective March 1, 1971 in addition to the passenger rate increase of 15 percent which has been decided by the Railways to become effective on even date.

(ii) The measures taken for 1970 mentioned under (a) above have been or are being renewed with effect for 1971.

(c) Nevertheless, the Assistant Secretary for Finance of the Federal Government, currently here for negotiations of another project, told us frankly in a recent discussion of these problems in the Bank how difficult it would be for the Federal or Republic Governments to prepare a coherent plan for 1971 now. Yugoslavia is in the process of reorganization of economic responsibilities and recalculation of resources. This reorganization is not confined to the transport sector and is subject to change following the current discussions on the Five-Year Plan and on the division of political and economic responsibilities between the Federation and the Republics. Whereas the Republics have not yet taken over the responsibility for covering railway deficits, the Federal Government cannot do so following implementation of the economic reform of 1965. The solution of these constitutional and policy problems has been further complicated and delayed by the recent devaluation of the Dinar which has made necessary a reconsideration of resource availabilities and uses. In spite of these problems we understand that the Government is now trying to complete the measures required to meet the railway deficits in 1971.

(d) Given the fact that the lack of action under the Second Railway Project is primarily due to the Republics, the overlap in the beneficiaries (Roads V: Slovenia, Macedonia, Kosovo - Railways II: Slovenia, Macedonia, Serbia, Croatia, Bosnia-Hercegovina, Montenegro) is not sufficient to secure action by temporarily withholding further road financing, especially so because the Railway Enterprises in Skopje (Macedonia) and Ljubljana (Slovenia) have no financial problems, or at least no substantial problems.

(e) The transport sector mission planned for this year will include an independent team of railway experts. They will examine the railway problems from a fresh point of view and recommend appropriate action. The mission originally scheduled for September 1970 will probably have to be postponed until October 1971 for reasons not related to the transport sector. The mission is to comment on the draft Federal Five-Year Plan and to advise the relevant authorities on sectoral policies; however, preparation of the draft plan has been delayed due to the general problems mentioned in paragraph 8 (c) above. Given the magnitude of the railway problems, the possible inappropriateness of the present agreements due to the changing situation in Yugoslavia and the size of the undisbursed portion of the Railway Loan 395-YU, we should be prepared to consider reappraising and renegotiating this loan.

9. I certainly agree that maximum pressure should continue to be applied to the Yugoslavs. However, I think that we should not delay negotiations on the roads loan until a Letter of Agreement ensuring local funds in 1971 for executing the railway modernization program has been received.

Recommendation

10. I recommend that the Bank invite the Federal Government to send representatives to negotiate a loan of $35 million substantially in accordance with paragraphs 6.02 to 6.05 of the Appraisal Report.

M. P. Benjenk
Director

Attachment

Population: 19.9 m
GNP Per Cap: $570

IVa. YUGOSLAVIA - 5 YEAR OPERATIONS PROGRAM
(By Fiscal Year - Amounts in $ millions)

			1971	1972	1973	1974	1975	1976
4-YUG-AT-02	Forestry II	IBRD			10.0			
4-YUG-DD-01	DFC - YIB I	IBRD		20.0				
4-YUG-DD-02	DFC II	IBRD			25.0			
4-YUG-DD-03	DFC III	IBRD					30.0	
4-YUG-II-04	Industry	IBRD		20.0				
4-YUG-II-03	Industry Modern. IV	IBRD				20.0		
4-YUG-PP-01	Power	IBRD		20.0				
4-YUG-QQ-01	Tourism II - Babin Kuk	IBRD	20.0					
4-YUG-QQ-02	Tourism - Unidentified II	IBRD		15.0				
4-YUG-QQ-03	Tourism - Unidentified III	IBRD				15.0		
4-YUG-QQ-04	Tourism I - Portoroz	IBRD	10.0					
4-YUG-TH-04	Railways	IBRD					30.0	
4-YUG-TH-05	Roads V	IBRD	36.0					
4-YUG-TH-06	Roads VI	IBRD			30.0			
4-YUG-TH-07	Roads VII	IBRD				30.0		
4-YUG-RR-01	Water Supply - Multipurpose I	IBRD	40.0					
4-YUG-RR-02	Water Supply - Multipurpose II	IBRD			25.0			
4-YUG-WE-03	Water Supply - Dubrovnick	IBRD		4.0				
4-YUG-XX-02	Unallocated II	IBRD			10.0			
4-YUG-XX-03	Unallocated III	IBRD				10.0		
4-YUG-XX-04	Unallocated IV	IBRD					15.0	

	Total 1964-68	1969-73	1972-76
IBRD	175.5	429.5	329.0
No.	5	19	17

	1971	1972	1973	1974	1975
IBRD	106.0	79.0	100.0	75.0	75.0
No.	4	5	5	4	3

P & B 3/10/71

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 19, 1971

MEMORANDUM TO THE LOAN COMMITTEE

India - Haryana Agricultural Credit Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 19, 1971 from the South Asia Department, entitled "India - Haryana Agricultural Credit Project" (LC/O/71-40).

2. Comments, if any, should be sent to reach Mr. David Thomas (ext. 2294) by 5:00 p.m. on Wednesday, March 24.

3. It is planned then, if the Committee approves, to inform the Government that the Association is prepared to begin negotiations for the proposed credit on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/0/71-40

March 19, 1971

LOAN COMMITTEE

MEMORANDUM FROM SOUTH ASIA DEPARTMENT

INDIA: Haryana Agricultural Credit Project

1. Attached is an appraisal report (No. PA-80) dated March 9, 1971, entitled India - Haryana Agricultural Credit Project, recommending that the Association make a credit to India of US$ 24.3 million equivalent for this project. Also attached is a copy of the gross operating program as of mid-March; revision of this program is under consideration to ensure a two year (FY 71-72) IDA lending program to India of about $ 600 million.

Background

2. In recent years the Government of India (GOI) has given priority to the introduction of the new agricultural technology through increasing the availability of improved inputs and by providing economic incentives to farmers. In support of this new strategy the Bank Group continues to support institutional credit programs which help farmers finance on-farm investments necessary to make good use of new high-yielding seed varieties, fertilizer and irrigation facilities.

3. This project in the State of Haryana would be the fourth in a series of agricultural credit projects; in addition, a fifth project in Tamil Nadu (US$ 35 million) was appraised in October, 1970 and should be ready for negotiation shortly. Two other agricultural credit projects in Maharashtra and Mysore are now being appraised for presentation early in FY 72; the third such project scheduled for FY 72 will be in either Bihar or Uttar Pradesh.

Bank/IDA Lending Program

4. For the current fiscal year India's allocation from IDA is US$ 245 million, of which US$ 30.4 million has been approved for two credits (Agro-Aviation US$ 6 million and Andhra Pradesh Agricultural Credit US$ 24.4 million). Negotiations on a grain storage project (US$ 5.0 million) were suspended because of GOI's unwillingness to agree to international tendering for silo construction. Appraisal of the Cauvery Delta Irrigation and Drainage Rehabilitation project (US$ 26 million) was completed nearly a year ago, but because of an unexpected interstate water dispute

could not be brought to negotiation. Appraisal reports are now being completed for the Pochampad Irrigation Project (US$ 35 million) and Cochin Fertilizer (US$ 20 million). An appraisal report has been prepared for a second Power Transmission Project (US$ 75 million), which is scheduled for presentation to the Executive Directors on April 27. Negotiations for a Fourth Telecommunications Project (US$ 78 million) will begin on March 17. If all of these credits are negotiated before the end of June, presentation of one or two may have to be deferred to keep within the IDA allocation. Needless to say, appraisal work is proceeding on several other projects which should be ready for negotiation early in FY 72.

5. The latest economic report, "Economic Situation and Prospects of India" (SA - 13a April 29, 1970), indicated that the economy was moving out of the recession brought about primarily by the effect of bad harvests in 1965/66 and 1966/67. It also reported an encouraging improvement in the balance of payments. Despite these favorable developments, India still requires substantial aid on concessionary terms for economic development purposes. I do not expect these conclusions to be altered by the economic report for 1971, which is now being prepared.

The Project

6. The Haryana Agricultural Credit Project would provide IDA financing in support of a three-year program of investments in farm mechanization and in minor irrigation. The borrower would be GOI. The proceeds of the Association credit would be lent to farmers through the Agricultural Refinance Corporation (ARC, the all-India institution which is participating in the earlier projects of this nature), the Haryana State Cooperative Land Mortgage Bank (LMB) and its federated Primary Land Mortgage Banks, and selected commercial banks (which would be required to accept the same terms and conditions of lending to farmers as the LMB). An innovation in the Haryana project is the proposal to finance, on a small scale, sprinkler irrigation which could be less expensive than traditional forms in certain areas of the State (paragraph 3.06).

7. Benefits to the Indian economy would result from a higher cropping intensity, which would increase the production of foodgrains and other commercial crops, and from a shift which could be made in the cropping pattern to more valuable and more labor intensive crops. At full production, which is expected by 1978, gross production value would have increased by about US$ 32 million equivalent a year, and increased production in foodgrains, vegetable oils and cotton, commodities in which India is not as yet self-sufficient, would lead to foreign exchange savings. Based on projected world market prices the overall rate of return to the economy would be about 15% for mechanization and between 22% and 27% for irrigation. Sensitivity tests using a rate of exchange

(9.50 rupees to US$ 1) which more accurately reflects the effective cost of imports in India yield higher rates of return (paragraph 6.02). Because of high domestic support prices, particularly for wheat, benefits to farmers are estimated to be high with financial rates of return at present prices ranging from 39% to 66% for minor irrigation and at about 40% in the case of mechanization.

8. The appraisal report estimates the total cost of the project at about US$ 43 million equivalent. The proposed credit would finance the total estimated foreign exchange cost of US$ 21.9 million and make a contribution to local expenditures on minor irrigation investments. US$ 2.7 million equivalent of the foreign exchange costs represents the c.i.f. value of dealers' initial imports of tractor spares, which we might not finance in other circumstances. However, our intention is to finance not only the foreign exchange cost of tractors but also 50% of the cost of minor irrigation works. By making funds available to finance imported spares we reimburse India promptly for foreign exchange expenditures incurred. These funds will be re-lent to ARC along with a percentage of minor irrigation expenditures in order to bring IDA's contribution to these costs to about 50%. Farmers, contractors and dealers will provide 28% of the total project costs; a proportion we believe to be reasonable and desirable as a means of mobilizing local resources and yet ensure that as large a number as practical become beneficiaries under the project. The LMB and participating commercial banks will contribute 15% and ARC the balance of 57%. In effect, the IDA credit (56%) will more or less fully refinance the amount provided by ARC (paragraph 3.13).

9. Procedures for tractor procurement would follow those established in other Indian agricultural credit projects. Farmers would choose their preferred make of tractor after being apprised of unit prices offered by eligible suppliers for bulk orders at varying quantities. Eligible suppliers would be restricted to those manufacturing or approved to manufacture tractors in India. The Association would disburse only against imported tractors. The number of eligible suppliers is now five (including dealers representing suppliers in the US, UK and Germany) but seven others (including additional dealers from the countries listed above, plus France, Austria and Japan) may become eligible during the three-year project. This arrangement provides adequate competition along with sufficient specialization to encourage maintenance of proper service facilities. As in the case of the Andhra Pradesh project, we propose to stipulate in the credit documents that if any contract is awarded despite the reasonable objection of the Association, an appropriate amount of the Credit may be cancelled.

10. Self-propelled combines, which are not presently manufactured in India, will be procured by international competitive bidding. In the case of tractor-drawn harvesters, international competitive bidding will also apply but local manufacturers are expected to compete with a level of preference of 15%. There is considerable implement manufacturing capacity

in India, and especially in Haryana; the present supply is adequate, and quality and prices are reasonable. However, hard steel components for tractor implements are in short supply in India and importation after international competitive bidding would be essential to ensure that adequate supplies of implements of acceptable quality would be available for the project. Implement costs, except for the foreign exchange cost of imported components, have been excluded from project costs for the purposes of the financing plan, because of GOI's insistence on reserved procurement.

Issues

11. The relatively low price of imported tractors, especially in relation to current Indian crop prices, attracted the attention of some Executive Directors when the Gujarat project was discussed (May, 1970) and also during Loan Committee consideration of the Andhra Pradesh Agricultural Credit project (October, 1970). As a result, we requested GOI to undertake an immediate review of tractor prices and to present definite proposals on appropriate measures to increase prices, preferably before the Haryana project was negotiated, since it was already expected to contain a large allocation for imported tractors. Nevertheless, we do not at this time intend to make any specific requirement regarding price increases, since tractors are still on the "zero tariff" list under the GATT. In 1968 in accordance with GATT procedures the Government of India initiated discussions to be released from the zero tariff; these negotiations, which are, of course, not wholly within GOI's control, have not yet been concluded. We understand that there are only a few remaining problems raised by U.S. and U.K. concerning the compensatory concessions on a number of items offered by India; the GOI is hopeful that a successful conclusion can be reached within the next few months. The GATT negotiations were undertaken with a view to the imposition in due course of a tariff on tractors. Under the circumstances, I see little point in making a price increase through a tariff adjustment a condition of the proposed Haryana credit. It is our intention, however, to make it clear to GOI that after this and the Tamil Nadu Agricultural Credit project, (which should be before Loan Committee within a few days), no further tractor financing will be submitted for approval of the Executive Directors unless an acceptable increase in tractor prices is achieved or assurances obtained that such a price increase is imminent. In the meantime, however, we continue to appraise projects with a tractor component.

12. The effect of mechanization on rural employment was an issue which attracted the attention of Executive Directors during the presentation of the Punjab and Andhra Pradesh credits (June and December, 1970, respectively). Annex 2 discusses this matter in some detail and presents the special facts relating to the situation in Haryana. It is not possible to quantify the net effect of mechanization on total labor use on the basis of the evidence available at present. However, there are good

indications that the increased cropping intensity and the probable shift to higher valued crops will create new job opportunities. Furthermore, since most of the farm labor force in the State of Haryana owns land, or has some form of tenancy arrangement, and only 12% are landless laborers; and since there is a shortage of labor during peak cultivation periods; the immediate danger of creating a new unemployment problem as a result of this mechanization project seems minimal. These conclusions have been reached only after serious and careful assessment of all the information presently available.

13. In order to improve our knowledge regarding the short and long run effects of mechanization on rural unemployment, the Economics Department, in collaboration with Projects and Area, is planning to commission a comprehensive study in the States of Gujarat and the Punjab. Indian research institutions would be responsible for much of this work. We hope that these studies will provide better information and more thorough analysis regarding the employment effects of the type of agricultural mechanization and intensification to be financed under the proposed Haryana project.

14. Concessionary terms for smaller farmers in the Andhra Pradesh Credit project were provided by extending maturity periods and reducing down-payments in respect of minor irrigation and land levelling. The GOI has not proposed any similar softening of lending terms for this project, nor do we consider them necessary. The minor irrigation component consists almost entirely of tubewells, the main components of which have an economic life of only seven years (whereas in the Andhra Pradesh project much of the minor irrigation was in the form of longer-lived dugwells). Nor are smaller down-payments warranted, since 15% (out of 20% required) can be contributed in kind (including the labor of the borrower). Furthermore, in Haryana, another agency, the Small Farmers Development Association, is working out special projects to cater for the needs of about 100,000 small farmers during the next few years. Nevertheless, during negotiations it is possible that the State Government will propose some form of concessionary lending for small farmers; and if this happens, we are prepared to consider the proposal on its merits.

15. Appointments. Since many of the general issues affecting this type of project have been resolved during negotiations of earlier projects, I do not expect any major difficulty in this case. Moreover, there is no need to employ consultants, nor are there significant subsidies on State-sponsored services, which we wish removed. The report recommends that the appointment by LMB of an Agricultural Economist and a Chief Inspecting Officer should be a condition of effectiveness of the credit. These new posts were readily agreed to during appraisal. It is possible that the appointments have already been made. If this is not the case, they should be made promptly. Nevertheless, I am not convinced that it is appropriate to make such appointments conditions of effectiveness. Therefore, if

appointments have not already been made, we shall explore alternative safeguards during negotiations.

Credit Amount

16. The appraisal report recommends a credit of $ 24.3 million. I would suggest that this amount be rounded to $ 25 million and the appraisal report modified accordingly. I do not understand how a less "rounded" figure can be justified for a three-year farm improvement program of this kind and there is little in our previous experience with India which would justify this appearance of accuracy. Our intention is to finance a portion of a continuing program; if this credit provides more finance for minor irrigation and mechanization than can be justified in the next three years, the balance can be cancelled at the end of that period.

Recommendations

17. I recommend that the borrower be invited to negotiate a credit of US$ 25 million on the basis of the recommendations set out in paragraphs 7.01 and 7.02 of the appraisal report, as qualified by the comments in this memorandum.

G. B. Votaw
Deputy Director
South Asia Department

Attachments

Population: 556 m
GNP Per Cap: $ 76

INDIA - 5 YEAR LENDING PROGRAM

		($ million)							
		Fiscal Year						Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Agri. Credit - Punjab	IDA	27.5							
Agri. Credit - Gujarat	IDA	35.0							
Agri. Credit - Haryana	IDA		25.0						
Agri. Credit - Tamil Nadu	IDA		35.0						
Agri. Credit - Andhra Pradesh	IDA		24.4						
Agri. Credit - Mysore	IDA			25.0					
Agri. Credit - Maharashtra	IDA			25.0					
Agri. Credit - Unidentified	IDA			25.0					
Irrigation - Kadana	IDA	35.0							
Irrigation - Pochampad	IDA		40.0						
Irrigation - Tawa	IDA			46.0					
Irrigation - Jayakwadi	IDA			20.0					
Irrigation - Unidentified	IDA			20.0					
Agricultural Aviation	IDA		6.0						
Agri. Industry Unident.	IDA			10.0					
Agri. Unident. (7 projects)	IDA				150.0				
Agri. Unident. (7 projects)	IDA					165.0			
Agri. Unident. (7 projects)	IDA						165.0		
Grain Storage	IDA			5.0					
Telecommunications IV	IDA		78.0						
Telecommunications V	IDA				40.0				
Telecommunications VI	IDA					40.0			
Telecommunications VII	IDA						35.0		
DFC - ICICI VIII	IBRD	40.0							
DFC - ICICI IX	IBRD			40.0					
DFC - ICICI X	IBRD						40.0		
Education - Agri. University	IDA			20.0					
Education Unidentified	IDA						20.0		
Fertilizer - Nangal (Public)	IDA			20.0					
Fertilizer - Cochin (Public)	IDA		20.0						
Fertilizer - Debottlenecking	IDA			5.0					
Iron Ore - Marcona	IDA				40.0				
Industry - Tata Fertilizer	IBRD				25.0				
Industrial Imports VI	IDA	75.0							

(Cont'd.)

