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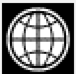

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(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

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December 23, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Ireland - Industrial Credit Company, Ltd. (ICC) Loan

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 23, 1970, from the Europe, Middle East and North Africa Department, entitled, "Ireland - Proposed US $10 Million Bank Loan for the Industrial Credit Company, Ltd. (ICC)" (LC/O/70-~~130~~ 131).

2. Comments, if any, should be sent to reach Mr. Horsley (ext. 4714) by 1:00 p.m. on Tuesday, December 29, 1970.

3. It is planned then, if the Committee approves, to inform the Government and representatives of the Electricity Supply Board 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)

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LC/O/70-~~130~~ 131

December 23, 1970

LOAN COMMITTEE

Memorandum from the Europe, Middle East and North Africa Department

IRELAND - Proposed US $10 Million Bank Loan for the Industrial Credit Company, Ltd. (ICC)

1. A report entitled "Appraisal of Industrial Credit Company Limited, Ireland", (DB-75), dated December 7, 1970, is attached for consideration by the Loan Committee.

Background

2. The only previous Bank loan to Ireland was made in FY 1969 to the Electricity Supply Board (ESB) for the Turlough Hill pumped storage power project; the loan amount was US $14.5 million, of which US $11.7 million was outstanding on October 31, 1970. Performance under this loan has been satisfactory, and there are no outstanding problems.

3. The Bank has one other operation under consideration for Ireland in FY 1971, a loan of $17.5 million to the Electricity Supply Board for a power project on which a memorandum was circulated to the Loan Committee on December 18, 1970. It is expected to be ready for consideration by the Executive Directors at about the same time as the proposed loan to ICC. The Bank's Five-Year Lending Program for FY 1971-75 is attached. On the basis of most recent information about project cost, the amounts shown for FY 1971 should be read as $17.5 for the power project and $10 million for ICC.

ICC's Position and Role

4. ICC was incorporated in 1933 as a public company with the purpose of providing funds for industry through a variety of forms of financing. It was given wide powers enabling it to underwrite capital issues, to provide issuing house facilities and to make permanent capital available to industry through long- and medium-term loans and direct equity investment. Through its underwriting and issuing house services it has played a role in the development of the Irish capital market, although this market is still a small one. ICC is a state-sponsored and largely state-financed company, which is expected by the Government to operate on commercial principles. The present chairman, Dr. J. P. Beddy, is much respected in financial circles; under his leadership the ICC Board and management have remained generally independent of Government influence in the day to day management of the company and in making investment decisions. The management and staff are well qualified and experienced.

5. ICC has established a position as the main institution in Ireland providing long-term industrial finance to Irish-owned enterprises. It has also shown considerable initiative in moving into new areas of activity when the need has been identified. As a result, it has diversified into hire purchase finance for industrial equipment, leasing of machinery, finance for distributive trades, shipping finance and merger business. In recent years ICC's position in Irish industry has been somewhat overshadowed by the Industrial Development Authority (IDA), which was established by the Government in 1952, as part of a major change in industrial promotion policy, to provide special incentives to attract new export-oriented industries to Ireland. A policy of liberal grants has enabled it to achieve this objective. Together with the short-term loans and overdrafts of the commercial and merchant banks, IDA is meeting a significant portion of the initial capital requirements of new large-scale, and mainly foreign, industrial enterprises. While ICC also finances some of these firms, its main role in the recent past has continued to be the financing of the expansion or modernization of existing Irish firms.

6. ICC's resource position has been tight since 1968. At October 31, 1970 it had resources of £ 26.2 million($ 62.9 million). Of this total, 52 percent was Government loans, 45 percent was capital and reserves and the balance was deposits or miscellaneous credits.

7. As measured by its return on net worth, ICC has not been a profitable investment for the Government in the past decade. Its profits in recent years have been adversely affected by the following factors: (a) a narrow spread (about 1 percent) between its average costs of borrowing and lending; (b) substantial losses on three large projects; (c) the need to accelerate the previously inadequate level of provisions for possible losses; and (d) between 1958 and 1968 some of its funds were tied up in projects that yielded no income to ICC, in particular, two projects for which the Government used ICC as a financial intermediary and which were not appraised by ICC. Furthermore, ICC is subject to normal taxation and receives no subsidies in the form of cheap money from the Government.