($ million)

		Fiscal Year 1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73
Family Planning	IDA			15.0					
Power Transmission II	IDA		75.0						
Power Transmission III	IDA			60.0					
Power Unidentified I	IDA				15.0				
Power Unidentified II	IDA					15.0			
Power Unidentified III	IDA						60.0		
Highways II	IDA			30.0					
Railways X	IDA	55.0							
Railways XI	IDA			50.0					
Shipping	IDA			80.0					
Transportation Proj. Unident.	IDA				60.0				
Transportation Proj. Unident.	IDA					50.0			
Water Supply - Bombay	IDA			27.5					
Water Supply Unidentified I	IDA				15.0				
Water Supply Unidentified II	IDA					15.0			
Unallocated I	IDA			16.5					
Unallocated II	IDA				180.0				
Unallocated III	IDA					35.0			
Unallocated IV	IDA						40.0		
	IBRD	40.0		40.0	25.0		40.0	189.0	145.5
	IDA	227.5	303.4	500.0	500.0	320.0	320.0	591.0	1683.4
	Total	267.5	303.4	540.0	525.0	320.0	360.0	780.0	1828.9
	No.	6	8	19	8	6	6	13	44

3/11/71

Note: The IDA lending program is to be adjusted to - 245.0 (1971) 350.0 (1972) 350.0 (1973) 350.0 (1974) 350.0 (1975)

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

DECLASSIFIED

SEP 05 2014

WBG ARCHIVES

LC/M/71-5

March 19, 1971

Minutes of Loan Committee Meeting held at 4:00 p.m. on Thursday, February 4, 1971 in the Board Room.

A. Present:

J. Burke Knapp, Chairman
Mr. S.R. Cope
Mr. S. Aldewereld
Mr. W.C. Baum
Mr. M.P. Benjenk
Mr. B. Chadenet
Mr. R. Chaufournier
Mr. D.J. Fontein
Mr. K.G. Gabriel
Mr. H.N. Graves
Mr. E.K. Hawkins
Mr. M.L. Lejeune
Mr. L. Nurick
Mr. G. Votaw
Mr. G.K. Wiese
Mr. I.M. Wright
Mr. David Pearce, Secretary

In Attendance:

Mr. R. Adams
Mr. H.B. Bachmann
Mr. D. Bahl
Mr. B. Cheek
Mr. W. Diamond
Mr. J. Elkouby
Mr. T.M. Jones
Mr. R. Meda
Mr. L.A.G. Moss
Mr. R. Sadove
Mr. J.G. Yenny

B. Senegal - Urban Site and Services Project

1. The Committee considered a memorandum dated January 26, 1971 from the Western Africa Department entitled "Senegal - Request for Bank Assistance in Financing an Urban Site and Services Project" (LC/O/71-10), which recommended that the Bank should consider financing a project designed to accommodate part of Senegal's low-income urban population, specifically the clearing

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Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

Copies for Information:

President
The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

and plotting of land, the installation of drainage, sewerage and water systems and sanitary facilities, and the construction of roads. The total cost of this urban development program, accommodating about 100,000 people on 360 ha. in Dakar and about 60,000 on 200 ha. in eight other cities, would be about $10 million, of which the Dakar component would represent $6.5 million.

2. The Committee, noting that Senegal's "Parcelles Assainies" program, of which the proposed project would form a part, constituted a new and practical approach to the urban problems now confronting many developing countries, endorsed the principle of Bank Group financing for this type of project.

3. The Committee also noted that:

(a) Subject to certain minimum specifications, settlers would be permitted to build on their parcels of land whatever housing was within their means. Experience in a pilot project in Pikine, a suburb of Dakar, and also in similar projects in Korea, Chile, Peru and Turkey indicated that the quality of such housing improved as the owners' incomes increased.

(b) Settlers would be given technical assistance in constructing their own housing. The provision of ancillary "community extension services" would be crucial to the success of the scheme.

(c) By providing basic urban infrastructure and encouraging self-help housing, the project would create both private and public savings. It would also generate substantial indirect benefits, such as improved health and welfare and increased labor productivity. Its economic justification would be conceptually similar to that of a population project.

(d) Bank association with the project would, in addition to helping Senegal minimize the economic and social costs of urbanization, serve as a vehicle for acquiring experience in a new area of operations. If successful, it would also "demonstrate" one solution to a problem shared by many developing countries.

4. The Committee approved the Western Africa Department's recommendation that, subjec to appraisal, the Bank should advise the Government of its agreement in principle to consider financing the proposed Parcelles Assainies project.

Secretary's Department
March 19, 1971

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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March 19, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Turkey - Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 19, 1971 from the Europe, Middle East and North Africa Department, entitled "Turkey - Education Project" (LC/O/71-39).

2. Comments, if any, should be sent to reach Mr. Mendoza (ext. 4811) by 1:00 p.m. on Wednesday, March 24.

3. It is planned then, if the Committee approves, to inform the Government that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

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LC/0/71-39

March 19, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

TURKEY - Education Project

1. This memorandum recommends a Bank loan of $13.5 million to finance the foreign exchange component of school construction, furniture and equipment and of related technical assistance. A report entitled "Appraisal of an Education Project in Turkey" (PE-28), dated March 16, 1971, is attached hereto in support of the recommendation. No significant policy issue is involved in this project.

Background

2. Bank Group lending to Turkey to date consists of nine credits and twelve loans amounting to $284.1 million, of which $89.3 million is still undisbursed. Despite early delays on some of the projects, execution has been generally satisfactory. The proposed loan is the third operation to be submitted to the Board in this Fiscal Year, a $40 million loan to TSKB and a $4.5 million IDA credit for a dairy product project, having been approved in November 27, 1970, and February 22, 1971, respectively; four other projects are still under consideration by the Bank Group for FY 1971 for a fertilizer project ($23 million), agriculture (fresh fruits and vegetables - $25 million of which $15 million from IDA), and power (two projects totaling $30.5 million). Further processing of these projects will be kept under review in the light of developments in the political situation. The Bank's lending program for the next five years (copy attached) envisages total lending of about $700 million.

The Economy

3. A report entitled "The Development Prospects of Turkey" (EME-30a, dated February 1, 1971) describes Turkey's economic performance and appraises the country's prospects. After the devalu-

ation and the complementary stabilization program adopted in August 1970, the short term management of the economy has been good. Intensive efforts are being made to encourage exports and spur investment in private industry. The annual program for 1971 envisages an export increase of some 10 percent, particularly in manufactured exports. However, relative price adjustments due to devaluation still have to be absorbed in final costs. There are also large increases in salary costs, and increased costs of imports for the public sector which have to be met by the Budget. Firm economic management will be important in the coming months if Turkey is to build a suitable environment for rapid progress towards external viability. Despite these problems, appropriate policies should enable Turkey to achieve in the long run a 7 percent growth rate and still maintain reasonable internal price stability. But the balance of payments remains vulnerable, and the foreign exchange reserves are not sufficient to tide the country over any adverse developments and allow significant liberalization.

4. Turkey will continue to need substantial foreign assistance for some time to come. The debt service burden in 1970 was about 19 percent of total foreign exchange earnings, but with the expected growth of foreign exchange earnings it could drop to about 16 percent in 1977. Although Turkey should continue to seek as much foreign aid as possible on concessionary terms, it has a margin for borrowing on conventional terms.

The Project

5. The proposed project would be the first Bank operation in the education sector in Turkey and would improve and expand the present educational system by providing equipment for a number of existing schools throughout the country as well as for the Service Equipment Production Center and the Educational Film, Radio and Television Center. Construction of a new Management Training Institute and six new Adult Training Centers and the equipment for these institutions will represent about one-third of the project cost. Technical assistance in the form of fellowships abroad and the services of expatriate specialists in the country to assist the above institutions in implementing new curricula, introducing new teaching methods and modernizing educational equipment production techniques, is also included in the project.

6. The project is expected to reduce the increasing shortage of technicians, craftsmen, semi-skilled workers and managerial personnel which constitutes an obstacle to the industrial development of the country. A sufficient supply of teachers is ensured by current government programs to expand teacher training institutions and by the assistance provided for in the project to complement these programs. A UNDP project will also aid the supply of instructors.

7. The two new features that this project will introduce in the country's educational system are: (i) the establishment of two new types of institutions; and (ii) the participation of industry in the development of training policies in order to relate training to the manpower needs of the country. The establishment of a residential management training institute responds to the acute shortage of managerial skills in the country. The six adult training centers to be set up in the major towns of Turkey have the dual objective of providing employable skills to immigrants coming from rural to industrial areas, and of reducing the immigrants' problem of adjustment to a different environment and way of life. Participation of industry in the development of training policies will be ensured through the establishment of local advisory committees with representatives from local industries for each technician school and through the establishment of a committee at the national level with representatives from the ministries concerned, chambers of commerce and industry and state enterprises, to advise the Ministry of Education on these matters.

8. Total cost of the project (including contingencies) is estimated at $17.9 million of which $12.7 million in foreign exchange. The proposed loan would cover the foreign exchange component of the project plus interest and other charges on the loan during construction, which are estimated at $0.8 million.

9. Part of the project will be executed (establishment of the two new types of institutions) by a project unit to be set up in the State Planning Organization and the remainder by another project unit to be established in the Ministry of Education. A project Director, responsible to the Undersecretary of the State Planning Organization, will coordinate the work of the two units and will be responsible for the financial and administrative control of the project as well as

for communication with the Bank. No difficulties are foreseen in the proposed arrangements for the administration of the project. Contracts for civil works and procurement of equipment and furniture will be awarded on the basis of international competitive bidding on packages of a sufficient size to encourage foreign contractors and equipment producers to participate in the bidding.

Recommendation

10. I propose that the Bank invite the Turkish Government to negotiate a $13.5 million loan along the lines of the recommendations of paragraphs 6.01 and 6.02 of the attached appraisal report.

Munir P. Benjenk
Director
Europe, Middle East and North Africa
Department

Population: 35.7 million
Per Cap. Inc: $213

Attachment 1

TURKEY - ACTUAL AND PROPOSED LENDING THROUGH 1976

($ millions)

		Through	Fiscal Years													Total	Total	Total
		1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1964-68	1969-73	1972-76
Livestock I - Dairy	IDA									4.5								
" II -	IDA										15.0							
" III - Dairy	IDA											10.0						
" IV -	IDA													20.0				
Fruit-Vegetables I	IBRD									10.0								
" I	IDA									15.0								
" II	IDA											15.0						
" III	IDA													20.0				
Seyhan Irrigation I	IDA	20.0																
" II	IBRD							12.0										
" II	IDA							12.0										
Irrigation Rehabilitation I	IDA										10.0							
" " II Unident.	IDA												15.0					
" " III "	IDA														25.0			
Irrigation Ceyhan-Aslantas	IBRD										55.0							
Grain Silos	IBRD	3.9																
Agriculture Credit I Unident.	IBRD											15.0						
" II "	IBRD													20.0				
Agriculture Unidentified I	IDA												25.0					
" " II	IDA														30.0			
DFCs - TSKB I & II	IBRD	18.0																
" III	IDA	5.0																
" IV & V	IDA			15.0														
" VI	IBRD					10.0												
" VI	IDA					15.0												
" VII	IBRD							25.0										
" VIII	IBRD									40.0								
" IX	IBRD											40.0						
" X	IBRD													40.0				
- Second Company I	IBRD												15.0					
" " II	IBRD														15.0			
Education I - Vocational	IBRD									12.0								
" II - Agricultural	IBRD											10.0						
IGSAS Fertilizer	IBRD									23.0								
Eregli Steel	IBRD										65.0							
Paper Mill - Forestry	IBRD											20.0						
Industry & Mining - Unidentified I	IBRD												40.0					
" " " II	IBRD														25.0			
Power - Seyhan	IBRD	25.2																
- Keban Transmission	IBRD							25.0										
- TEK I	IBRD									24.0								
" II Unidentified	IBRD											35.0						
" III "	IBRD													35.0				
- Cukurova I	IDA	1.7																
" II	IDA			24.0														
" III	IBRD							11.5										
" IV	IBRD									6.5								
Urbanization I (incl. water & power)	IDA										15.0							
" II (incl. sewerage)	IDA											15.0						
" III	IDA													15.0				
Ports I & II	IBRD	16.3																
Tourism I	IBRD										5.0							
" Unidentified II	IBRD												15.0					
" " III	IBRD														20.0			
Railways I	IBRD										35.0							
" Unidentified II	IBRD												40.0					
" " III	IBRD														35.0			
Program Loan	IBRD											40.0						
Operations program	IBRD									115.5	160.0	160.0	110.0	95.0	95.0		509.0	620.0
	IDA									19.5	40.0	40.0	40.0	55.0	55.0		111.5	230.0
	Total									135.0	200.0	200.0	150.0	150.0	150.0		620.5	850.0
	No									7	7	9	6	6	6		27	34
Lending program	IBRD	63.4				10.0		73.5		86.0	130.0	130.0	80.0	65.0	65.0	10.0	419.5	470.0
	IDA	26.7		39.0		15.0		12.0		19.5	40.0	40.0	40.0	55.0	55.0	54.0	111.5	230.0
	Total	90.1		39.0		25.0		85.5		105.5	170.0	170.0	120.0	120.0	120.0	64.0	531.0	700.0
	No	9		2		1		4		5	6	8	5	5	5	3	23	29
IBRD o/s inc. undisbursed		41.2	37.2	32.9	29.2	36.0	32.4	102.5	100.0	181.8	307.1	431.7	505.9	564.2	622.1			
exc. undisbursed		41.2	37.2	32.9	29.2	28.8	29.9	33.1	42.0	57.9	87.2	164.8	239.0	330.3	427.2			
IBRD - gross disbursements		60.7	-	-	-	2.8	4.8	6.5	11.3	20.1	34.0	83.0	80.0	98.0	104.0			
- net disbursements		41.2	-3.9	-4.2	-3.7	-0.6	1.3	3.6	8.8	15.9	29.3	77.6	74.2	91.3	96.9			
- net transfer		21.2	-5.8	-5.2	-5.2	-1.9	0.1	2.1	6.4	12.6	23.6	67.1	58.4	79.6	79.0			
IBRD/IDA - gross disbursements		61.0	4.7	6.7	15.4	20.0	21.2	17.5	20.5	24.9	42.6	97.2	105.0	124.5	137.0			
- net disbursements		41.5	4.7	6.7	15.4	16.6	17.7	14.6	18.0	20.7	37.9	91.5	98.8	117.1	129.1			
- net transfer		21.5	1.1	1.5	10.1	15.0	16.1	12.7	15.1	16.8	31.6	80.2	82.1	88.3	99.8			
European Investment Bank - gross disbursements				0.2	6.6	22.5	30.3	35.0	24.0	26.0	30.0	35.0	40.0	45.0	45.0			

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 18, 1971

MEMORANDUM TO THE LOAN COMMITTEE

India - Second Power Transmission Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 18, 1971 from the South Asia Department, entitled "India - Second Power Transmission Project" (LC/O/71-38).

2. Comments, if any, should be sent to reach Mr. Abd El Aty (ext. 2019) by 5:00 p.m. on Monday, March 22.

3. It is planned then, if the Committee approves, to inform the Government that the Association is prepared to begin negotiations for the proposed credit on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
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Copies for Information:

President
The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-38

LOAN COMMITTEE

March 18, 1971

MEMORANDUM FROM SOUTH ASIA DEPARTMENT

INDIA - SECOND POWER TRANSMISSION PROJECT

1. Attached is a draft appraisal report dated February 26, 1971, recommending that the Association make a credit of US$75.0 million equivalent to India for a second power transmission project. Also attached is a copy of the gross operating program for India; revisions of the program are under consideration with a view to ensuring IDA lending to India of about US$600 million in the two years FY 71/72.

Background

2. The Bank has made thirty-nine loans to India for a total of US$1.05 billion and the Association thirty development credits totalling US$1.3 billion, in each case net of cancellations. Of these loans and credits, twelve, amounting to US$232 million, have been for power development.

3. The proposed credit would assist in financing power transmission development programs to be carried out by nine State Electricity Boards (SEBs) as part of their $2 billion investment program in the current Plan period (1970/74) and would aid in institutional improvements particularly in the area of financial management.

Bank/IDA Lending Program

4. For this fiscal year, India's allocation from IDA is US$245 million of which US$30.4 million has been approved for two credits (Agro-Aviation US$6 million and Andhra Pradesh Agricultural Credit US$24.4 million). Negotiations for a fourth Telecommunications Project (US$78 million) will begin on March 17. Appraisal reports have been completed for two agricultural credit projects (Tamil Nadu US$35 million and Haryana US$25 million), and are being prepared for Pochampad Irrigation (US$35 million) and Cochin Fertilizer (US$20 million). We propose to negotiate all these credits before June 30; however, presentation to the Executive Directors may have to be deferred in one or two cases to keep within the IDA allocation. Appraisal work is also proceeding on several other projects with a view to their negotiation early in FY 72.

5. The most recent economic report, "Economic Situation and Prospects of India" (SA-13a, April 29, 1970), indicated that the economy was moving out of the recession, brought about primarily by the effect of two bad harvest years in 1965/66 and 1966/67. It also reported an encouraging improvement in the balance of payments. The report concluded that despite these favorable developments, India still requires substantial aid on concessionary terms for economic development purposes. I do not expect these conclusions to be altered by the economic report for 1971, which is presently being prepared.

The Project

6. The proposed project is to finance the purchase of equipment and materials required to implement power transmission programs in nine States of India. Transmission works to be financed include about 5,500 circuit km of transmission lines operating at voltages between 66 kV and 220 kV and about 90 substations with an aggregate capacity of about 4,200 MVA. These are being constructed by the SEBs as part of their Fourth Plan development programs. The nine Boards participating in this project propose a total investment for the years 1970/74 of about $2,260 million equivalent, of which $750 million is for the development of transmission and distribution facilities and another $410 million is for rural electrification. Another project, providing similar financing for the SEBs not included in the present proposal, is scheduled for appraisal later in 1971.

7. Per capita consumption of electric power in India has been growing at a rate of about 10 percent per annum during the last twenty years, and is expected to continue at a similar rate over the next few years. In order to meet this rising demand, India plans to expand installed capacity from 15.5 million kW in March 1970 to 22 million kW by March 1974. About 70 percent of total energy production is utilized in the industrial sector, 11 percent in the domestic sector, 7 percent in the agricultural sector and the remainder in other sectors.

8. The power sector has changed significantly in recent years. Interconnection of transmission systems within each state was largely accomplished during the late 1960's, and plans are being implemented to integrate transmission systems on a regional basis. Most types of electrical equipment are now manufactured in India, and significant export orders have been obtained recently. SEBs, which were organized from government departments in the late 1950's, are seeking greater autonomy to manage their own affairs. On the financial side, a commercial form of accounts has been adopted,and increasing use is being made of new sources of financing (e.g. commercial banks, the Life Insurance Corporation and the Agricultural Finance Corporation), so that Boards are no longer wholly dependent on loans from their state governments to supplement internal cash generation. Progress in institutional reform, while substantial, is far less than growing demands on the power system require. I believe that the pace of reform could be accelerated, if greater commitment of Bank staff members' time and effort were made.

Procurement

9 We have agreed with GOI that all procurement for the project will be on the basis of international competitive bidding. In evaluating bids, a preference of 15% will be allowed for domestic manufacturers, although the prevailing import duties for such items (and indeed the across-the-board tariff which IMF and Bank economists consider similar to a foreign exchange tax) are significantly higher than 15%. We understand that GOI intends to give the benefit of its normal export incentives for this type of equipment to domestic manufacturers participating in bidding under the project. We expect that Indian manufacturers will win an important share of the bids and

that these arrangements for international competition will result in some reduction in prices to participating SEBs. The estimated cost of equipment and materials to be financed by the credit is about Rs 562 million, equivalent to US$75 million. This estimate is based on ex-factory prices for recent bids for similar goods with, however, some allowance for reductions expected to result from international competitive bidding (paragraphs 5.03-5.08).

10. The first Power Transmission Project (Loan No. 416-IN) financed only imported equipment and the foreign exchange component of some locally produced items. In the years after 1965, when that Project was approved, Indian policies placed more and more emphasis on self-sufficiency, insisting on indigenous procurement wherever possible and apparently without much regard for cost or delay. Largely as a result of these policies $20 million of the original $70 million was cancelled, and the remaining $50 million financed imported equipment and materials for a substantially larger project, implemented over 5-1/2 years instead of the originally intended three. Most of these changes are well summarized in Annex V of R68-137.

11. Because of the different concept of this new project, which is not limited to imported items, the appraisal mission does not expect a repetition of the difficulties experienced under Loan No. 416-IN. Moreover, procurement procedures have been simplified. Items reserved for local procurement have already been excluded from the project. Delays in ordering should not occur, and GOI has agreed to issue import permits promptly as required and without further administrative review. These arrangements will be confirmed during negotiations. Finally, the credit will provide that disbursements can be made only in respect of orders placed not later than 18 months after the signing of the agreement, i.e. up to about December 31, 1972 (paragraphs 5.06-5.10).

Financial Reforms

12. An important objective of Loan No. 416-IN was the implementation of institutional reform in SEBs by improving their earnings, their financial management and their accounting systems. All SEBs were beneficiaries and all, together with their respective State Governments, gave GOI undertakings satisfactory to the Bank regarding financial policies. According to these undertakings, SEBs were to achieve the GOI target of an 11 percent return on assets within an agreed period of time - generally, no later than 1970/71, in some cases two or three years earlier. (Originally, the Bank had proposed a target return of 10 percent on net assets in operation, but we agreed to the higher target, recommended by a committee of state power ministers, after it had been accepted by GOI.) By 1968, partly because of the economic recession of 1965/67, these targets had to be revised and SEBs' undertakings are now on a more realistic basis (paragraphs 1.03 - 1.04).

13. Although Loan No. 416-IN has been instrumental in effecting improvements in the financial operations of the SEBs, much more needs to be done. Accordingly, in this project, the first in what is expected to be a series of similar projects, we propose to concentrate on two aspects of the SEBs' financial condition which appeared to warrant immediate attention. These are

the impact of rural electrification and the problem of the substantial accumulation of unpaid interest. Rural electrification appears to account for about 20 percent of the total assets of the nine SEBs, yet the financial information presently available is not in a form which can readily identify the precise effects of rural electrification on SEB finances. It appears, however, that tariffs for rural electricity are generally of a concessionary nature and seriously impair SEB finances. Therefore, in accordance with an informal understanding reached during appraisal, GOI is preparing financial data in respect of each SEB for rural electrification, separated from other operations. This should clearly identify the problems involved and permit consideration of possible solutions. The credit agreement will provide for a formalization of the understanding reached in the field and for the information to be submitted to the Association in accordance with an agreed timetable. Agreement will also be sought on the need to prepare data on the effects of concessionary tariffs for certain industrial users.

14. The capital structure as well as the financial situations of some Boards has been distorted by the accrual of large amounts of interest due on loans from State Governments (paragraphs 4.05 et seq); therefore GOI has been asked to discuss the appropriate treatment of these items with State Governments and SEBs and to make proposals with regard thereto by a date to be agreed upon. This understanding will also be confirmed during negotiations. The treatment of interest is part of a wider problem concerning the overall financial structure of SEBs, certain provisions of the Electricity (Supply) Act and tariff structures generally. These broader issues will receive more specific attention in subsequent lending operations after the requested financial data has been analysed.

Justification

15. It is obvious that the expansion of transmission and distribution facilities must keep pace with the installation of generating plant if growing demand is to be served properly, and under the Fourth Plan India aims to achieve this balance. The proposed credit will assist SEBs in using their existing generating capacity more effectively; moreover, as a result of international competitive bidding, prices paid by SEBs for transmission line materials and substation equipment should be lower. We also hope that the Bank staff's continued association with the power sector will assist in the implementation of important institutional reforms.

Revision of the Draft Appraisal Report

16. Mr. Wiener and I have discussed some editorial changes in the draft report which we think it would be desirable to incorporate in the grey cover. These changes are largely points of detail. However, a specific change will be the deletion of the proposal that accumulated interest should be waived (paragraph 4.08) and the substitution of a more general undertaking that GOI will discuss the appropriate treatment of these items (paragraph 14 above). I do not consider it necessary to defer negotiations, which are tentatively scheduled to begin on March 24, simply to produce a modified edition of the appraisal report, since there is no difference of substance between ourselves and Projects.

Recommendation

17. Subject to the views of the committee, I recommend that India be invited to negotiate the proposed credit of US$75 million on the basis of the recommendations set out in paragraph 7.01 of the Appraisal Report as qualified in this memorandum.

Gregory B. Votaw
Deputy Director
South Asia Department

Attachments

Population: 556 m
GNP Per Cap: $ 76

INDIA - 5 YEAR LENDING PROGRAM

		($ million)							
		Fiscal Year						Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Agri. Credit - Punjab	IDA	27.5							
Agri. Credit - Gujarat	IDA	35.0							
Agri. Credit - Haryana	IDA		25.0						
Agri. Credit - Tamil Nadu	IDA		35.0						
Agri. Credit - Andhra Pradesh	IDA		24.4						
Agri. Credit - Mysore	IDA			25.0					
Agri. Credit - Maharashtra	IDA			25.0					
Agri. Credit - Unidentified	IDA			25.0					
Irrigation - Kadana	IDA	35.0							
Irrigation - Pochampad	IDA		40.0						
Irrigation - Tawa	IDA			46.0					
Irrigation - Jayakwadi	IDA			20.0					
Irrigation - Unidentified	IDA			20.0					
Agricultural Aviation	IDA		6.0						
Agri. Industry Unident.	IDA			10.0					
Agri. Unident. (7 projects)	IDA				150.0				
Agri. Unident. (7 projects)	IDA					165.0			
Agri. Unident. (7 projects)	IDA						165.0		
Grain Storage	IDA			5.0					
Telecommunications IV	IDA		78.0						
Telecommunications V	IDA				40.0				
Telecommunications VI	IDA					40.0			
Telecommunications VII	IDA						35.0		
DFC - ICICI VIII	IBRD	40.0							
DFC - ICICI IX	IBRD			40.0					
DFC - ICICI X	IBRD						40.0		
Education - Agri. University	IDA			20.0					
Education Unidentified	IDA						20.0		
Fertilizer - Nangal (Public)	IDA			20.0					
Fertilizer - Cochin (Public)	IDA		20.0						
Fertilizer - Debottlenecking	IDA			5.0					
Iron Ore - Marcona	IDA				40.0				
Industry - Tata Fertilizer	IBRD				25.0				
Industrial Imports VI	IDA	75.0							

(Cont'd.)

($ million)

		Fiscal Year 1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73
Family Planning	IDA			15.0					
Power Transmission II	IDA		75.0						
Power Transmission III	IDA			60.0					
Power Unidentified I	IDA				15.0				
Power Unidentified II	IDA					15.0			
Power Unidentified III	IDA						60.0		
Highways II	IDA			30.0					
Railways X	IDA	55.0							
Railways XI	IDA			50.0					
Shipping	IDA			80.0					
Transportation Proj. Unident.	IDA				60.0				
Transportation Proj. Unident.	IDA					50.0			
Water Supply - Bombay	IDA			27.5					
Water Supply Unidentified I	IDA				15.0				
Water Supply Unidentified II	IDA					15.0			
Unallocated I	IDA			16.5					
Unallocated II	IDA				180.0				
Unallocated III	IDA					35.0			
Unallocated IV	IDA						40.0		
	IBRD	40.0		40.0	25.0		40.0	189.0	145.5
	IDA	227.5	303.4	500.0	500.0	320.0	320.0	591.0	1683.4
	Total	267.5	303.4	540.0	525.0	320.0	360.0	780.0	1828.9
	No.	6	8	19	8	6	6	13	44

3/11/71

Note: The IDA lending program is to be adjusted to - 245.0 (1971) 350.0 (1972) 350.0 (1973) 350.0 (1974) 350.0 (1975)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/71-16

March 18, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "India - International Competitive Bidding for Civil Works Contracts" held on Monday, February 22 and Friday, February 26, 1971 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

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The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

LM/M/71-16

March 18, 1971

Minutes of Special Loan Meeting to consider "India - International Competitive Bidding for Civil Works Contracts" held on Monday, February 22 and Friday, February 26, 1971 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Aldewereld, Broches, Cargill, Chadenet, Baum, Geolot, H. Scott, Votaw, Wapenhans, Darnell, Kirk, Guinness, Hardy, Cunningham, Halverson and Pearce (Secretary).

2. Issue: The meetings had been called to consider Mr. Cargill's memorandum of February 12, 1971 to the Chairman entitled "India - International Bidding for Civil Works Contracts" and Mr. Wapenhans' memorandum of February 19 to Mr. Cargill entitled "India - Pochampad Irrigation Project - International Procurement," both of which drew attention to the Indian Government's unwillingness, for political reasons, to accept international competitive bidding for civil works. The immediate concern of both meetings was the Pochampad Irrigation Project, requiring \$3 million for equipment and about \$65 million for civil works, for which a \$32 million IDA credit was proposed to finance (a) the foreign exchange component of internationally procured equipment and (b) 50 per cent of local expenditures. The \$65 million civil works component consisted of: (i) \$8 million for resettlement, land acquisition and supporting services, (ii) \$8 million for contracts already awarded (mainly Pochampad Dam), (iii) \$17 million for works for which international competitive bidding was admittedly unsuitable, and (iv) \$32 million for major works (main canals, roads). The Bank/IDA requirement for international competitive bidding on major civil works was also an issue in the Wheat Storage and 2nd Highways Project.

3. Discussion: The meetings noted that:

(a) Although local contractors were capable of undertaking the civil works at reasonable prices, with acceptable quality and in accordance with project schedules, and would probably win most, if not all, of the contracts, there was nevertheless no prima facie technical reason why, for the \$32 million major civil works contracts (cf. para. 2(iv) above), international competitive bidding in accordance with Bank/IDA guidelines should not apply.

(b) The Association had waived its requirement for international competitive bidding for civil works in the Kadana Irrigation Project (Credit No. 176-IND) on the grounds that (i) construction was already well advanced, (ii) the project was of high priority, (iii) the contracts were designed for low-cost labor-intensive construction generally unattractive to international bidders, and (iv) IDA financing would ensure the project's early and efficient completion.

(c) The Pochampad Irrigation project was also already under construction and of high priority. Of the civil works contracts still to be awarded, $32 million were for major works for which international competitive bidding was technically feasible and, in the Agriculture Projects Department's view, desirable. The probability that Indian contractors would win these contracts did not justify an 'a priori' judgement by IDA that foreign contractors would not bid, if permitted to do so. In any event, such an assumption might unnecessarily invite criticism by other Bank/IDA members.

(d) On the other hand, Indian officials had made it quite clear that international competitive bidding for civil works would be unacceptable without a Cabinet decision, which would be unobtainable at least until after the general election. The risk, however low, that a foreign contractor might win in international competitive bidding was one which Indian politicians reportedly could not ignore.

4. The meeting considered the Pochampad Irrigation Project and, with reference to India's exceptional circumstances, alternative methods for comparing local and foreign bids, including the use of shadow labor costs and shadow foreign exchange rates. The South Asia Department drew attention to (i) the time which had elapsed since project appraisal (more than one year ago), (ii) the fact that the international competitive bidding issue had only recently been raised, and (iii) the implications of this issue for Bank/IDA lending for the Wheat Storage, Second Highways and subsequent irrigation projects, including the much larger Tawa Irrigation Project, which was currently being appraised.

5. The Chairman said that the only satisfactory solution to what had become a recurrent problem would be for the Bank/IDA and the Indians to negotiate a new regime for international competitive bidding for civil works, approved by the Indian Cabinet. Since this might take some time, the question arose whether the Pochampad Irrigation Project should be postponed indefinitely. The Chairman said that he was prepared to recommend a waiver of international competitive bidding for civil works in Pochampad as an exception, pending agreement with the Indians on a new regime. The Agriculture Projects Department cautioned against proceeding further with Pochampad and other forthcoming irrigation projects until the international competitive bidding issue had been resolved.

6. Decision: The meeting concluded without reaching a decision on the Pochampad Irrigation Project. It was suggested that the problem be reviewed further with the President.

David Pearce
Secretary

Cleared by: Messrs. Cope
Baum
H. Scott
Votaw/Kirk/Cunningham
Wapenhans

cc: Loan Committee
Participants

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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March 17, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Iraq - Telecommunications Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 17, 1971 from the Europe, Middle East and North Africa Department, entitled "Iraq - Telecommunications Project" (LC/O/71-37).

2. Comments, if any, should be sent to reach Mr. Metherate (ext. 4819) by 1:00 p.m. on Monday, March 22.

3. It is planned then, if the Committee approves, to inform the Government and representatives of PT & T that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
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Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL
LC/0/71.37

March ~~15~~ 17, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

IRAQ - Telecommunications Project

Introduction

1. Attached for consideration by the Loan Committee is a report (PU-65) entitled "Appraisal of the 1972-76 Telecommunications Program - Iraq", recommending a loan of US $22.0 million to the Government of Iraq to help finance a telecommunications project.

2. To date, the Bank has made two loans to Iraq for a total of US $25.3 million equivalent, net of cancellations: US $6.3 million for flood control (1950), and US $19 million for roads (1966). The road project is progressing satisfactorily, after a long initial delay, and is expected to be completed by September 1972. The currently undisbursed amount of US $5.4 million should be fully utilized by that time.

3. After the first loan was made in 1950, the Bank did not receive further requests for assistance, since oil revenues provided Iraq with sufficient foreign exchange to carry out its development program without recourse to external borrowing. In the early sixties, however, a considerable increase in public expenditure led the Government to seek foreign financing, and early in 1963 it approached the Bank for assistance which resulted in the 1966 road loan. The internal political instability, together with the Government's reluctance to approach western sources for assistance, delayed further dialogue until relations between Iraq and the Bank were reactivated after the present regime assumed power in July 1968. At a country program review in February 1971 with Mr. McNamara, the attached Five-Year Lending Program (FY 1971-76) was approved. The proposed loan constitutes the only lending operation for FY 1971. Four projects are under active preparation which should lead to lending operations in FY 1972 and FY 1973 for irrigation and drainage, power, education and grain storage.

Economic Situation

4. An economic mission visited Iraq in October/November 1970. Its draft report is expected to be finalized shortly.

5. Iraq had undertaken a series of development plans in the fifties and sixties. The most recent one (1965-69) was marked by substantial shortfalls in the realization of its targets. The actual growth rate fell significantly short of the planned 8 percent target. Public investment over the period was 55 percent short of that anticipated in the Plan. The virtual cessation of investment by the foreign oil companies, the low rate of public savings and investment and inadequate planning and administration, besides an unstable political climate, were the major forces underlying this unsatisfactory performance.

6. A Five-Year Development Plan (1970-74) formulated by the present Government appears to be a better basis than the earlier Plans for improving performance. It projects a total investment of US $ 3 billion to be financed mostly from oil revenues and domestic savings, together with some external assistance. It anticipates an average annual growth rate of 6.8 percent in GDP, with agriculture expanding at an average rate of 7 percent and industry of 12 percent per annum. The key accent is on the development of the agricultural sector, to which 34 percent of the Plan outlay has been allocated.

7. Oil continues to be the key sector in the Iraqi economy accounting for nearly 40 percent of the GNP, 90 percent of exports and over 50 percent of Government revenues. With the arrangements reached with the foreign oil companies over the past months, it is expected that the virtual stagnation in the oil sector which prevailed in the past decade would be replaced by considerable improvement in both oil production and revenues. As a consequence of the agreement reached in Teheran with the oil companies last month the increase in oil revenues this year would be about 40 percent and even greater if present negotiations in respect of oil exported via the Mediterranean result in agreement. Agriculture accounted in 1969 for about 20 percent of the GDP. Agricultural production has been limited by insufficient use of modern technology. Manufacturing accounts for almost one-tenth of GDP. Its share in total production, however, understates its contribution to economic growth; over the last 15 years manufacturing output has expanded at a higher percentage rate than any other sector of the economy.

8. Although revenues from oil contribute a major portion of current revenues of the Government, a strong effort was made between 1966 to 1969 to increase revenues through new taxation measures. As a result, tax revenues increased by nearly 18 percent and the total revenues by nearly 31 percent. Due to a substantial increase in current expenditures during the period 1966-69 public savings were nevertheless insufficient to finance public investment. As a result, there was heavy public sector reliance on the domestic banking system which reached substantial proportions in 1969/70, partly due to the fact that Iraq also made net repayments of external debts in that year.

9. However, since November 1970 the Government has been easing some of the tax measures that it had taken previously and it is anticipated that particularly with the new net oil earnings, the Government is unlikely over the next two to three years to rely on increase in current revenues through increase in taxes. In the last few years, Iraq's reliance on external finance for public investment, has been very modest. Apart from suppliers' credits and some bilateral assistance from the East European Bloc, very little external financing has been available to the country. As a result, debt servicing is not a serious problem to Iraq. In 1968, the debt service ratio was 2.2 percent. With a low debt service ratio and an economic performance which is expected to improve over the next few years, Iraq can be considered creditworthy for limited Bank lending.

10. The present Government has been in power since July 1968. It has been consolidating itself internally since then, and several recent measures taken by it seem indicative of its sense of growing confidence. It has recently been taking steps to ease some of the past political controls, modifying the highly centralized control over industry and seeking a greater role for private enterprise. It effected a settlement with Kurdish insurgents in March 1970, which also assisted the Government substantially in focussing its attention to development problems. Although there are frequent changes at ministerial levels, the past purges at public administrative levels no longer occur. As a result, the morale and quality of public administration, which had been considerably weakened, is being gradually restored.

<u>The Project</u>

11. The proposed project, described in detail in paragraph 3.01 of the attached report, is the Telecommunications Expansion Program of Iraq's Post, Telegraphs and Telephones Administration (PT&T) to be implemented between 1972 and 1976. It includes:

(a) the installation of about 100,000 lines of local exchange and related facilities, to double the number of local exchange lines;

(b) installation of a microwave long distance link between Basrah and Mosul and ultra high frequency links to 16 urban centres in northeast Iraq, with provision for multiplexing equipment for 1,500 channels and interconnections for 6 TV stations;

(c) link to the Kuwait earth satellite ground station for international service;

(d) facilities for direct long-distance dialling service;

(e) facilities for national and international telex service and extension of manually-operated telegraph exchanges; and

(f) consultancy services.

The proposed Bank financing of US $22 million will cover the foreign exchange cost of certain selected items in the Expansion Program, i.e. local network cables, microwave system and multiplexing equipment, microwave bearer for TV spurs, long-distance switching, multimetering and airconditioning equipment, detailed in Table 2 of Annex 10 of the appraisal report.

12. The total cost of the project, including contingencies, is estimated at about US $56 million with a foreign exchange component of approximately US $35 million. Since PT&T has already placed orders for the supply and installation of about 60 percent of the exchange equipment and cables for local exchange lines, the full cost of such procurement will be met by Iraq. Similarly, a loan of about US $2.1 million is proposed to be obtained by PT&T from the Central Bank of Iraq for the telex facilities under the project, since the Central Bank will substantially benefit from the installation of these facilities. The proposed Bank loan of US $22 million would meet the remaining foreign exchange requirements of the Expansion Program. It would cover 59 percent of the foreign exchange component, or about 40 percent of total cost of the Telecommunication Expansion Program.

13. In respect of contracts for items already ordered, and to be covered by Iraqi financing, limited international competitive bidding was followed. The same procedure is expected to be followed for other items not covered by Bank financing. Procurement of items proposed for Bank financing would take place on the basis of international competitive bidding.