The Project

8. The Government has asked the Bank to assist ICC in financing industrial development in Ireland as it expects this institution to play an important and expanding role. An appraisal mission from the Development Finance Companies Department visited ICC in August and November 1970. Its report concludes that ICC could utilize a loan of up to US $12.5 million to meet the estimated foreign exchange costs of its industrial term-lending business through the end of CY 1972. However, in order to maintain an incentive for ICC to borrow both abroad and domestically, and also to keep the total of Bank lending to Ireland in FY 1971 within acceptable limits, I recommend and the DFC Department agrees that the amount of the loan be reduced to $10 million.

9. ICC forecasts an increase of its annual loan and equity commitments from £ 8.6 million in 1969 (FY ending October 31) to £ 10.9 in FY 1972.

This increase is similar to the expected growth pattern of fixed investment in manufacturing industry, which is expected to rise from £ 60.0 million in 1969 to just over £ 95 million in 1972.

10. The implication of these forecasts is that ICC will only maintain its current share of the market, which at present is about 6 percent of total manufacturing investment. Even this conservative objective may be difficult to attain, however, since ICC will have to make substantial efforts to raise the financial resources required. Its commitments between October 1970 and December 1972 (including uncovered commitments at the end of October 1970 of approximately £ 2 million) would total about £ 24 million. ICC has estimated that receipts from loan repayments, retained earnings, portfolio sales and the anticipated net increase of term deposits during this period will amount to about £ 10.6 million. The remaining gap of £ 13.4 million (or $ 32.3 million equivalent) would be filled by loans from the Government of between £ 3 and £ 4 million annually, the Bank loan of $ 10 million, and additional borrowing on the domestic and foreign capital markets.

11. ICC's earnings forecasts indicate that a substantial improvement is expected. The company has been taking steps during the past three years to write off losses and to make provisions to bring its portfolio into line with its real worth, and has now substantially completed the necessary revaluation. It is therefore in a good position to grow and to improve its earnings performance. Profits after provisions and taxes are expected to be about 5-8 percent of average net worth during the period 1971-75. ICC intends to keep the book value of its portfolio in line with real worth and to make conservative allowances for possible losses annually.

12. ICC's debt-equity ratio at the end of 1972 is expected to be about 2:1 and the appraisal report recommends a maximum ratio of 3:1. There are few large Irish enterprises and the majority of ICC's loans are therefore relatively small; it is proposed that the initial free limit should be $100,000. An aggregate free limit of 30 percent of the loan amount should ensure that ICC would submit about 20 projects to the Bank each year for approval. Although ICC's staff is competent, its appraisals lack sufficient depth in technical and economic examination, and internal reporting and project supervision should be strengthened. ICC's management is aware of these deficiencies and intends to effect the necessary improvements.

13. The Government has confirmed that it will assume the foreign exchange risk on the Bank loan and will not require repayments on Government advances while the Bank loan is outstanding. During negotiations, arrangements should be agreed upon to protect ICC against the possibility of having to retain high-cost Government advances should interest rates decline. ICC will also be asked to agree on a fixed repayment schedule for the £ 1.8 million loan it received from the Irish banks.

14. The Government development strategy of industrial incentive schemes has been very effective in bringing about a rapid growth of export-oriented

manufacturing industries. With this new industrial base successfully established, the Government has been reviewing its incentive policies and has concluded that incentive grants can now be made less generous and more selective. This view is reinforced by the high cost of the subsidies channelled through IDA. A more detailed analysis of the industrial incentive schemes is given in the appraisal report (paras. 2.08-2.13). The changes in the Government's industrial development policies will be discussed during negotiations to ensure that they will lead to the creation of long-term, internationally competitive industry, and to clarify further the future roles of IDA and ICC. The new policies are expected to enlarge the scope for ICC operations by directing new industries to ICC for loans and equity finance.

The Economy

15. The Irish economy is discussed in a report entitled "Current Economic Position and Prospects of Ireland" (EMA-2) dated November 29, 1968, in an updating memorandum (EMA-23a) dated July 2, 1970, and in the memorandum on the Tarbert 3 Power Project circulated to the Loan Committee on December 18, 1970. Each of these documents concludes that Ireland is creditworthy for Bank lending.

Recommendations

16. I recommend that the Bank invite the Government of Ireland and the Industrial Credit Company to send representatives to Washington to negotiate a loan to ICC substantially on the conditions set forth in Section VI of the appraisal report, except that the amount of the loan would be $10 million as discussed in paragraph 8 of this memorandum.

M. P. Benjenk
Director

Attachment

Annex

Population: 2.9 m.
GNP per Cap.: $980

IRELAND - ACTUAL AND PROPOSED LENDING PROGRAM THROUGH FY 1975

($ millions)

		Through	Fiscal Years							Total	Total	Total
		1968	1969	1970	1971	1972	1973	1974	1975	1964-68	1969-73	1971-75
Livestock I	IBRD						10.0					
Livestock II	IBRD								10.0			
Education I	IBRD					10.0						
Education II	IBRD							10.0				
DFC - ICC I	IBRD				15.0							
DFC - ICC II	IBRD						15.0					
Power-Turlough Hill	IBRD		14.5									
Power-Tarbert 3	IBRD				10.0							
Power-Pigeon House B	IBRD					15.0						
	IBRD	-	14.5	-	25.0	25.0	25.0	10.0	10.0	-	89.5	95.0
	No.		1		2	2	2	1	1		7	8

EME&NA
December 15, 1970

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

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LM/M/70-49

December 23, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Congo (Brazzaville) - Compagnie des Potasses du Congo" held at 4:30 p.m. on Monday, December 14, 1970 in Conference Room B.

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

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/70-49

December 23, 1970

Minutes of Special Loan Meeting to discuss "Congo (Brazzaville) - Compagnie des Potasses du Congo" (Loan No. 480-COB) held at 4:30 p.m. on Monday, December 14, 1970 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Aldewereld, Broches, Chadenet, Chaufournier, Fuchs, Nurick, Cheek, Delaume, El Darwish, Thalwitz and Pearce (Secretary).

2. Issue: The meeting had been called to review the status of the Congo (Brazzaville) - Potash Mining Project, for which a $30 million loan (480-COB) had been approved on January 9, 1967 and, in particular, to consider the Bank's position in light of the project's technical failure.

3. Discussion: The meeting considered several memoranda summarising the technical, financial and legal status of the project and, in reviewing alternative courses of action, noted that:

(a) While CPC considered that future exploration adjacent to its existing mine and within its concession might be justified, the Bank should regard this new project, if it materialized, as an entirely separate venture, i.e. subordinate to the immediate priority of resolving CPC's current difficulties. Moreover, Bank Group assistance for a new project, assuming that it was requested and seriously considered, would consist of a Bank loan, not an IDA credit as suggested by CPC's sponsor.

(b) The case for the Bank considering rescheduling its loan, to permit CPC to develop a future plan of operation, was weak because (i) the existing project was no longer economically viable, and (ii) the project's technical, commercial and financial risks were the responsibility of CPC's shareholders.

(c) The legal case for the Bank prematuring its loan now would be based on several technical violations of the loan agreement by CPC. The Bank's position, however, was not as clear cut as that of the European Investment Bank (EIB), whose loan agreement gave it the right to premature immediately. Prematuring by the EIB would, because of interrelated events of default, authorize the Bank to premature at the same time. If CPC's shareholders decided to dissolve the company and cease operations, the

Bank would clearly be entitled to premature its loan after 30 days' notice.

(d) However, a CPC decision to liquidate would probably provoke a strong reaction in the Congo and, in the event of nationalization, the Bank, while entitled to exercise its remedies against CPC and the Congolese Government, would lose the benefit of the shareholders' guarantees, owing to the "force majeure" clause. If, on the other hand, CPC were reorganized to permit majority participation by the Congolese Government, the Bank would not object provided that this were the object of a negotiated agreement between CPC's shareholders and the Government. The danger for the Bank in these circumstances would be that during the reorganization period - possibly several years - the Congolese Government might misunderstand or disagree with CPC's objectives and decide to nationalize the company anyway.