14. The proposed Bank loan would be made to Iraq, who in turn would make the loan proceeds available to PT&T on the same terms and conditions. PT&T would execute the project. Microwave Services International Inc., a US consulting firm which assisted in preparing the microwave portion of the Expansion Program, have been retained to assist PT&T as engineering consultants and for bid evaluation. PT&T will have all equipment and networks installed, commissioned and tested by suppliers who win bids for the various items of equipment. They will also be required to train Iraqi technicians and supervise the operation and maintenance of the installed items for a period of 18 months after commissioning.

15. Taking into account the projected increases in tariffs, the internal financial rate of return of the project is estimated to be about 21 percent. The improvement and expansion of telecommunications

services, in which virtually no investments were made in the past 10 years, will produce other benefits besides revenues. The proposed project is expected to double the present local telephone service to meet a large outstanding demand for telephone communications. The long-distance and related facilities will not only link the main centres of economic activity in Iraq, but also provide the country with international connections.

Major Project Issues

16. The project poses some problems on the financial side, mentioned below, especially in the area of accounting and financial management.

17. Financial Management: PT&T is a wholly Government-owned entity, with a Board of Directors and Chairman nominated by the Government. While the Board is vested with adequate authority, it has displayed reluctance to take decisions particularly with regard to tariffs, personnel and procurement and usually seeks authorizations on these matters from the Minister of Communication. PT&T is financially independent of the Government for its current expenses. For capital expenditures, while it can and does borrow from the domestic banking system, it essentially relies on capital funds from the Government. The organizational structure of PT&T generally follows the conventional pattern, with separate functional units for postal and telephone and telegraph operations. While PT&T's technical management is adequate, the administrative and financial methods and management are weak, and need improvement. To improve these aspects, PT&T has engaged a firm of management consultants (Arab Research and Administrative Centre - UAR), who will also advise on the introduction of separate accounting systems for telecommunication and postal operations and study the feasibility of separating, in the long term, these operations.

18. Revision in Tariffs: The net revenues accruing to PT&T are inadequate; in 1970 they were not sufficient to cover the cost of telecommunication expenses as assessed on a notional basis. The Government and the PT&T have recognized the need to adjust tariffs to enable at least the telecommunication operations to be put on a profitable basis, and to generate some funds towards the proposed project and for PT&T's future expansion needs. The appraisal mission had recommended to the Government and PT&T that tariff changes be made in two phases, the first one for increases in the rates of local telephone service for all subscribers and charges for leased circuits, to be made effective by July 1971, and the second one, to increase charges for local and long-distance calls by about 20 percent, to be made effective by 1973. A recent Bank mission to Iraq was informed that the Minister of Communication was studying the recommendations for an increase in the local rates. The question of increased charges for leased circuits is being studied by a Committee. The Minister, however, assured that decrees for both these tariff adjustments, to be

made effective by July 1, 1971, could be issued by mid-April. This would be in keeping with the recommendation in the appraisal report that the first phase of tariff revision should be completed and ratified by the Government before Board presentation of the loan. In case, however, it transpires during negotiations that there might be some delay in the actual issuing of the decrees I recommend, with a view not to delay Board presentation, that we seek a written assurance from the Government regarding the issue of the decrees, and make their issue and ratification a condition of effectiveness.

19. Financial Reorganization of PT&T: At present, PT&T's financial structure is not clearly accounted for in the form of debt and equity. As is the case with all public entities, the capital funds required for projects included in the National Development Plan (such as the proposed project) are channelled through the Ministry of Planning, but not as equity, nor are any regular repayments or interest charges prescribed. Under Iraqi law, in case public enterprises (including PT&T) make profits, 10 percent of the net profits are appropriated as a contribution to the National Development Plan, 15 percent paid to the Ministry of Planning towards the repayment of capital funds which may have been provided for projects, and 25 percent by the Government for public fiscal use.

20. In order to bring PT&T's financial arrangements in line with commercial practices, the appraisal report suggests that the PT&T's financial structure be suitably revised in the form of debt and equity and appropriate arrangements made for proper debt service. It has been proposed that the Government's contribution to PT&T for the proposed project be channelled as equity and not as debt, that in view of the above-mentioned appropriations of profits stipulated by the law, certain Articles of the relevant law be waived, and that the proposed loans from the Bank and the Central Bank of Iraq be channelled to PT&T as debt to be repaid by PT&T on the same terms and conditions on which the Government obtains these loans.

21. During discussions by a recent mission with the Government, it was indicated that while the Government appreciated the intentions of the above-mentioned proposals, they would imply a basic policy change in the financing arrangements for the National Development Plan that the Government had set up. A waiver in such arrangements only for PT&T, might raise questions which might be very difficult to resolve. In view of the sensitivity of the situation, the Public Utilities Department and the Area Department deem it prudent that this aspect should be discussed with the Government prior to negotiations. A Bank mission will therefore visit Iraq shortly to discuss the extent to which the present arrangements for financing projects in the National Development Plan need to be modified in order to meet our requirements for the

financial restructuring of PT&T operations, and to explore alternative ways of meeting the objectives of the financial reorganization of PT&T which might be mutually satisfactory to the Bank and the Government.

Compensation for Contractors' Claims

22. A number of foreign contractors have long standing claims against the Government of Iraq for works and services performed for preceding regimes. When the road project (Loan No. 457-IRQ) was presented to the Executive Directors in 1966, the question of these claims was raised. It was the consensus of the Executive Directors at that time that this issue should not hold up approval of the loan but that the Bank should follow the matter and keep in touch with progress in settling it. Since then the Bank has been in contact with the Government on various occasions on the questions of the settlement of these claims. From the information available, it would appear that most of these claims are being discussed by the Government and quite a few of them, for example the claims of French contractors, have already been settled. Some of the claims are also being reviewed in the Iraqi courts. We propose to ask the Government to inform us during negotiations about the further progress made in settling the claims, and to confirm the Government's intentions to continue its efforts for their reasonable settlement and to keep us informed of developments.

Recommendation

23. I recommend that the Government of Iraq and the PT&T be invited to negotiate a loan of US $22 million for the proposed Telecommunications project on the terms and conditions set forth in Section 6 of the appraisal report and in this memorandum. Prior to negotiations a Bank mission would visit Iraq to discuss the matters relating to the financial restructuring of PT&T mentioned in paragraphs 19 to 21.

M. P. Benjenk
Director

Attachments: 1. Five-Year Lending Program
2. Appraisal Report

Population: 9.4 million
Per Cap. Inc: $295

IRAQ - ACTUAL AND PROPOSED LENDING THROUGH FY 1976
($ millions)

Attachment 1

		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972 1/	1973 1/	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
		Fiscal Years																
Agricultural Credit - Unidentified	IBRD												10.0					
Agriculture - Northern Region I - Unidentified	IBRD											10.0						
Agriculture - " " II- "	IBRD														10.0			
Flood Control	IBRD	12.8																
Irrigation I - Lower Khalis	IBRD										30.0							
Irrigation II - Unidentified	IBRD													20.0				
Livestock - Unidentified	IBRD												10.0					
Grain Storage	IBRD											10.0						
Telecommunications I	IBRD									22.0								
Telecommunications II	IBRD												15.0					
Education I - vocational and technical	IBRD										8.0 1/							
Education II - unidentified	IBRD													10.0				
Power I - Basra	IBRD										15.0							
Power II - Unidentified	IBRD														15.0			
Roads I	IBRD				23.0													
Roads II - Unidentified	IBRD											20.0						
Roads III - Unidentified	IBRD														15.0			
Operations Program	IBRD									22.0	53.0	40.0	35.0	30.0	40.0	23.0	115.0	198.0
	No.									1	3	3	3	2	3	1	7	14
Lending Program	IBRD	12.8			23.0					22.0	35.0	28.0	35.0	30.0	35.0	23.0	85.0	163.0
	No.	1			1					1	2	3	3	2	3	1	6	13
IBRD o/s including undisbursed					23.0	23.0	22.9	22.9	18.9	40.3	74.6	101.8	136.0	164.1	195.2			
excluding undisbursed					-	3.7	8.0	9.1	11.4	14.3	21.6	35.8	57.0	84.1	111.3			
IBRD - gross disbursements		6.3				3.7	4.4	1.2	2.2	3.5	8.0	15.0	22.0	29.0	31.0	8.1	29.9	105.0
- net disbursements		-				3.7	4.4	1.2	2.2	2.8	7.3	14.2	21.2	27.1	27.2	8.1	27.7	97.0
- net transfer		- 1.0	-	-	-	3.7	4.1	0.7	1.5	1.8	5.6	10.0	16.7	20.6	18.7	7.8	19.6	71.6

1/ In the review meeting in Mr. McNamara's office on February 19, 1971, the President directed that the education project, scheduled for FY 1972, be postponed to FY 1973.

Europe, Middle East and North Africa Department
1/15/71

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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WBG ARCHIVES

March 17, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Colombia - Second Bogota Water Supply Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 17, 1971 from the South America Department, entitled "Colombia - Proposed Loan for the Second Bogota Water Supply Project" (LC/O/71-36).

2. Comments, if any, should be sent to reach Mr. Frost (ext. 2193) by 5:00 p.m. on Friday, March 19.

3. It is planned then, if the Committee approves, to inform the Government and representatives of EAAB that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

Copies for Information:

President
The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-36

March 17, 1971

LOAN COMMITTEE

Memorandum from South America Department

COLOMBIA - Proposed Loan for the Second Bogota Water Supply Project

1. Attached is the draft Appraisal Report No. PU-66, recommending a Bank loan of US$88 million to the Empresa de Acueducto y Alcantarillado de Bogota (EAAB) to assist in financing a project to expand and improve the water supply facilities for the city of Bogota.

Lending Program

2. The proposed loan would be the fourth submitted to the Loan Committee as part of the current year's lending program for Colombia, which comprises six projects. (See attached five-year lending program). Negotiations have been substantially completed on the Telecommunications II (US$15 million) and Caqueta Land Colonization (US$8.1 million) projects. I have recently submitted the Fourth DFC loan (US$40 million) to the Loan Committee, and I expect to submit the Second Atlantico (US$3.8 million) project later this month. Loan negotiations for Palmira Water Supply (US$2 million), Bucaramanga Sewerage and Erosion Control (US$6 million) and Development Finance Institute (US$15 million) projects were initiated but not concluded in FY 1970 because of unresolved project problems. Negotiations may be concluded on the Palmira project in time for presentation to the Executive Directors in FY 1971, but this is unlikely in the case of the other two projects.

3. The proposed loan would be the third made to Colombia in the water supply sector, following a loan of US$14 million (with US$4.6 million of joint financing) made in FY 1968 for the first Bogota Water Supply Project, and a loan of US$18.5 million made in FY 1970 for the Cali Water Supply and Sewerage Project. The Bank's lending program in this sector in FY 1971-75 is forecast to amount to US$166 million.

The Economy

4. This is covered in the Memorandum to Loan Committee of December 11, 1970 on the Second Telecommunications Project (LC/O/70-127).

The Project

5. The proposed Project is the second phase of the long range master plan for expansion of the Bogota water supply system. The first phase, being implemented satisfactorily under Loan 536-CO, will keep water supply ahead of demand through 1976. The proposed second Project

is to be completed in 1976, and would cover demand through 1985. It will divert, treat, and distribute water originating in the Chingaza area 40 km east of Bogota by means of:

- a dam on the Chuza River, on the eastern side of the Cordillera Oriental;
- a 39-km conveyance system, consisting of 33 km of tunnels and 6 km of pipelines, from the dam to the city;
- a treatment plant;
- additions to the Bogota water distribution system;
- the supply of operational equipment; and
- engineering services for the proposed and for future projects.

6. The Chingaza area has a very large potential yield of water of which only 35 percent would be developed by the proposed Project. Nevertheless, it is necessary to include the full conveyance system of tunnels and pipelines in this Project, and this accounts for the long construction period (1971-76) and large capital requirements of the Project. Highly mechanized construction methods are required to carry out the large and difficult Project works and this accounts for the foreign exchange component at 70 percent, which is high by comparison with most water supply projects.

7. The proposed loan is substantially larger than the US$35 million originally included in the lending program in June, 1970. The Chairman of the Loan Committee agreed that the Appraisal Report be prepared on the assumption that the loan amount be US$88 million, with the understanding that a final decision would be taken upon submission of the Project to the Loan Committee. Because of constraints on the total volume of Bank lending to Colombia we had first attempted to mitigate the effect of the Project's large capital requirements upon the amount of the prospective loan by planning to continue with joint financing as employed in the first project. However, this turned out to be unsuited to the physical characteristics of the Project, which consists principally of civil works (in contrast to the first project which has a large equipment component).

8. While the financing of some local costs is justified on macroeconomic grounds, US$86 million of the proposed loan would cover foreign costs, and only US$2 million would be for local costs of engineering services -- this in order to put competent foreign and Colombian consultants on an equal footing by financing 50 percent of the costs of engineering services irrespective of origin. The proposed loan is equivalent to about 75 percent of total project financing requirements,

including interest during construction on the proposed Bank loan. However, external financing plays a relatively less important role in EAAB's total investment program, accounting for only 43 percent of financing forthcoming from all sources. EAAB's investment program in 1971-76 includes important sewerage, drainage and flood control works, which had been postponed in 1968-70 in order to permit the available local financing to be used for the first water supply project, and which would have to be further delayed if the Bank loan did not cover the full foreign element of total financing requirements.

9. Cash generated internally would finance 46 percent of EAAB's investment program and less than two percent would be required from the Government budget. Bogota's water tariffs, which were doubled in 1968 to finance the first project, are currently being increased by 30 percent to 9 U.S. cents per cubic meter (34 U.S. cents per 1,000 gallons), which is high in comparison with tariffs in other Colombian cities. The financial position of the proposed Borrower is sound, and earnings have been satisfactory with rates of return of 9 to 10 percent on a realistically revalued rate base. Future earnings are expected to yield rates of return of 9 to 12 percent during the period of construction. The internal financial rate of return is expected to be 14 percent for the water supply and sewerage program of which the proposed Project is the main element.

10. The Project will also increase the hydroelectric potential of the Bogota River where the Empresa de Energía de Bogotá (EEEB) is presently completing a 550 MW Power System which has been developed with substantial Bank assistance. Bearing in mind that the proposed Project would only exploit about one-third of the water potential of the Chingaza area, the subsequent development of this area would permit a progressive increase in hydro-power benefits over the long-term future. EEEB has agreed to make a contribution of Col$ 280 million to the financing of the Project, equivalent to 12 percent of Project costs, or 6 percent of EAAB's total investment program.

11. The term recommended for the proposed loan is 30 years including a 7 year period of grace. On macroeconomic grounds, we have agreed to make loans for infrastructure projects in Colombia on minimum repayment terms of 25 years; and the Project has a construction period of six years and a physical life of 75 years.

Recommendation

12. I recommend that the Government and EAAB be invited to send representatives to negotiate a loan of US$88 million for the Second Bogota Water Supply Project, on the terms and conditions set forth in the attached draft Appraisal Report.

Gerald Alter
Director

Attachment

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 15, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Colombia - Fourth Development Finance Companies Loan

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 15, 1971 from the South America Department, entitled "Colombia - Proposed Fourth Development Finance Companies Loan" (LC/O/71-35).

2. Comments, if any, should be sent to reach Mr. Flood (ext. 2191) by 1:00 p.m. on Thursday, March 18.

3. It is planned then, if the Committee approves, to inform the Government that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
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Copies for Information:

President
The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-35

March 15, 1971

LOAN COMMITTEE

Memorandum from South America Department

COLOMBIA - Proposed Fourth Development Finance Companies Loan

1. Attached is the draft Appraisal Report No. DB-77 recommending a Bank loan of US$40 million to the Banco de la Republica for use by five private development finance companies.

Lending Program

2. The proposed loan would be the third presented to the Loan Committee as part of the current year's lending program which comprises six projects. (See attached five-year lending program). Negotiations have been substantially completed on the Telecommunications II (US$15 million) and Caqueta Land Colonization (US$8.1 million) projects. I expect shortly to submit the Bogota II Water Supply (US$88 million) and Second Atlantico (US$3.8 million) projects to the Loan Committee. Loan negotiations on the Palmira Water Supply (US$2 million), Bucaramanga Sewerage and Erosion Control (US$6 million) and Development Finance Institute (US$15 million) projects were initiated but not concluded in FY 1970 because of unresolved project problems. Negotiations may be concluded on the Palmira project in time for presentation to the Executive Directors in FY 1971, but this is unlikely in the case of the other two projects.

The Economy

3. This is covered in the memorandum to the Loan Committee of December 11, 1970 on the Second Telecommunications Project (LC/O/70-127).

Background

4. The proposed loan would be the fourth loan for the use of the five private development finance companies (DFC's). The first loan, of US$25 million (451 CO), was made in May 1966 and committed in less than 18 months. The second loan, of US$12.5 million (534 CO), made in May 1968 and the third loan, of US$25 million (625 CO), made in June 1969 were each largely committed in less than 18 months. Because of

the unexpected rapidity with which the third loan was committed, most of the DFC's already have a substantial number of projects awaiting financing, and it is the purpose of this loan to provide the funds required to eliminate the backlog and to assure the availability of this type of financing to Colombia's industrial sector for the next 18 months. Based on our experience under the existing loans, and the current pace of industrial activity in Colombia, the proposed loan amount of US$40 million may prove a conservative figure. However, I am not querying the proposed loan amount, particularly as the Bank is planning to send a preparation mission for a further loan as soon as this loan is approved (see paragraph c. below).