4. The meeting noted that an extraordinary meeting of CPC's shareholders was scheduled for early January, 1971. While the Bank, in concert with EIB, might find grounds to premature its loan now, in view of the project's total collapse, it was nevertheless desirable that the Bank cooperate with the parties concerned in efforts to explore alternative solutions. This might include not insisting upon immediate total repayment and agreeing on a schedule of repayment over a period of 3-4 years. However, in refraining from prematuring its loan now, the Bank would perpetuate the danger of a complete breakdown in relations between CPC, its sponsors and the Government and the attendant risk of Congolese nationalization - an event which would release the shareholders from their financial guarantee obligations to the Bank and adversely affect Bank/Congolese relations. It was therefore reasonable for the Bank to condition its cooperation upon a waiver by the shareholders of the "force majeure" clause in the Shareholders Guarantee Agreement, thus placing the Bank in the same situation as that of EIB.

5. Decision: The Chairman decided that, as its minimum position, the Bank should condition its cooperation, and specifically its continued willingness to refrain from prematuring its loan, upon a waiver by the shareholders of the "force majeure" clause (i.e. the political risk). It was further agreed that the Bank's position should be communicated to CPC's shareholders at a meeting to be called prior to the extraordinary shareholder meeting.

Cleared by: Messrs. Knapp
Chadenet
Chaufournier/Thalwitz
Fuchs
Delaume

David Pearce
Secretary
Loan Committee

cc: Participants

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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LC/A/70-11

December 22, 1970

NOTICE OF MEETING

A Meeting of the Loan Committee will be held on Monday, December 28, 1970, at 4:30 p.m. in the Board Room.

AGENDA

Morocco

The Committee will consider the attached memorandum of December 22, 1970, from the Europe, Middle East and North Africa Department entitled, "Morocco - Proposed fifth loan to Banque Nationale pour le Developpement Economique (BNDE)" (LC/O/70-130).

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
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Vice President (IFC)

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LC/O/70-130

December 22,1970

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

MOROCCO - Proposed fifth loan to Banque Nationale pour le Developpement Economique (BNDE)

1. The attached appraisal report (No. DB-74) recommends a Bank loan of $25 million to Banque Nationale pour le Developpement Economique (BNDE) to be used for making loans to, and other investments in, industrial and other productive enterprises in Morocco. The proposed loan would cover the foreign exchange component of specific projects.

Background

2. Total Bank loans to Morocco now amount to $153.0 million (of which $13.6 million has been repaid) and IDA credits total $18.3 million. The volume of loans and credits to Morocco is expected to average about $55 million per year over the next few years, with Bank loans accounting for about 73 percent of the total. The proposed Five Year Lending Program (copy attached) for FY's 1972-1976 amounts to $220 million in Bank loans and $85 million in IDA credits.

3. The proposed loan would be the second operation of the four planned for Morocco in this Fiscal Year. A loan of $10 million to Credit Immobilier et Hotelier (CIH), an institution which aids development of tourism through the financing of hotel construction, was approved by the Executive Directors on August 12, 1970. Appraisal missions for a second loan of $10 million to Caisse Nationale de Credit Agricole (CNCA) and a loan and credit for Education, totalling $10 million, are presently in Morocco. Total Bank/IDA lending in FY 1971 is thus expected to reach $55 million but this amount may be altered in the light of the conclusions of the appraisal missions for CNCA and Education.

4. The Bank Group has been associated with BNDE ever since the Government relinquished its majority ownership in 1962. IFC holds equity of approximately $1 million, amounting to about 25 percent of BNDE's share capital. The Bank has made four loans to BNDE: $15 million in December 1962, $17.5 million in May 1966, $15 million in November 1968 and $15 million in March 1970, totalling $62.5 million. The fourth loan, which had an uncommitted balance of $1.3 million as of November 30, 1970, is expected to be fully committed soon.

The Economy

5. An Economic Report entitled: "Economic Developments and Prospects in Morocco" (EMA-27a) dated September 30, 1970, was distributed to the Executive Directors on October 16, 1970. The Report's conclusions confirm that on the basis of recent economic performance and prospects, Morocco is creditworthy for additional borrowing on conventional terms. The report also indicates that in the period 1965-68 there was a steady but relatively small increase in the value of industrial production, but that preliminary data for 1969 suggest a much faster growth of industrial output (9.4 percent). Extensive analysis and data on the industrial sector are provided in the Bank's Report on "Mining and Manufacturing in Morocco" (PI-5) dated September 1, 1970.