5. There are several matters connected with this loan which I wish to call to your attention:

a. Caldas Situation

6. In October 1970, and for reasons described in the Appraisal Report, it became apparent that the Caldas DFC was facing a liquidity crisis and the possibility of serious portfolio losses. After consulting with the Bank, Caldas and the Banco de la Republica (BR) requested the Bank to suspend consideration of pending applications for sub-project approvals and disbursements under the existing loans, and advised the Bank that no further applications would be submitted until Caldas' situation was clarified and a plan of remedial action approved. A review of Caldas' situation has since been carried out by a consultant on behalf of the Bank, working in coordination with Caldas' auditors and another consultant contracted by Caldas. The final report of the Bank consultant has now been submitted. It concludes that Caldas still faces serious difficulties but that important steps are already being taken to resolve them. (On this basis, disbursements totalling about US$60,000 have been approved for three sub-projects with particularly urgent need of funds from Caldas). Representatives of Caldas have been invited to the Bank on March 22 to discuss the consultant's recommendations and to crystallize decisions on outstanding issues in the proposed plan of remedial action. We will report to the Chairman of the Loan Committee on the outcome of these discussions. Meanwhile, I agree with the recommendation of the Development Finance Companies Department that Caldas be allocated US$4 million of the proposed loan but that it not be permitted to draw on any portion of the loan funds until a reappraisal of Caldas' situation shall have determined to the Bank's satisfaction that the liquidity of the company has been restored, that fresh injections of share capital have been assured and that the other recommendations of the Bank's consultant are being or will be carried out.

b. Interest Rate to Sub-Borrowers

7. As the draft Appraisal Report indicates, the Colombian parties have not yet responded to our request for a proposal regarding the level of the interest rate to the ultimate sub-borrowers. On the most recent loan (625 CO) the sub-borrower has an option: he may pay an interest rate of 10 percent if he carries the exchange risk, or the Banco de la Republica (BR) is prepared to carry the risk for a premium of 8 percent. Looking at the total of 18 percent solely in financial terms, it covers the Bank's interest rate (6.5 percent), a reasonable spread to the DFC's (3 percent), an appropriate fee to the BR (0.5 percent), and the 8 percent charge by the BR for exchange risk coverage. The draft Appraisal Report recommends that for the fourth loan a rate of 18.75 percent (or 10.75 percent) be used as a criterion for assessing the Colombian proposal. The 0.75 percent increase would cover the increase in the Bank's interest rate from 6.5 percent to 7.25 percent. In my opinion, the appropriateness of the 18.75 rate depends largely on whether the Colombian Government agrees that 8 percent is the proper charge for exchange risk coverage. The rate of increase in domestic prices in Colombia has been averaging slightly less than 7 percent per annum for the past two years, and the most recent Economic Report (WH 200a) estimates that it will average about 7 percent per annum over the next few years. The policy of the Colombian Government in recent months has been to depreciate the peso at a rate slightly in excess of the rate of increase in domestic prices. On this basis, the 8 percent charge would seem about right. The Government may not expect, however, to keep the rate of depreciation at this level indefinitely, and in view of the average twelve-year period of sub-loans may decide that a charge somewhat lower than 8 percent would be appropriate for this loan. South America and Development Finance Companies Departments agree, therefore, that, from a financial standpoint, a rate of 18.75 should be used as the standard against which to judge the Colombian proposal but that we should be prepared to consider 18 percent or even a slightly lower rate during negotiations. A nominal interest rate within this range would also provide a reasonable real interest rate reflecting the opportunity cost of capital.

c. New Development Finance Companies

8. During the past few years a number of new development finance companies have been established in Colombia, and at the time of the appraisal mission, Government representatives pressed for inclusion of these companies in the proposed loan. The Government representatives were advised at that time that the Bank would be prepared to consider such request but that we would need to receive the Government's detailed proposal by no later than December (1970) if the loan were not to be delayed. The Government representatives agreed to present their proposal by the end of December. No such proposal was forthcoming, however, and the BR was advised that for lack of such proposal the inclusion of new companies under the fourth loan would cause considerable delay. The BR

was also advised that we are prepared to consider giving access to future Bank loans to new financieras if suitable arrangements could be worked out and that we are prepared to send a mission to Colombia, as soon as the proposed loan has been approved, to begin discussions of a possible fifth loan. The BR was told that the administrative burden of continuing the direct relationship which we now have with the five DFC's would be too great if more DFC's were added, so that any new arrangements would require our lending to a central agency (probably the Private Investment Fund of the BR) which would not be merely a channel for the loan funds, but would be the substantive borrower. As such, it would be responsible for appraising other institutions and their investment proposals in accordance with Bank standards and for supervising the work of the participating DFC's. We do not yet know what the reaction of the Colombian Government will be to this proposal, but it is hoped that our willingness to send a preparation mission to Colombia as soon as the proposed loan is approved will remove the question as an issue for the fourth loan.

d. Local Resource Requirements

9. According to the Appraisal Report, the DFC's have not been able to sell their bonds on the open market largely because of incentives granted by the Government for the purchase of public sector bonds. The Report says that the DFC's will need to raise substantial amounts of local currency resources during the next few years if they are to meet the growing needs of their industrial clients for financing. No significant problem is expected for the clients receiving Bank funds; they are generally the larger or more profitable customers of the DFC's and are likely to receive first priority in the allocation of their local currency resources. In order to assure, however, that the DFC's will be in a position to provide the range of financing required by all their clients (principally working capital), and that the DFC's help develop the capital market, the Development Finance Companies Department recommends that during negotiations discussions be held and understandings reached with the Government and the DFC's on measures to facilitate bond sales by the DFC's.

10. There is, however, some difference of opinion between the South America and Development Finance Companies Departments on this issue. Based on the evidence so far available, I am not satisfied that it would be necessary to facilitate bond sales by the DFC's to enable Colombian industrialists to meet their working capital needs. A higher level of bond sales would, of course, have advantages for the DFC's clients, as they would be able to obtain working capital financing on longer terms than would normally be available from commercial banks. It is not clear, however, that such longer terms would be essential, and

the Government might prefer to assure the availability of adequate working capital by other means, such as altering its qualitative credit controls to permit more funds to flow to industry through the commercial banking system. I have discussed these concerns with the Development Finance Companies Department, and they agree that the Appraisal Report's recommendation with respect to bond sales be broadened to read that we would discuss with the Colombian Government and the DFC's during negotiations the question of local resource requirements for industry and what measures might be appropriate to assure its availability in adequate amounts and that we would review these questions again with the Colombian parties following completion of the study of the interest rate structure and the capital market currently underway in Colombia.

Recommendation:

11. I recommend that the Bank commence negotiations of a loan of US$40 million to the Banco de la Republica, guaranteed by the Republic of Colombia, for the use of the five Colombian Development Finance Companies, on the terms and conditions set forth in the Appraisal Report, suitably modified to take into account the recommendation in paragraph 10 above.

Gerald Alter
Director

Attachment

Population, mid-1970: 21.6 mn.
Per capita GNP, 1969: US$300

COLOMBIA - ACTUAL AND PROPOSED LENDING THROUGH FY 1976

Attachment 1

($ millions)

		Fiscal Years																
		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Agricultural Credit I	IBRD	10.0																
Agricultural Credit II	IBRD							17.0										
Livestock I	IBRD				16.7													
Livestock II	IBRD								18.3									
Livestock III	IBRD											15.0						
Livestock IV	IBRD													15.0				
Irrigation-Atlantico I	IBRD					9.0												
Irrigation-Atlantico II	IBRD									3.8								
Irrigation-Cesar I	IBRD										10.0							
Irrigation-Cesar II	IBRD													15.0				
Land Settlement I	IBRD									8.1								
Land Settlement II	IBRD											10.0						
Land Settlement III	IBRD														20.0			
Forestry	IBRD														30.0			
Agricultural Credit III	IBRD												20.0					
Fisheries	IBRD													15.0				
Telecommunications I	IBRD					16.0												
Telecommunications II	IBRD									15.0								
Telecommunications III	IBRD												20.0					
DFC I	IBRD				25.0													
DFC II	IBRD						12.5											
DFC III	IBRD							25.0										
DFC IV	IBRD									40.0								
DFC V	IBRD											30.0						
Development Finance Inst. (IFI-I)	IBRD										15.0							
DFC-VI	IBRD													30.0				
IFI-II	IBRD													20.0				
Paz del Rio I	IBRD	30.0																
Paz del Rio II	IBRD											30.0						
Hanna Nickel	IBRD											25.0						
Education I	IBRD							7.6										
Education II	IBRD								6.5									
Education III	IBRD											10.0						
Education IV	IBRD													10.0				
Power I-VIII	IBRD	155.8																
Power XIII (Medellin)	IBRD		5.0															
Power XIV (Medellin)	IBRD		45.0															
Power XV (Bogota)	IBRD						18.0											
Power XVI (Interconexion)	IBRD							18.0										
Power XVII (Chivor)	IBRD								52.3									
Power-Guatape II	IBRD											30.0						
Power Interconnection North-South	IBRD												20.0					
Tourism	IBRD												15.0					
Highways I-IV	IBRD	66.9																
Highways IV	IDA	19.5																
Highways V	IBRD							17.2										
Highways VI	IBRD								32.0									
Highways VII	IBRD										27.0							
Highways VIII	IBRD												20.0					
Highways IX	IBRD													20.0				
Railways I-IV	IBRD	76.3																
Railways V	IBRD							18.3										
Railways VI	IBRD										20.0							
Bogota Urban Transport	IBRD											20.0						
Water Supply - Bogota I	IBRD						14.0											
Water Supply - Bogota II	IBRD									88.0								
Cali Water Supply and Sewerage	IBRD								18.5									
Sewerage - Bucaramanga	IBRD										6.0							
Water Supply - Palmira	IBRD									2.0								
Water Supply	IBRD										20.0							
Water Supply	IBRD												25.0					
INSFOPAL	IBRD														25.0			
	IBRD	339.0	50.0		41.7	25.0	44.5	103.1	127.6	156.9	98.0	170.0	120.0	125.0	75.0	161.2	655.6	588.0
	IDA	19.5																
	IBRD/IDA (gross)	358.5	50.0		41.7	25.0	44.5	103.1	127.6	156.9	98.0	170.0	120.0	125.0	75.0	161.2	655.6	588.0
	No.	23	2		2	2	3	6	5	6	6	8	6	7	3	9	31	30
	IBRD (net)	339.0	50.0		41.7	25.0	44.5	103.1	127.6	156.9	71.0	150.0	100.0	90.0	75.0	161.2	608.6	486.0
	No.	22	2		2	2	3	6	5	6	5	7	5	5	3	9	29	25

South America Dept.-March 8, 1971

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/71-4

March 15, 1971

Minutes of Loan Committee Meeting held at 4:15 p.m. on Thursday, February 18, 1971 in the Board Room.

A. Present:

J. Burke Knapp, Chairman
Mr. S.R. Cope
Mr. M.P. Benjenk
Mr. B. Chadenet
Mr. R. Chaufournier
Mr. D.J. Fontein
Mr. K.G. Gabriel
Mr. E. Gutierrez
Mr. A. Koch
Mr. P. Sella
Mr. A. Stevenson
Mr. G. Votaw
Mr. G.K. Wiese
Mr. J.H. Williams
Mr. David Pearce (Secretary)

In Attendance:

Mr. J.G. Boyd
Mr. R.A. Calkins
Mr. P. Glaessner
Mr. R.S. Gregory
Mr. N. Horsley
Mr. A. Karaosmanoglu
Mr. H.E. Kopp
Mr. J. Kulski
Mr. E. Lamers
Mr. A. Odone
Mr. D.T. Scarisbrick
Mr. J.A. Simmons

B. Yugoslavia - Babin Kuk Tourism

1. The Committee considered a memorandum dated February 16, 1971 from the Europe, Middle East and North Africa Department entitled "Yugoslavia - Proposed Loan for Babin Kuk Tourism Project" (LC/O/71-19) and the accompanying draft appraisal report (PT-1 dated January 15, 1971), which recommended that the Federal Government and Minceta, a trading enterprise in Dubrovnik and the sponsor, be invited to negotiate a $18 million loan to finance the estimated foreign exchange component and interest during construction of a

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Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

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The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

$49 million tourism project - the Bank's first operation in this sector. The project, one of the largest of its kind in Yugoslavia or elsewhere, would establish an integrated tourism complex at Dubrovnik comprising 9 hotels and associated facilities for over 5,000 persons.

2. The Europe, Middle East and North Africa Department, recalling that all previous loans to Yugoslavia had been channeled through the Federal Government or the Yugoslav Investment Bank, said that the recent decentralization of Yugoslavia's economy now made it possible to lend directly to enterprises. The proposed loan would be made to the "Babin Kuk Hotel Tourist Center, Dubrovnik (BKHTC)," an entity analogous to a subsidiary company, whose sole "shareholder" would be Minceta. The establishment of BKHTC, a condition of loan presentation, would insulate the project from Minceta's other diverse activities and facilitate its supervision by the Bank. The project's size and pioneering nature required particular attention to be given to its organization and management and, owing to the absence of foreign or Yugoslav technical partners, substantial power and responsibility would be assumed by the internationally established firms of architects and management consultants to be employed. Since the project would place additional demands on the Dubrovnik area's already strained infrastructure, particularly roads, water supply, sewerage and the airport, the Federal Government, the loan's guarantor, would be required to give assurances that the appropriate investments would be undertaken in accordance with an agreed schedule.

3. The Committee's discussion of the project centered upon two main issues: the financing plan and hotel/tourism subsidies.

4. The Chairman, drawing attention to the project's reliance on loan capital and to BKHTC's unfavorable debt/equity ratio in the early years of its operations, said that he was concerned about the small equity contribution proposed (comprising land valued at $1.5 million, $1.2 million initial working capital to be provided by Minceta from its own resources, and the investment of an $8 million loan to Minceta from the Privedna Banka of Zagreb) on two grounds: (i) the security of the Bank's loan, apart from the Federal Government's guarantee, and (ii) the subsidy to BKHTC implied by Bank assistance to a single enterprise which, in the absence of foreign equity participation (e.g. by IFC or by IIYC), might invite criticism of the Bank. In reply, the Tourism Projects Department said that, in Yugoslavia's peculiar circumstances, a 20 per cent actual equity contribution was very good. Moreover, Minceta's $20.1 million loan to BKHTC (42 per cent of total project cost), also to be financed by the Privedna Banka on terms of 30 years at about 3 per cent interest, could be considered quasi-equity. The Bank's loan, which the Yugoslavs had agreed would rank senior to Minceta's loan and to any other medium- and long-term loans raised by BKHTC, would be adequately protected. Finally, while a Bank

loan represented the most favorable foreign financing, it was much less favorable than Yugoslav financing; neither, however, was available. The Chairman, while agreeing that the Bank would be protected adequately, said that, in his view, it would be desirable if the proportion of equity financing could be increased to permit participation by a foreign investor, who might also contribute to the project's management.

5. Turning to the issue of hotel/tourism subsidies, the Chairman, noting that the Bank's loan would not qualify for Yugoslav federal and republic interest rate subsidies for tourism projects, questioned whether the project should benefit from the subsidy element involved in a Bank loan. The project was a commercial operation and the question arose whether its sponsor should not be expected to pay the market rate for capital; for tourism projects in other countries, the Chairman continued, the Bank should probably increase the cost of its loan to the borrower by means of a guarantee fee, thus making it comparable to market rates.

6. In reply, the Tourism Projects Department stated that:

(a) Tourism incentive schemes, including loans at favorable interest rates, loan guarantees, grants and fiscal incentives, were a world-wide phenomenon and reflected Governments' desires to earn more foreign exchange than would otherwise accrue if tourism's capacity and prices were determined only by market forces. Since other countries in the Mediterranean employed such subsidies, Yugoslavia would be at a competitive disadvantage if it did not follow suit.

(b) It was rational for Governments to subsidize hotel loans for tourism because the benefits of tourism were shared throughout the economy, not just by the hotel/facilities concerned, which bore the cost of attracting tourists.

(c) The Bank, in lending to the Credit Immobilier et Hotelier, Morocco, had accepted the Moroccan Government's subsidy on sub-loans to the hotel industry.

7. The Chairman commented that, although tourism incentive schemes might be justified, interest rate subsidies were not necessarily the best mechanism. The Bank could accept selective incentives but, in his view, general interest rate subsidies on its loans would be undesirable.

8. Regarding other aspects of the project, the Committee noted that:

(a) A $20 million loan, as recommended by the Tourism Projects Department, would be justified on grounds of leverage and avoidance of an undue burden on the co-lender, Privedna Banka.

(b) Depending on the outcome of bidding, the loan might finance a small amount of local costs. The post-script to the President's Review Meeting on the Country Program Paper confirmed that this would be justified in Yugoslavia.

(c) The question of IFC participation in the project would, at IFC's request, be considered further.

9. The Committee approved the Europe, Middle East and North Africa Department's recommendation that the Government and Minceta be invited to negotiate a $20 million loan substantially in accordance with Section 8 of the appraisal report, as modified by the Department's memorandum.

Secretary's Department
March 15, 1971

LOAN COMMITTEE

LC/M/71-3

March 12, 1971

Minutes of Loan Committee Meetings held at 11:00 a.m. on Wednesday, February 17, 1971 in the Board Room, and 10:30 a.m. on February 18, 1971 in Room C1006.

A. Present:

Mr. J. Burke Knapp, Chairman
Mr. S.R. Cope
Mr. H. Chenery
Mr. W.C. Baum
Mr. M.P. Benjenk
Mr. A. Broches
Mr. R. Chaufournier
Mr. D.J. Fontein
Mr. K.G. Gabriel
Mr. P.D. Henderson
Mr. M.L. Lejeune
Mr. H.O. Schmitt
Mr. G. Votaw
Mr. G.K. Wiese
Mr. David Pearce (Secretary)

In Attendance:

Mr. N.J. Bennett
Miss A.L. Datar
Mr. H. Mirza
Mr. L. Nurick
Mr. T.K. Osgood
Mr. S. Sankaran
Mr. H. Scott
Mr. A. Stevenson

B. Nigeria - Rehabilitation Program Loan

1. The Committee considered a memorandum dated February 12, 1971 from the Western Africa Department entitled "Nigeria - Rehabilitation Program Loan" (LC/O/71-18), which recommended that the Bank invite the Nigerian Government to negotiate an $80 million loan to finance part of its postwar rehabilitation needs as outlined in its Second National Development Plan (1970-74).

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Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

2. The Committee noted that the justification for program assistance to Nigeria - the first such operation since the Directors' recent reconsideration of Bank/IDA program lending policies and procedures - was threefold: (a) Nigeria's substantial rehabilitation needs, which exceeded normal development requirements, (b) its reduced pipeline of projects, owing to the recent civil war, and (c) its immediate short-term requirement, until export earnings and public savings had increased, for free foreign exchange to finance the capital imports needed for new investment. Nigeria's estimated foreign exchange gap, net of expected private capital inflows, would be about \$350 million for the two years 1970/71-1971/72, of which \$150 million would be covered by disbursements from existing Bank/IDA and bilateral commitments. The Nigerians hoped to finance the remaining \$200 million from the proposed \$80 million rehabilitation program loan and by \$120 million of new commitments from bilateral and other multilateral agencies.

3. The Chairman, noting that Nigeria had not yet used its IMF drawing rights or its \$31 million SDR holdings, that part of its large pipeline of foreign exchange applications - equivalent to the value of 2-3 months imports as of mid-January, 1971 - included overdue payments to foreign suppliers, and that the Western Africa Department proposed not to attach specific conditions to the loan, asked why the Nigerians had not drawn upon their IMF resources to liquidate their overdue payments. Their failure to do so was costly to the Nigerians themselves and constituted a potential embarassment to the presentation of the loan to the Directors for approval, even though Bank disbursements would be limited to expenditures incurred after the date of the loan agreement.

4. The Western Africa Department replied that Nigeria wanted to conserve its IMF resources, which were small compared with its large payments backlog, as a contingency against eventual unforeseen, short-term crises. Its net short-term financial position was precarious and, if needed, IMF holdings, unlike any other source of assistance, could be called upon very quickly. It was therefore reasonable for Nigeria to seek as much long-term assistance as possible to meet its enormous reconstruction needs and, although all financial resources were in principle fungible, its IMF holdings could not be considered a substitute for the type of long-term assistance proposed by the Bank. As far as their overdue obligations were concerned, the Nigerians themselves were not exactly sure what proportion of the pipeline of foreign exchange applications these represented. This information would be sought during negotiations. Finally, since the Nigerians and the Bank had established a satisfactory dialogue, assurances on selected issues (e.g. Nigeria's rehabilitation financing plan, balance of payments management, preparation and administration of a project program) rather than specific conditions would, in the Western Africa Department's view, provide a sufficient basis for presenting the loan to the Directors. A letter of representation from the Nigerian Government on these issues, to accompany the draft loan agreement, was envisaged.

5. The Chairman said that he was still concerned about (i) the possibility that loan proceeds would be disbursed against overdue payments - in his view, the Bank could not permit its funds to be used directly to liquidate overdue payments - and (ii) the status of a letter of representation in the event of the Nigerians' failure to adhere to their assurances. Other Committee members also felt that, compared with the Bank's conditions of assistance to other countries, a letter of representation by the Nigerians was a less onerous obligation.

6. The Western Africa Department said that, whatever procedures were applied, the Bank's loan would help finance, directly or indirectly, Nigeria's pipeline of foreign exchange applications in respect of qualifying imports, some of which had reached Nigeria as early as December, 1970. It would be difficult, if not inappropriate, to distinguish between payments that were actually overdue, i.e. for which payment was outstanding beyond normal commercial limits, and those which were not. Regarding the proposed letter of representation, the Department pointed out that the proposed program loan was a single operation; Nigeria's policy performance was satisfactory; and, in the context of the Bank's fruitful but sensitive relations with Nigeria, the imposition of specific conditions would not add to its substantial leverage by virtue of its proposed lending program.

7. The Chairman decided that, in view of the arguments advanced by the Western Africa Department, a letter of representation on economic policy issues would provide a satisfactory basis for the loan.

8. The Chairman, at a separate meeting held in his office on Monday, February 22, decided that the Bank should ask the Nigerians to liquidate the backlog of their overdue payments within a defined period. Secondly, disbursement procedures should be set up in such a way that, while no distinction need be made between contracts signed or imports made before and after the loan was signed, the Bank's loan would not be used to finance payments overdue when the loan was signed.

9. The Chairman approved the Western Africa Department's recommendation that the Government be invited to negotiate the proposed $80 million loan.

Secretary's Department
March 12, 1971

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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March 11, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Spain - Agricultural Research Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 11, 1971 from the Europe, Middle East and North Africa Department, entitled "Spain - Agricultural Research Project" (LC/0/71-33).

2. Comments, if any, should be sent to reach Mr. Guillot (ext. 4724) by 5:00 p.m. on Monday, March 15.

3. It is planned then, if the Committee approves, to inform the Government that the Bank is prepared to begin negotiations for the proposed loan on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

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Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

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Mr. M. Shoaib, Vice President
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Vice President (IFC)

CONFIDENTIAL

LC/0/71-33
March 11, 1971

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

SPAIN - Agricultural Research Project

1. The attached appraisal report (No. PA-74) of an Agricultural Research Project recommends a Bank loan of \$12.7 million to the Government of Spain. If approved, this would be the first Bank group operation wholly concerned with agricultural research.

2. Spain has so far received 6 Bank loans for a total amount of \$225 million. These loans were for transportation, including roads, ports and railways, for livestock development and for education. The most recent loan, for an education project, was made in FY 1970 and amounted to \$12 million.

The Economy

3. The economic mission that recently returned from Spain is preparing its report. The mission concluded that Spain has a good potential for further economic growth although the rate of growth is expected to be slower than in the 1960's, when it averaged 7.5 percent per year, partly because of the need to allocate more resources to slow gestation investments in such fields as education, research and environmental improvement. There will also be more severe balance of payments constraints than in the past largely due to the slower growth expected in tourist earnings and workers remittances. To utilize its growth potential fully, Spain will continue to require substantial amounts of external capital. Because of its unused debt servicing capacity (the debt service ratio is expected to attain a peak of 5.6 percent in 1971 on the basis of 1970 export earnings), Spain can borrow abroad in the capital markets. However, even after reasonable recourse to international markets, future capital requirements will remain large enough to justify Bank lending.

4. A new Country Program Paper was discussed by the Economic Committee on March 3 and will be reviewed by Mr. McNamara on March 24. The primary objective of Bank lending to Spain is to introduce and support much needed structural and policy reforms through loans to priority sectors. The proposed lending program for 1972-76 (attached) gives approximately equal emphasis to transportation, agriculture, education and industry. Agriculture is expected to receive loans of about \$90 million during this period, about 22 percent of the total.

Background

5. The growth in agricultural production during the past decade of 3.5 percent per year has lagged far behind overall economic growth. The balance of external trade in agricultural products has shown an increasing deficit, which in 1969 amounted to nearly $300 million. Agricultural yields and techniques in Spain are lower than in most other European countries, and the need for improving the efficiency of agricultural research and extension was first pointed out by the 1965 FAO/Bank Agricultural survey mission. While academic agricultural research is up to international standards in some instances, applied research remains fragmented, poorly equipped and is handicapped by inadequately trained staff.

6. In April 1970, the Government requested a Bank loan to help finance an agricultural research and extension project. With the advice of subsequent Bank missions, the number of proposed research centers was reduced and the planned research became more "mission-oriented", i.e. towards solving high priority problems relating to key commodities. Since the project constituted a new departure for the Bank, a memorandum dated September 10, 1970 (LC/O/70/100) was distributed to the Loan Committee, together with the preappraisal report, and a meeting was held on September 14, 1970 (LC/M/70-8), which approved the sending of an appraisal mission. The Loan Committee found the proportion of the loan allocated for technical assistance justified, as well as the conditions the Bank proposed to attach to the project. The Chairman noted that an eventual Bank loan should not exceed the project's estimated foreign exchange cost and that the repayment terms should be relatively short. The appraisal mission visited Spain in November/December 1970.

The Project

7. There have been no basic changes in the targets and composition of the project since the meeting of the Loan Committee, with the exception that the reorganization of agricultural extension activity has been excluded from the project, because it appeared premature at this time to integrate extension services with research. However, first steps in this direction have been initiated through a recent Government decree which provides for better coordination of research and extension at all levels within the Ministry of Agriculture. Furthermore, at least two regional extension specialists would be located at each research center under the project to ensure full use of the facilities by the extension services. The project would consist of the establishment of six commodity-oriented specialized research centers, covering altogether 85 percent of the agricultural output of Spain, within the Instituto Nacional de Investigaciones Agrarias (INIA). It includes a substantial component of technical assistance to meet the shortage of agricultural research talent in Spain, by providing for the engagement of about 20 international research specialists for long-term service within INIA, about 30 short-term consultants and about 200 fellowships abroad for Spanish scientists.

8. The proposed Bank loan of $12.7 million would finance the foreign exchange cost of the project estimated at 49 percent of the total project cost, excluding the purchase of necessary land for some research centers. About $5.7 million would finance the building and equipment of the research centers; another $5.0 million would cover the foreign exchange cost of technical assistance; the remainder is for contingencies. The economic rate of return is difficult to determine for this kind of project, but it is estimated to be in the range of 15 percent to 30 percent (see paragraph 4.02 and Annex 11 of the appraisal report). The appraisal report recommends on project grounds that the loan be for 20 years including 5 years of grace. A shorter term could be considered appropriate on country grounds. However, since no benefits can be expected to accrue in the first ten years of implementation of the project, and because of its character as a basic and non-direct revenue producing service, I recommend adherence to the terms proposed in the appraisal report. The recent loan for education, which among our Spanish operations comes closest to the character of the proposed project, was also for a duration of 20 years.

Institutional arrangements

9. The proposed six specialized research centers would be staffed with full-time professional and technical personnel. This would require a change in Government employment conditions, since present working hours and salaries are such that research personnel almost uniformly hold second jobs. To help upgrade the quality of research work, INIA scientists at each center would be assisted by a team of international research specialists recruited on a contract basis for 3 to 5 years; one of these specialists would act as Research Coordinator (technical director) of each center. Moreover, each center would have access to the assistance of short-term consultants. The Government would appoint an agricultural scientist of international repute as National Research Coordinator to assist INIA's management in coordinating research programs.

10. Another important institutional change to be implemented by the Government would be to give the recently created National Council for Research and Extension power to recommend the channeling of Government finance for all official research organizations. This is expected to improve the rational allocation of funds to agricultural research.

11. It had been originally anticipated that financing could be requested from UNDP for the technical assistance component of the project. However, in subsequent discussions with the Government it was agreed that this was not possible, because UNDP commitments in Spain are at such a level that no further assistance can be expected.

12. The implementation of the project will entail recurrent operating expenses for the Government expected to amount to about $7 million per year at full development.

Procurement

13. As indicated in the appraisal report, international competitive bidding is not appropriate for all components of the project. All contracts for the erection of buildings and the supply of furnishings, services and utilities would be awarded under international competitive bidding. Domestic manufacturers would be accorded a margin of preference for purposes of bid comparison which would be the existing rate of custom duty applicable to competing imports or 15 percent of the CIF cost, whichever is the lower. Scientific equipment will be provided on specification of the center users while farm and transport equipment will be obtained under the Government's standard competitive bidding procedures from domestic and locally established foreign firms. The definition of CIF costs, as in the case of Loan 699 SP (Education project), would be exclusive of any compensatory tax which is levied in Spain in addition to custom tariff to offset tax advantages given to foreign exporters in their own countries.

Recommendation

14. I recommend that the Bank invite the Government of Spain to send representatives to negotiate a loan of $12.7 million equivalent for a period of 20 years including a 5 year grace period, substantially in accordance with Section V of the appraisal report.

M. P. Benjenk
Director

Attachment

Population: 33.3 million
GNP Per Cap: $804

SPAIN - ACTUAL AND PROPOSED LENDING PROGRAM THROUGH FY 1976

($ million)

Attachment 1

		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Livestock I	IBRD								25.0									
Livestock II	IBRD											30.0						
Livestock III	IBRD														30.0			
Agricultural Research	IBRD									13.0								
Ebro delta drainage	IBRD										20.0							
Reforestation	IBRD												15.0					
Unidentified	IBRD														20.0			
Education I	IBRD								12.0									
Education II	IBRD										40.0							
Education III	IBRD													35.0				
Highways I	IBRD		33.0															
Highways II	IBRD												50.0					
RENFE I	IBRD			65.0														
RENFE II	IBRD						50.0											
RENFE III	IBRD									85.0								
Ports I	IBRD				40.0													
Ports II	IBRD										40.0							
Industry Unidentified	IBRD											50.0						
Industry Unidentified	IBRD													50.0				
Industrial Credit Unidentified	IBRD												30.0					
Urbanization Unidentified	IBRD														30.0			
Operations Program	IBRD									98.0	100.0	80.0	95.0	85.0	80.0		315.0	440.0
	No.										3	2	3	2	3		9	13
Lending Program		—	33.0	65.0	40.0	—	50.0	—	37.0	98.0	80.0	65.0	80.0	75.0	80.0	188.0	280.0	380.0
	No.		1	1	1		1		2	2	2	2	2	2	3	4	8	11
IBRD Loans Outstanding																		
-including undisbursed		-	31.3	95.2	135.2	135.2	185.1	182.1	213.6	311.6	387.6	436.3	530.0	613.5	690.2			
-excluding undisbursed		-	-	-	22.6	66.7	94.1	131.8	149.2	159.2	176.5	337.9	330.0	392.9	463.7			
IBRD Gross disbursement		-	-	1.7	23.7	44.0	27.5	39.9	22.4	17.7	27.0	75.0	94.0	64.0	77.0	96.9	276.0	337.0
Net disbursement		-	-	1.7	23.7	44.0	27.5	36.0	16.7	10.0	17.3	64.7	82.4	50.9	60.6	96.9	144.7	275.9
Net transfers		-	-	1.4	23.0	41.5	23.0	30.0	8.6	0.2	15.8	47.3	58.5	25.3	27.0	88.2	101.9	170.9

Europe, Middle East and North Africa Department
February 25, 1971

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 11, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Uganda - Second Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 11, 1971 from the Eastern Africa Department, entitled "Uganda - Second Education Project" (LC/O/71-34).

2. Comments, if any, should be sent to reach Mr. Clements (ext. 4914) by 5:00 p.m. on Monday, March 15.

3. It is planned then, if the Committee approves, to inform the Government that the Association is prepared to begin negotiations for the proposed credit on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

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Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-34

March 11, 1971

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

UGANDA - Second Education Project

I. INTRODUCTION

1. A faction of the army seized power in Uganda on January 25, 1971 and established a military government under Major General Idi Amin. Although there were clashes for some days between General Amin's forces and troops loyal to President Obote, General Amin appears to be in firm control and likely to remain so provided he can retain control of the armed forces. The extent of his popular support is unclear, but there is no evidence of any significant support for Mr. Obote, who is now in Tanzania, and there had been scant respect for the majority of his Ministers.

2. On February 2 Major General Amin dissolved parliament, dismissed the cabinet, assumed all executive and legislative powers, and announced that he would rule by decree until the country could be returned to civilian rule. He appointed a largely civilian Council of Ministers, eight of them senior civil servants. Day-to-day administration, and communication with the Bank, have continued substantially uninterrupted. (It may be noted that Uganda rolled over its holding of the March 1969 Two-Year Bonds.) The new Government has not yet issued statements of policy and none may be forthcoming for some time. However, one can infer from criticism of the Obote Government by General Amin that there is likely to be some moderation in the so-called "move to the left". In 1970, the Government had announced an extensive program of nationalization. A recent speech by the new Minister of Finance, Mr. Wakhweya, formerly Secretary to the Treasury and well known to us as a constructive and able man, indicated that the new Government would review the proposals for nationalizing those companies with whom compensation terms had not yet been agreed or with whom negotiations were not yet far advanced. He argued that Uganda should use for its own development the capital required to finance the compensation that would otherwise have to be paid and added that it was important to reestablish confidence in Uganda among private investors. The other Ministers concerned with the proposed education project are a mixture of known and unknown quantities. The Minister of Education was Education Minister in Buganda prior to 1966; the new Minister of Agriculture, Forestry and Cooperatives had been Commissioner of Prisons since 1962; the new Minister of Health was formerly Permanent Secretary of that Ministry; and the new Minister of Labour was formerly Permanent Secretary in the President's Office.

3. Britain, Ghana and Australia have officially recognized the new regime in Uganda. Tanzania, Uganda's partner with Kenya in the East African Community, and Somalia have stated that they will not do so, creating an impasse within the Organization of African Unity on the issue of

Uganda representation. Tanzania's attitude obviously raises doubts about future cooperation within the Community, a matter of general concern to the Bank Group but with no obvious bearing on the proposed IDA credit. Despite the limited formal recognition so far, the international community generally appears ready to accept the new Government as one with which normal business may be conducted. The policy adopted by several countries including the United States has been to avoid the step of recognizing the Government formally but to begin to re-establish normal working relations with Uganda once it was evident that the new regime was in effective control of the country.

4. On receipt of the news of the coup we withheld further disbursements on existing loans and credits to Uganda and postponed the departure of a livestock appraisal mission pending clarification of the situation. We also delayed submitting the proposed education project to the Loan Committee, on the grounds that an invitation to the new Government to negotiate a credit would indicate a willingness in principle to enter into an agreement with the Government. Disbursements have now been resumed and the appraisal mission is currently in the field. As far as the proposed education project is concerned, the new Minister of Finance has recently written to us indicating that the Government wishes to proceed with the project and that it is ready to send representatives to Washington for negotiations. I believe that the Government is sufficiently stable and acceptable to permit us to go forward with negotiations and that there is nothing to gain by deferring them any longer. As far as we can ascertain, no legislation of significance to the consummation of the proposed credit has been suspended or altered, but before proceeding to present the credit to the Executive Directors we plan to obtain satisfactory legal opinion on the point. The Government has announced its intention to honor all existing obligations.

II. THE PROJECT

5. The first IDA Credit to Uganda for education, of $10.0 million signed in April 1967, is helping the Government to expand secondary school enrollment and to improve the curriculum in secondary schools by adding science subjects and practical courses. Under the project 24 new secondary schools are being constructed and 15 existing schools are being provided with additional facilities. Construction work at these schools is expected to be completed in mid-1971, but a delay in deliveries of furniture and equipment due to inefficient procurement may necessitate a postponement of the Closing Date by about six months beyond the present date of December 31, 1971.

6. Uganda is unusual in that a very substantial proportion of the students at primary and general secondary level are enrolled in private schools. Taking account of these schools and the additions to the public

school system being provided under the First Education Project, there is no need for a number of years to come for any significant expansion at primary or general secondary level. On the other hand, the shortage of trained manpower is becoming more acute in almost every field as the economy expands. The Government's determination to "Ugandanize" the economy as soon as possible will make the shortage still more acute. Despite the extensive private school system, the Government has been spending quite heavily on public education, which accounted for 16 percent of total capital expenditure and 28 percent of recurrent expenditure in the 1970-71 budget. While there is an urgent need now to focus attention on vocational training for agriculture, industry, commerce and the para-medical profession, very careful planning is required to achieve a better balanced system within the limits of available resources.

7. The attached appraisal report (No. PE-25) recommends an IDA Credit of $7.3 million for a project consisting of: (a) a teacher training program, including the provision of accommodation and equipment, to fill a serious gap in the supply of secondary school teachers in commercial, technical and agricultural subjects; (b) a major expansion of specialized training facilities in the fields of industry, agriculture and health and extensions to four upper secondary schools in accordance with projected manpower needs; and (c) technical assistance for certain of these items and for the establishment of a planning group to assist the Government improve its long-term educational planning by identifying education priorities and accommodating them within the limits of the country's resources.

8. The proposed project would help to redress the present lack of balance in the Uganda education system. The cost of running the project's institutions and programs in 1975/76, when fully operative, would constitute 1.3 percent of the Central Government's total recurrent expenditures on education. This total would then represent 29 percent of the Government's recurrent expenditures in all sectors together, which is high but still within the Government's capacity.

III. ISSUES AND HIGHLIGHTS

Financing Plan

9. The total estimated cost of the proposed project is $10.4 million, of which the foreign exchange component is estimated to be $5.5 million. Over the last four years, the Bank Group's policy has been to finance on the average about 70 percent of the costs of projects in Uganda, which has generally resulted in some local cost financing. For the reasons set out in paragraph 17, I consider that we need to continue that policy. The proposed credit is therefore in the amount of $7.3 million (70 percent of $10.4 million) and would finance $1.8 million of local costs in addition to the whole of the foreign exchange costs.

10. The proposed amount of IDA lending, however, includes approximately $2 million equivalent for technical assistance, some of which may be made available from other sources, such as ILO, WHO and the U.K. Government, which have been approached by the Uganda Government and have shown interest in principle. This technical assistance consists of 80 man-years of specialist services, principally for the secondary teacher training program and the proposed new vocational training center, together with 18 man-years of fellowships to train Ugandans to take over from the foreign specialists as soon as possible. The problem is that we know neither how much assistance can in fact be obtained from other sources nor how quickly. I consider that we should therefore avoid the risk of delay by making provision for the whole amount in the proposed credit, reducing the credit to take account of assistance secured before submission to the Executive Directors and providing in the Credit Agreement for cancellation to the extent that finance for technical assistance is obtained subsequently from other sources.

11. To take account of possible variations in the cost of the project to be financed by the Association, the appraisal report recommends in paragraph 5.05 that we disburse 70 percent of the actual project cost (up to a limit of $7.3 million). I think it desirable to avoid the necessity for changing the percentage disbursement in various categories as portions of the credit are cancelled in the event of other donors providing technical assistance, and important to avoid ambiguity about the amount of any cancellations to be effected. I propose therefore that the Development Credit Agreement should specify that the Association shall cancel $31,000 of the credit for each man-year of the services of educational specialists and $4,500 for each man-year of fellowship grants obtained from other donors, regardless of the terms on which the donor in question actually provides assistance; these amounts represent the estimated foreign exchange cost of the technical assistance concerned. The Education Projects Department agrees with the proposed arrangement. If all technical assistance presently included in the project were provided from other sources, the total project cost would be reduced to $6.9 million and the proposed IDA credit to $4.7 million, which would then be 68 percent of the total project cost. Local expenditure financing by IDA would remain unchanged at $1.8 million.

Secondary School Extensions

12. The Government, on the basis of a project proposal prepared with Unesco assistance, originally requested extensions to 40 general secondary schools, largely a continuation of the program financed under the First Education Project. The appraisal mission could not find justification for the larger part of this request and we propose that the secondary school extensions be confined to four upper secondary schools to provide places for an additional 500 science students for which the manpower demand is strong. In addition, because of the high percentage of revenue which Uganda is already spending on education and the high cost of boarding facilities,

it is desirable that this expansion should be limited to day-student places and, on the basis of our present information, we are satisfied that four schools could in fact be identified which could be expanded for additional day-student enrollment. The Government, however, has claimed that it is difficult to select four schools for expansion without provision for boarding. We have requested the Government to provide more information to support its argument and the matter would be discussed further during negotiations.

Health Training Facilities

13. Uganda has a serious problem in providing adequate health care for a population that is exposed to virtually all the diseases of temperate climates as well as most major tropical diseases. The economic benefits of more effective health services are difficult to quantify, but there can be little doubt that they would be substantial in terms of reduced sickness and hence lower absenteeism and higher productivity. Two major obstacles to improving health care in Uganda are the lack of adequate facilities and qualified tutors for training para-medical staff. The proposed project would establish (a) a small medical tutor training college to train professionally qualified medical personnel of various categories to become teachers in para-medical training schools, and (b) a training school for nurses and midwives adjacent to one of the principal hospitals. We would seek an assurance that, within one year of signing the credit, the Government would upgrade facilities for training purposes at the hospital by extending the maternity and pediatric wards.

Project Management

14. The existing project unit for the First Education Project does not have the capacity to carry out the more complex second project. It is, therefore, proposed that a new project unit be established in the Ministry of Education to be responsible for implementing the proposed project as well as completing the first project. The new unit would consist of a project director, an architect, both to be acceptable to the Association, a procurement specialist and an accountant. Approved nominations for the posts of project director and architect would be required before presenting the project to the Executive Directors. Establishment of the project unit and the appointment of the project director and architect would be conditions of effectiveness. Because the proposed project involves several Ministries in addition to the Ministry of Education, it is proposed that a Project Management Committee, consisting of the Permanent Secretaries of the Ministries of Finance, Education, Agriculture and Forestry, Labour and Health, should be established for general supervision of the project and coordination among the Ministries involved. The Permanent Secretary of the Ministry of Finance would be Chairman of this Committee and the Project Manager would report to him directly. Establishment of the Committee would be a condition of presentation of the proposed credit to the Executive Directors.

Procurement

15. All contracts for the supply of furniture and equipment and for construction would be awarded under procedures consistent with the Guidelines on international competitive bidding. It is unlikely that firms not already operating in Uganda would submit bids, except for equipment, due to the varied locations and diversity of types of project institutions. At the Government's request, it is proposed to accord domestic manufacturers a preference of up to 15 percent of the c.i.f. price on competing imports.

16. Our policy so far has been to accord such a preference only when requested by the Government of the borrowing country. This practice has led to a somewhat anomalous situation in that preferences have been granted for certain projects but not for others. I consider it desirable to reconsider this policy in future cases as may be necessary to arrive at a consistent treatment in all projects in East Africa, taking into account the fact that Kenya, Tanzania and Uganda have established a regional economic organization, the East African Community, and a Common Market. I am considering the various aspects of this matter and may wish to propose a change in the present policy as it applies to future projects in this area.

IV. ECONOMIC SITUATION

17. The last economic report on Uganda (No. AE-2 dated June 9, 1969) noted that Uganda had been successful in mobilizing local resources on a significant scale to finance development. The report also noted, however, that with a continued improvement in its ability to prepare and execute projects, Uganda's domestic resources could prove increasingly inadequate to sustain development at a level that was both desirable and feasible, and hence that the need for external assistance would probably increase. An economic mission from the Bank visited Uganda during November-December 1970 and its report is being prepared. In general, the resource situation outlined in the 1969 economic report remains. The annual level of Central Government development expenditure in the third and fourth year of Uganda's 1966-71 Plan has been substantially higher than in the first two years. While external resources were expected to finance 56 percent of this program, their contribution in practice turned out to be only 45 percent. In the event, Uganda has had to make up the deficiency through additional taxation and domestic borrowing, and also by supplier credit/contractor finance arrangements. The recent economic mission has confirmed that the amount of external assistance which Uganda requires will exceed the foreign exchange cost of projects likely to attract external finance. Hence some financing of local expenditure for high priority projects, such as the proposed education project, is justified.

18. In May 1970, the Government announced its intention to acquire

up to 60 percent shareholding in all banks, insurance, oil, bus and major manufacturing companies, and in agricultural estates. More than eighty enterprises could be affected by the decision. In the period immediately following this announcement there was some uncertainty concerning the manner in which the Government would compensate for the assets acquired. The general procedures and principles for compensation have now been clarified and in general seem satisfactory, and negotiations are proceeding with various firms. The claims of the bigger, internationally based firms are being investigated first and agreement has been reached with the oil distribution companies, one bank and a large tobacco company. As indicated in paragraph 2 above, the new regime has announced that it does not intend to "unscramble" agreements which have already been concluded with foreign companies or which are nearing conclusion but that it would review the 60-40 arrangement for the remaining companies. I do not believe that the situation provides any reason for postponing negotiations for the proposed credit. We would, however, inform ourselves more fully of the position before deciding to submit the credit to the Executive Directors.

V. RECOMMENDATION

19. I recommend that the Association invite the Republic of Uganda to send representatives to Washington to negotiate a development credit of $7.3 million equivalent for the project substantially on the terms and conditions set forth in the attached appraisal report with the exception mentioned in paragraph 11 of this Memorandum.

J.H. Williams
Deputy Director

Attachment: Five-Year Lending Program

Population: 9.8 m.
GNP Per Cap.: $100

Attachment

UGANDA - 5 YEAR LENDING PROGRAM

		($ million) Fiscal Years 1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73
Agricultural Credit I	IDA				7.0				
Livestock II	IDA			4.0					
Livestock III	IDA						5.0		
Tobacco I - Farming	IDA		4.0						
Tobacco II	IDA						7.0		
Smallholder Tea II	IBRD			6.0					
Smallholder Tea III	IBRD						8.0		
Agriculture Unidentified	IDA						5.0		
Education II	IDA		7.3						
Education III	IDA					12.0			
Murchison Falls Power	IBRD					30.0			
Tourism	IBRD					7.0			
Roads II	IDA	11.6							
Roads III	IDA				7.0				
Roads IV	IDA						5.0		
Kampala Water Supply	IDA				7.0				
	IBRD			6.0		37.0	8.0		6.0
	IDA	11.6	11.3	4.0	21.0	12.0	22.0	18.4	50.9
	Total	11.6	11.3	10.4	21.0	49.0	30.0	18.4	56.9
	No.	1	2	2	3	3	5	3	9

Eastern Africa Department 2/17/1971

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 10, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Indonesia - Tea Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 10, 1971 from the East Asia and Pacific Department, entitled "Indonesia - Tea Project" (LC/0/71-32).

2. Comments, if any, should be sent to reach Mr. John Foster (ext. 2555) by 5:00 p.m. on Monday, March 15.

3. It is planned then, if the Committee approves, to inform the Government that the Association is prepared to begin negotiations for the proposed credit on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

Copies for Information:

President
The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-32

March 10, 1971

LOAN COMMITTEE

Memorandum from the East Asia and Pacific Department

INDONESIA: Tea Project

1. The Government of Indonesia has asked the Association for a Credit to finance a tea estate project in Indonesia. The proposed project would consist mainly of the rehabilitation and development of tea and cinchona (quinine) on two groups of Government-owned estates in Java, PNP's XII and XIII. A copy of the appraisal report entitled "Indonesia: Tea Project" (PA-78) dated February 25, 1971, is attached.

The Lending Program

2. The Association has made thirteen credits to Indonesia totalling \$170.9 million. Credits for the production and distribution of rice seeds, and for a highway rehabilitation and construction project, are also expected to be ready for presentation to the Executive Directors before the end of this fiscal year. If it is clear in May that all three of these Credits can be successfully negotiated in this fiscal year, it will have to be decided which Credits we will present before June 30, 1971, taking into account the availability of IDA funds for Indonesia.

3. If approved, this Credit would be the Bank Group's first lending operation for the development of tea and cinchona in Indonesia, and would be the third project for development of plantation crops in the Government estates sector. Additional estate projects are planned in Fiscal 1972 and 1973, and a smallholder rubber project in Fiscal 1972. The details of all proposed lending are contained in the Lending Program which is annexed.

The Economy

4. The last full economic report on the position and prospects of Indonesia (EAP-19a) was issued on November 27, 1970.

5. Indonesia's recent economic performance has been satisfactory. The efforts of the Government, assisted by external donors, have brought about financial stability and laid the groundwork for economic rehabilitation and further development. In 1970 economic progress has become clearly discernible. Output and exports have both increased markedly, construction activity is expanding, and the rehabilitation and improvement of infrastructure facilities is under way. Business confidence in the Government's economic policies is increasing as is evidenced by capital repatriation and the rising level of private investment activity. Further improvement in economic performance calls for continuation of the recent economic policies combined with substantial progress in administrative reform.

6. Reflecting the increasing pace of development activities, total development expenditure rose by more than one-third in 1970/71 and is expected to rise by another third in 1971/72. Government revenues increased by 42 per cent in 1970/71 and are expected to increase by another 20 per cent in 1971/72; these increases are impressive, particularly under the present conditions of price stability. Of special importance is the fact that the routine budget surplus - the contribution of Indonesia's own resources to the development budget - has risen from zero in 1968 to one-fifth of the development budget this year, and is expected to cover almost one-fourth next year. The 1971/72 aid request submitted in December 1970 to members of the Inter-Governmental Group for Indonesia amounted to \$640 million - as compared to \$600 million requested, and fully subscribed, this year.

7. Indonesia's exports maintained a rapid rate of expansion rising from \$770 million in 1967 to \$1,160 million in 1970/71, an average annual growth rate of 14.5 per cent during the period. Though the growth rate is expected to decline somewhat due to weakening rubber prices, the prospects for Indonesia's exports, paced by a steadily expanding oil sector, remain encouraging. So far stabilization and year-to-year development have been the preoccupation of Indonesian economic policy and of Bank economic work. Now, however, a basis has been established for a longer term view of economic prospects and policy and resource requirements. A Bank mission is now in Indonesia for the purpose of this longer term assessment, in association with the Bank Resident Staff.

8. Two exchange reforms were carried out in 1970, one in April simplifying the exchange rate system, and another in December establishing a single exchange rate. Since April, in an exchange regime of virtually complete freedom, both exchange rates and the price level have been stable.

9. An agreement for rescheduling of Indonesia's pre-1967 external debt (the so-called "Sukarno debt") over a period of 30 years was reached in April 1970 with the "Paris Club" of western creditor countries and Japan, which hold among them 40 per cent of the debt. In August 1970 a similar agreement on comparable terms was reached with the Soviet Union, which holds 42 per cent of the "Sukarno debt".

The Estates Sector

10. The estates sector is one of Indonesia's major earners of foreign exchange but its relative contribution has decreased from 60 per cent of total exports by value in 1938 to only 15-20 per cent today, due to deterioration of the estates caused by government neglect and political and economic uncertainty. The present Government is determined to bring the industry back to its former level of efficiency, but large investments are required for field and factory rehabilitation, new planting and replanting, and management needs to be reorganized and research facilities improved before this objective can be realized.

11. IDA Credits 155-IND (US$16 million) for a first estates project and 194-IND (US$17 million) for a second estates project were designed to bring about institutional and management reform and assist the rehabilitation of about 85 per cent of palm oil and 25 per cent of rubber in areas under government estates. The attached appraisal report notes that these projects experienced delays, mainly due to organizational problems that management has found it hard to change from sporadic financing to active forward planning with assured funds, and that technical assistance is not yet working smoothly in all cases. Some progress has been made, but rehabilitation is slower than expected and serious managerial and organizational problems continue, though they are gradually being resolved.

12. A supervision mission of Credit 155-IND in November/December 1970 reported that agricultural standards, management and physical progress of planting on one of the estates groups, PNP VII, is satisfactory; but poor management has contributed to shortcomings in project implementation in the other, PNP V. Disbursements as of January 31, 1971, amounted to $1,497,000; though procurement and disbursement are behind schedule, the position is expected to improve soon, since orders have been placed and contracts awarded for another US$3,497,000. The project has also been hampered by shortcomings in consultants' services, financed by the credit, on both PNP's. Credit 194-IND was declared effective on February 9, 1971, after some delays in appointing the Boards, executive managements and consultants for various services. We are urging that a number of steps be taken by the Government to improve project implementation under both Credits.

The Project

13. The proposed project would consist of the rehabilitation of about 21,000 ha of existing tea, new planting of 2,300 ha of tea and 1,100 ha of cinchona, as well as improvement of transport facilities and re-equipping and expansion of tea factories, on twenty-five estates in the PNP XII and XIII groups. Technical assistance would be furnished to strengthen management, by providing an Inspection Service and resident Advisors to introduce modern tea cultivation and processing methods, and to improve tea research. The proposed credit would finance a survey of the presently run-down and inefficient smallholder and private tea estates, with a view to recommending improvements and formulating projects to rehabilitate them.

14. The total cost of the project is estimated at about $25 million, including a foreign exchange component of $15 million (approximately 60 per cent of the total cost) which would be financed by the proposed credit. Procurement of goods for the project would be in accordance with the Association's Guidelines; and IDA would pay the full foreign exchange cost of goods, services and training. Local producers would be allowed a preference of 15 per cent or the actual tariff duty, whichever is less; and where a local producer is successful in the bidding, IDA would disburse for locally manufactured equipment a percentage of the total cost, to be agreed during negotiations, which represents ex-factory price net of import duties and other Indonesian taxes. The total of such procurement may amount to about $2 million. A small amount of imported office equipment estimated

to cost $50,000 is likely to be procured through local suppliers after obtaining competitive quotations, while housing, estimated to cost $2.19 million but having a small foreign exchange component of $330,000, would be submitted to local tender. In these cases, IDA would disburse 82 per cent of certified costs for office equipment and 15 per cent for housing, representing the estimated foreign exchange component. The case for local currency financing in Indonesia has been established, but we are not proposing that the local costs of this project be financed out of the proposed Credit because they would be met from self-generated funds of the PNP's.

15. A principal issue for negotiation would be the extent and timing of organizational and managerial changes sought under the project. As explained in the Appraisal Report, PNP policy is now directed by the Ministry of Agriculture, which is remote from management, inexperienced in commercial operation and responsible for too many PNP's to direct them effectively. Under the present system, estate earnings are appropriated to Treasury revenue without regard to investment needs, leaving the management with little incentive to maximize profits or generate income.

16. The Government has decided in principle to convert all PNP's into relatively autonomous commercial enterprises (PT), operating under the Commercial Code, with Government equity investment denominated in share capital, each PT with a Supervisory Board making policy for executive Management Boards to carry out. This would meet the Association's preference for more commercially-oriented operation of the PNP's. However, the Bank Resident Staff in Indonesia has cautioned that in view of the time required in Indonesia for formalizing such a conversion, there could be a long delay in presenting the project to the Executive Directors. In such an event, the project would have to be postponed to the next fiscal year.

17. The Appraisal Report recommends that the Association reach agreement with the Indonesian authorities before negotiations on one of the following courses of action: (a) during negotiations draft PT Charters of Incorporation would be submitted to the Association for approval, and before the Credit was declared effective PNP's XII and XIII would be converted into PT's, and a policy-making Board of Directors and an executive Management Board would be appointed for each PT; or (b) as an interim measure, the estate groups would continue as PNP's, and arrangements similar to those agreed under the first two estate projects (155-IND and 194-IND) would be made, namely the appointment of the policy-making Board of Directors and an executive Management Board, with formal conversion of both entities to PT's not later than December 31, 1971. While I agree that the adoption of a management structure along commercial lines, with or without formal conversion to PT, is important for the effective operation of the estates, it may take the Indonesian authorities some considerable time to select and appoint appropriate individuals. We therefore face the prospect of a lengthy period of time before the Credit can be declared effective. There are three other considerations: Firstly, the necessary appointments may well be made for one PNP/PT before those for the other; secondly, it would be an advantage if the firm that is to provide the

inspection service and the advisors could be appointed and working as soon as possible; thirdly, if formal conversion of the PNP's to PT's is an important step, the Association should have some means of ensuring that it takes place by December 31, 1971 (or whatever date is thought reasonable) other than to call the Credit. I therefore consider that the conditions for effectiveness of this Credit should be confined to the giving of the usual legal opinions, together with the matters set out in paragraph 8.04 (a), (b), (d) and (e) of the Appraisal Report. On this basis, disbursements could be made for technical assistance and research as soon as the Credit had been declared effective. Appointment of the various Boards (and if thought necessary, conversion to PT) would then be made a condition of disbursement, separately for each PNP/PT, in respect of the other elements of the project. We might include a provision that if this condition is not met by a certain date, for one or both of the entities, we would have the right to cancel the appropriate portion of the Credit.

18. In any event, assurances would also be sought following the precedents of Credits 155-IND and 194-IND, that appointments to the two Boards would be made in consultation with the Association. Other assurances to be sought follow mainly the pattern set under the earlier Credits.

19. The proposed project has an overall economic rate of return from tea and cinchona of 26 per cent. In the next ten years, total output of Indonesian tea is expected to increase only by about 4,000 tons net, including output from the project. Due to high potential local demand, it is unlikely that all of this increased production would enter the world market, which would therefore be virtually unaffected. Under the short-term international tea agreement for 1970/71 entered into among the main producers, Indonesia was allocated an annual export quota of 35,000 metric tons, but exports in 1970 fell short of this quota by 8,000 tons. Prices, especially for poor quality tea, are expected to decline in the world market. A higher price than now obtained is forecast for project tea because of the improved quality that would result. Indonesia has been an efficient low cost producer of tea and can be again in the future. The proposed project would help to reverse the decline in production and quality, provide a potential source of good planting material, make available the benefits of research facilities financed under the project and generally strengthen the tea industry.

Recommendation

20. With the qualification noted in paragraph 17 above, I agree with the Recommendations of the Appraisal Report that the project forms a suitable basis for an IDA Credit of $15.0 million, and recommend that the Government of Indonesia be invited to send representatives to negotiate such a Credit.

Raymond J. Goodman
Director
East Asia and Pacific Department

Attachments.

Population: 121.1m
Per Cap Inc: $80

INDONESIA - ACTUAL AND PROPOSED LENDING THROUGH FY 1976

Attachment 1

($ millions)

		Fiscal Years																
		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	Totals 1964-1968	Totals 1969-1973	Totals 1972-1976
Irrigation Rehabilitation I	IDA							5.0										
Irrigation Rehabilitation II (Djatiluhur)	IDA								18.5									
Irrigation Rehabilitation III	IDA									14.5								
Irrigation Rehabilitation IV	IDA										15.0							
Irrigation Rehabilitation V (Djatiluhur Ext)	IDA											15.0						
Estates I	IDA							16.0										
Estates II	IDA								17.0									
Estates III (Tea)	IDA									15.0								
Estates IV (Rubber & Oil Palm)	IDA										12.0							
Estates V	IDA											10.0						
Fisheries	IDA									3.5								
Rice Seeds Production	IDA									5.1								
Smallholder Rubber	IDA										4.0							
Livestock	IDA											5.0						
Sugar Industry Rehabilitation	IDA											11.0						
Forestry	IDA											9.0						
Agriculture Unidentified I	IDA											10.0						
Agriculture Unidentified II	IDA												35.0					
Agriculture Unidentified III	IDA													35.0				
Agriculture Unidentified IV	IDA														35.0			
Telecommunications I	IDA									12.8								
Telecommunications II	IDA											10.0						
Telecommunications III	IDA														10.0			
DFC I	IDA										10.0							
DFC II	IDA											10.0						
DFC III	IDA													20.0				
Education - Technical	IDA									4.6								
Education - Agriculture	IDA										7.0							
Education Unidentified I	IDA											5.0						
Education Unidentified II	IDA													10.0				
PUSRI Fertilizer Project	IDA								30.0									
Industry - Ombilin Coal Project	IDA											25.0						
Industry Unidentified I	IDA													30.0				
Industry Unidentified II	IDA														30.0			
Industrial Estates I	IDA										5.0							
Industrial Estates II	IDA												5.0					
Industrial Estates III	IDA														5.0			
Family Planning I	IDA										3.0							
Family Planning II	IDA												10.0					
Family Planning III	IDA														10.0			
Djakarta Power Distribution	IDA								15.0									
West Java Thermal Power Plant	IDA										30.0							
Power - Asahan	IDA												30.0					
Power Unidentified I	IDA												30.0					
Power Unidentified II	IDA														30.0			
Tourism - Bali	IDA										5.0							
Tourism Unidentified I	IDA												10.0					
Tourism Unidentified II	IDA														10.0			
Highways I	IDA							28.0										
Highways II	IDA									29.0								
Highways III	IDA										40.0							
Highways IV	IDA											30.0						
Highways V	IDA													30.0				
Marine Transport I	IDA										15.0							
Marine Transport II	IDA												30.0					
Transportation Unidentified I	IDA													30.0				
Transportation Unidentified II	IDA														45.0			
Water Supply I	IDA											5.0						
Water Supply II	IDA													10.0				
Technical Assistance I	IDA							2.0										
Technical Assistance II	IDA									4.0								
Technical Assistance III	IDA										4.0							
Technical Assistance IV	IDA												4.0					
Gross Total (all IDA) a/										88.5	150.0	145.0	154.0	165.0	175.0		515.0	789.0
No.										8	12	12	8b/	7b/	8b/		40b/	47b/
Net Total								51.0	80.5	60.0	90.0	90.0	90.0	126.0	126.0		371.5	522.0
No.								4	4	6	8	8	7	7	7		30	37
IDA Credits Outstanding																		
- including undisbursed								51.0	131.5	191.5	281.5	371.5	461.5	587.5	713.5			
- excluding undisbursed c/								0.3	2.9	13.4	53.5	130.5	224.4	318.6	416.8			
ADB								-	13.4	23.0	25.0	n.a.	n.a.	n.a.	n.a.			

a/ Gross total excludes program lending contingency item of $40-$50 million in 1972 and 1973 combined (see text, Section D)
b/ Will increase depending on project split-up of unidentified items
c/ Based on project lending only; the effect of program lending on the disbursement pattern is discussed in Section D of the text.

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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LM/M/71-15

March 10, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to consider "Congo (Brazzaville) - Compagnie des Potasses du Congo" (Loan No. 480-COB), held at 10:30 a.m. on Thursday, February 25, 1971 in Conference Room A.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
Director, Development Finance Companies Department
Director of the Economics Department
Controller

Copies for Information:

President
The Economic Adviser to the President
Sir Denis Rickett, Vice President
Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

LM/M/71-15

March 10, 1971

Minutes of Special Loan Meeting to consider "Congo (Brazzaville) - Compagnie des Potasses du Congo" (Loan No. 480-COB), held at 10:30 a.m. on Thursday, February 25, 1971 in Conference Room A.

1. Present: Messrs. Knapp (Chairman), Cope, Aldewereld, Broches, Chadenet, Chaufournier, Kalmanoff, Delaume, Mehlem, Thalwitz, Leduc and Pearce (Secretary).

2. Issue: The meeting had been called to consider Mr. Broches' memorandum of February 19, 1971 to files, which reported on his meetings with the President of the Compagnie des Potasses du Congo (CPC) and officials of the French Ministry of Finance on February 16 in Paris on the "force majeure" clause (cf. LM/M/70-49 dated December 23, 1970 and LM/M/71-3 dated January 26, 1971).

3. Discussion: The meeting noted that:

(a) CPC had hoped originally to attract capital from outside France and, for this reason, the Bank had agreed that the shareholders' guarantee of the Bank's $30 million loan (480-COB) need not cover political "force majeure." In fact, no non-French partners had been found and CPC's only shareholders remained companies owned by the French Government. In the circumstances, the reason for the "force majeure" exception had disappeared.

(b) Owing to the project's failure, CPC was to all intents bankrupt. The technical, financial and commercial risks, against which the Shareholders' Guarantee Agreement had been intended to provide protection, had materialized and should be borne exclusively by the guarantor-shareholders.

(c) Since the "force majeure" clause had lost its raison d'etre, the Bank wanted the guarantor-shareholders to acknowledge this explicitly. The Congolese Government might expropriate or nationalize CPC and, although the General Counsel was of the opinion that the guarantor-shareholders could not validly invoke the "force majeure" exception in that event, there was a risk that they might do so. A waiver of the "force majeure" clause was therefore justified; it was also a condition of the Bank's continued willingness to refrain from prematuring its loan.

4. Noting that CPC's first reaction to the Bank's proposition, i.e. that the guarantor-shareholders waive the "force majeure" clause, had been negative and that, if the Bank prematured its loan, it might be blamed for killing the project (a point to which the French Government had drawn attention), the Chairman suggested that CPC, in return for the Bank's refraining from prematuring its loan, might agree to a new repayment schedule not subject to "force majeure." On the other hand, it was still not entirely clear how far mining operations might be improved. A Bank supervision mission would shortly visit Brazzaville to look into this question.

5. The meeting agreed that the best solution for the Bank would be to induce the guarantor-shareholders to waive the "force majeure" clause, pending clarification of the project's future. The Bank's efforts should continue to be directed to this end by means of high-level representations to the French Government, the ultimate interested party, which was supplying the funds for CPC's continued operation. This approach, concentrating on the general issues rather than the legal technicalities, should take the form of a letter from the President to the French Minister of Finance explaining why the Bank considered that the "force majeure" clause had lapsed and suggesting that he try to persuade the guarantor-shareholders that the Bank was right.

6. Decision: The Chairman said that the Bank should pursue the "force majeure" issue directly with the French Government, in accordance with para. 5 above. The General Counsel would draft a letter for the President's signature.

David Pearce
Secretary

Cleared by: Messrs. Cope
Broches
Chaufournier
Delaume

cc: Loan Committee
Participants

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

March 9, 1971

MEMORANDUM TO THE LOAN COMMITTEE

Tunisia - Agricultural Credit Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated March 9, 1971 from the Europe, Middle East and North Africa Department, entitled "Tunisia - Proposed Loan and Credit for an Agricultural Credit Project" (LC/O/71-31).

2. Comments, if any, should be sent to reach Mr. Siebeck (ext. 4707) by 1:00 p.m. on Friday, March 12.

3. It is planned then, if the Committee approves, to inform the Government and BNT that the Bank and the Association are prepared to begin negotiations for the proposed loan and credit on the terms and conditions referred to in the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Vice President, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
General Counsel
Director of the Development Services Department
Directors of the Area Departments
Deputy Director, Projects
Directors of the Projects Departments
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/71-31

March 9, 1971

LOAN COMMITTEE

Memorandum from the Europe, Middle East and North Africa Department

TUNISIA - Proposed Loan and Credit for an Agricultural Credit Project

1. Attached for consideration by the Loan Committee is an appraisal report, entitled "TUNISIA - Agricultural Credit Project" (No. PA-79) dated March 1, 1971, which recommends a Bank loan of $5.0 million and an IDA credit of $3.0 million to help finance an agricultural credit project, the total cost of which would be $15.0 million.

2. This would be the eleventh Bank loan and the seventh IDA credit to Tunisia, bringing total Bank commitments to $86.4 million, and total IDA commitments to $47.9 million. It would be the second lending operation for Tunisia's agricultural development. In 1967, the Bank and IDA financed the Cooperative Farm project (Loan/Credit No. 484/99-TUN) which, after changes in Tunisia's agricultural policies affecting the character of projects, had to be revised and was renegotiated last September. The current 5-year operations program for Tunisia is attached.

The Economy

3. A Memorandum on Current Economic Position and Prospects of Tunisia will be distributed to the Executive Directors this week. It concludes that the economic policy changes introduced by the Government, which took office last November, give hope for overcoming the difficulties increasingly experienced by the Tunisian economy in recent years, and that the country can be considered creditworthy for some borrowing on conventional terms, provided that the bulk of new external assistance is made available on concessional terms. An economic mission is starting its work in Tunisia on March 8.

The Agricultural Sector

4. Measured in constant 1966 prices, the contribution of Tunisia's agricultural production to GDP has, despite a high level of investment, dropped from a one-time high in 1965 of about $200 million to about $150 million in 1970, thus falling even below the 1960 production level.

5. This disappointing performance can be explained by a number of reasons. Bad weather and, in particular, the heavy floods in fall 1969 depressed production. The program of organizing agricultural cooperatives led to misallocation of resources. Private farmers were left out of public investment programs, and under the threat of losing their land to cooperatives liquidated large parts of their productive assets.

6. The new Government is beginning to redefine agricultural policies. While this will take some time, immediate measures have to be taken to increase productivity in order to contain the rising food import bill. As such a measure, the Government has decided to help private farmers in the modern agricultural sector who, considering their experience, would be most responsive to a program which is expected to lead to considerable import savings on cereal and dairy products and to yield valuable foreign exchange on date exports.

The Project

7. Banque Nationale de Tunisie (BNT) would be in charge of the project. It is the second largest Tunisian commercial bank, and engages mainly in agricultural credit. The Government holds 25 percent of its capital, other public bodies 60 percent and 15 percent are held privately. BNT would be the Borrower of the $5 million Bank loan. The IDA credit of $3.0 million would be made to the Republic of Tunisia and re-lent to BNT at the terms and conditions of the Bank loan except that the interest rate would be 4 percent. The Bank/IDA financing would cover the project's foreign exchange component.

8. Given a 4 percent rate of relending of IDA funds, the average cost of Bank/IDA funds to BNT would be 6 percent. A sub-lending rate of 8 percent as suggested in paragraph 18 below would leave BNT with a 2 percent spread, which would meet its administrative expenses and provision for bad debts (about 1.3 percent of total project sub-loans), and still have a small margin for general reserves and profit.

9. The major part of the project (60 percent) will be for the mechanization of grain farming in northern Tunisia. Credit facilities would be opened to farmers for purchasing wheel and crawler tractors, combines, and attachments. BNT would, simultaneously, provide from its own sources short-term credit for financing inputs like high yielding seeds and fertilizers.

10. 14 percent of the funds available under the project would go into development of dairy farming in northern Tunisia and would help rebuild livestock herds which farmers reduced in 1969 when threatened by loosing their land to cooperatives. Investment for this sub-project would comprise the purchase of livestock, installation of groundwater pumps for small-scale irrigated fodder production, improvement and modernization of barns and mechanical equipment.

11. About 22 percent of project funds would be earmarked for date plantations in southern Tunisia. New oases would be created in the desert on water from artesian aquifers. This would require drilling of bore-holes up to 600 meters deep, installation of pumps where underground pressure would not be sufficient, irrigation and drainage equipment, land and soil preparation, planting of date palms and wind breaks, and ancillary installations. This sub-project would be carried out by Societe Tunisienne de l'Industrie Laitiere (STIL), a company with no direct State participation which has already gained considerable experience in oasis development.

12. The remaining 3 percent of project funds would finance technical assistance to improve BNT's project appraisal section and the public agricultural extension service network. The latter needs reinforcement, particularly in relation to the dairy farm sub-project.

13. Most of the goods and services needed for the project would be procured through existing commercial channels. Supplies are adequate, prices competitive and servicing facilities available. For livestock imports sub-borrowers would obtain price quotations from not less than three suppliers in at least two different countries. Drilling contracts under the date palm development sub-project would be awarded after international competitive bidding.

14. Financial rates of return would be high. For the grain farming sub-project, they would vary from 21 to 25 percent according to farm sizes, reach 26 percent for the dairy farm sub-project and 14 percent for the date development. The overall economic return on the project is estimated at 22 percent.

15. The Bank/IDA contribution would meet the foreign exchange expenditure amounting to 53 percent of project cost. 17 percent would be provided by BNT, and farmers would contribute the remaining 30 percent. Bank/IDA would disburse three-quarters on each sub-loan made by BNT which would correspond to the 53 percent overall foreign exchange component.

Particular Issues

16. Chapter VII of the Appraisal Report lists the subjects which will require discussion during negotiations and on which satisfactory assurances will be sought from the Government and BNT. Attention is drawn in particular to the questions of the interest rate on sub-loans and of BNT's financial position.

17. Sub-lending Interest Rates: The Appraisal Report (paragraphs 4.18 and 4.19) suggests an interest rate of 9 percent for lending operations under the project. At present a rate of 4 percent is applied to almost all forms of agricultural investment which would be financed under the project. This rate was confirmed by

new legislation which came into force as late as last October. It is part of a complex system of investment incentives which also fixes downpayments, and maturity and grace periods of loans, and provides furthermore for direct subsidies from Government funds to farmers which are intended to offset rather high taxes on imported goods.

18. The Government is beginning to review the system of taxation, and incentives for the agricultural sector. Completion of this review is expected to take time. The Government believes that until then it cannot substantially alter the total amount of support presently given to the farmer. It would accept an interest rate increase only if its impact is to some extent offset by a simultaneous increase in direct subsidy payments to farmers. On the basis of discussions which a Bank mission had in Tunis in February, it can be expected that as a compromise solution the Government will propose during negotiations to raise the interest rate to 8 percent and to pay direct subsidies towards investment cost which would bring the effective rate to about 6 percent. The present level of import taxes would be maintained, and taxes would very likely still exceed subsidies including those to be introduced.

19. The departments concerned recommend that such a solution be accepted. It would imply a decided change in the Government's present incentive system and already commit it to introduce, at least for the modern agricultural sector, a more market oriented interest rate policy. The subsidy payments should be considered acceptable since they would be part and parcel of a reorientation of policy. They should, however, be discontinued before the Bank could consider financing another agricultural credit project. We would ask for assurances that the same lending conditions be applied to agricultural credit for similar investments financed outside the Bank/IDA project.

20. Financial Situation of BNT: BNT's liquidity situation is strained (see paragraphs 4.11 and 4.12 of Appraisal Report). When the Government abandoned its policy on cooperatives in September 1969, BNT's total outstanding short-term loans which it had made from its own sources to cooperatives amounted to $11.8 million. These loans had been made at Government's recommendation and under Government guarantee. Part of the cooperatives have been dissolved since, and most of the remaining ones are unable to repay the full amount on schedule. During negotiationsof the amendments to the Cooperative Farm project (Loan/Credit No. 484/99) in September last year the Government agreed to a five year repayment schedule for the debts of maintained cooperatives, of which $6.7 million were due to BNT, and undertook to repay 40 percent itself under its guarantee to BNT. Debts of dissolved cooperatives to BNT amounting to $5.0 million were not settled then, but the Government indicated that it would repay these debts according to BNT's needs. The appraisal report expects BNT to face a liquidity shortage increasing to about $4.8 million in the fifth year of project implementation, and this gap would have to be met by the Government through repayment of dissolved cooperatives' debts in four annual installments starting in the first year of project implementation.

21. Under the agreement amending the Cooperative Farm project the Government agreed to sell surplus machinery not needed for the revised Cooperative Farm project, and to deposit the proceeds in a blocked Central Bank account. The minimum amount to be deposited in this account would reach $2.8 million by March 31, 1974. During negotiations it was envisaged that these funds should be used as Tunisia's local currency contribution for future agricultural projects. Since there is no Government participation in the proposed project, the Government will probably request that the Bank agree to repayment from the funds in the Central Bank account of part of the debts of dissolved cooperatives. This would not contradict the purpose of the Central Bank deposit scheme, which was to avoid that the proceeds from sales of excess machinery enter into the general budget and would be spent for other than development projects. I therefore recommend that we agree to a Government request to draw on the funds in the Central Bank account for repaying to BNT the debts of dissolved cooperatives.

22. BNT's stake in its main customer, STIL, (see paragraph 11 above) is higher than would be considered financially prudent (para. 4.07 of Appraisal Report) and would increase through sub-loans to STIL to be made under the project. As of now, loans to and equity holdings in STIL equal 60 percent of BNT's own capital and free reserves. This high financial engagement dates from the days when both institutions were under the same management. A gradual reduction of BNT's equity and loans to STIL would be required and a plan and schedule to this effect agreed upon during negotiations. This plan and schedule, which would also have to provide for adequate security on all outstanding BNT loans to STIL, would have to be formalized between BNT and STIL before presentation of the loan/credit to the Executive Directors. We would also require independent auditing of both institutions. BNT's general manager informed a Bank mission in February that BNT and STIL have made contacts with reputable auditing firms. The audit of the 1970 accounts would take at least two to three months, and the audit reports will not be available for negotiations. BNT's audit should, however, be furnished before presentation of the project to the Executive Directors. The appraisal report recommends that STIL's audit report be submitted at the same time. Preparation of this report will, however, take more time than that for BNT because of STIL's varied activities, and the departments concerned agree that the Bank's and IDA's interests would be sufficiently safeguarded as long as STIL's report is submitted before BNT approves any sub-loans to STIL.

Recommendation

23. I recommend that the Bank and the Association invite the Government and BNT to negotiate a loan and credit on terms and conditions proposed in Chapter VII of the Appraisal Report and in this memorandum.

M.P. Benjenk
Director

Attachments

AD.

Population: 4.9 m
GNP Per Cap: $230

IVa. TUNISIA - 5 YEAR OPERATIONS PROGRAM
(By Fiscal Year - Amounts in $ millions)

			1971	1972	1973	1974	1975	1976
4-TUN-AC-01	Agricultural Credit I	IBRD	4.0					
	Agricultural Credit I	IDA	3.0					
4-TUN-AC-02	Agricultural Credit II	IBRD				15.0		
4-TUN-AI-01	Irrigation	IBRD			5.0			
4-TUN-AF-01	Fisheries	IBRD		2.0				
4-TUN-DD-04	DFC - SNI IV	IBRD		10.0				
4-TUN-DD-05	DFC - SNI V	IBRD				10.0		
4-TUN-DD-06	DFC - SNI VI	IBRD						10.0
4-TUN-EE-03	Education III	IDA			9.0			
4-TUN-EE-04	Education IV	IDA					10.0	
4-TUN-IM-01	Phosphate Mining	IBRD			5.0			
	" "	IDA			5.0			
4-TUN-NN-01	Family Planning	IDA	4.8					
4-TUN-PP-01	Power	IBRD		10.0				
4-TUN-TH-02	Road Construction I	IBRD	24.0					
4-TUN-TH-03	Road Construction II	IDA						15.0
4-TUN-TL-01	Pipeline	IBRD	7.5					
4-TUN-TR-02	Railroads II	IBRD			10.0			
4-TUN-WA-01	Sewerage I	IBRD			4.0			
	" "	IDA			4.0			
4-TUN-WW-03	Water Supply I	IBRD					5.0	
	" "	IDA					5.0	
4-TUN-QQ-01	Sewerage & Tourism Infrastructure I	IDA		7.0				
4-TUN-QQ-02	Sewerage & Tourism Infrastructure II	IBRD				10.0		

	Total 1964-68	Total 1969-73	Total 1972-76
IBRD	34.0	122.3	94.0
IDA	19.0	53.8	57.0
Total	53.0	176.1	151.0
No.	5	19	16

	1971	1972	1973	1974	1975	1976
IBRD	35.5	20.0	24.0	35.0	5.0	10.0
IDA	7.8	9.0	18.0		15.0	15.0
Total	43.3	29.0	42.0	35.0	20.0	25.0
No.	4	4	5	3	2	2