The Project

6. BNDE continues to play a leading role in financing private industrial development, with the bulk of its loans financing imported equipment. Lending for hotel construction has practically been discontinued as a result of direct Bank lending to CIH. BNDE's direct loans approved in 1969, amounting to $13 million, were slightly above the all-time high of $12.5 million reached in 1968. Loan approvals for 1970 are expected to increase by over 50 percent to $20 million. As of June 30, 1970, the portfolio of outstanding loans was $40 million with no serious exposure or risk problems. BNDE's growing role in industrial investment during 1970 corresponded to a significant increase in investor interest, of which the most notable evidence is the rapid commitment of the fourth Bank loan to BNDE, reflecting an even faster increase in project approvals by BNDE.

7. BNDE's role in equity financing has recently been almost negligible although in its earlier years, BNDE was an important source of equity investment. The reason for the decline is mainly due to the constraint imposed by the Government after the creation in 1966 of a public sector institution for equity financing, the Societe Nationale d'Investissements (SNI). The Government considered BNDE essentially as a lender that would yield, if so requested, priority on equity investments to the Government and to SNI. Accordingly, only leftover projects were open to BNDE for equity investment. Nevertheless, BNDE hopes to attain a level of investment in share capital averaging about $600,000 a year for the next few years, except for 1971 when this figure should reach $1.7 million. This situation is far from satisfactory and we plan to discuss the matter with the Government during negotiations, so that the constraints to BNDE taking equity participations are gradually removed.

8. In connection with the fourth loan to BNDE, the Bank stressed the need to improve project preparation, strengthen BNDE's management and cope with the profitability issue. The quality of BNDE's appraisals has improved considerably over the last two years and has achieved a good standard of technical and financial efficiency. Economic appraisals of

projects need improvements particularly with a view to evaluat ing BNDE's overall impact on the economy. With regard to BNDE's management, Mr. Mohamed Bargach, formerly Minister of Agriculture, has been appointed Chairman of the Board of Directors of BNDE, and has assumed the responsibilities of BNDE's Director General. A deputy Director General has also been appointed, in accordance with the Bank's recommendation. From an overall view point BNDE's present management has still to prove itself over a longer period but appears satisfactory.

9. BNDE's profitability has improved to the point where it is no longer a matter of serious concern. BNDE's net profits are expected to grow from DH 3.3 million (equivalent to US$ 660,000) or 10 percent on equity in 1969 to DH 7.5 million (US$ 1.5 million) or 16 percent on equity in 1975. BNDE's increased profitability is the result of several factors, including the reduction in BNDE's share capital which took place in 1968. Government subsidies, however, are of substantial significance to BNDE's profitability. The increase in BNDE's lending rate on which we want to reach agreement during negotiations (see paragraphs 12-17 below), would provide a more appropriate basis for its profitability.

10. Based on a favorable outlook for industrial growth in Morocco, BNDE expects a higher volume of operations through 1975, but particularly in 1970/71. Loan approvals are expected to rise from about $13 million in 1969 to $20 million in 1970 to $21.3 million in 1971. To meet expected contractual commitments for 1971/72, BNDE will need about $41 million, of which $8 million will be for local currency financing and approximately $33 million for foreign exchange requirements. The fourth Bank loan is almost totally committed. BNDE expects that the Bank and AID will be the only sources to cover its foreign exchange needs. Assuming that BNDE will be able to use an existing $3 million AID loan, it will need to raise $30 million to meet forecast commitments for foreign exchange until the end of 1972. BNDE is therefore seeking Bank assistance to meet, if possible, its $30 million gap.

11. As of September 30, 1970, Bank's loans accounted for over 60 percent of BNDE's long-term resources. If the Bank were, as in the past, to meet the otherwise uncovered capital needs of BNDE, it would by 1975 be the source of over three quarters of BNDE's capital. This would be an excessive proportion. We intend therefore to propose in negotiations that BNDE should seek other sources of external capital by developing a capacity to meet market terms abroad. In order to spur BNDE towards other sources of financing, we plan to cover with the proposed loan only $25 million of the $30 million projected gap until the end of 1972, and will also point out that BNDE should not expect further Bank financing much before then.

Issues

12. Since BNDE's profitability, appraisal standards and management situation have improved, the Bank's concern focuses at this time on one issue: BNDE's lending rate and its effect on BNDE's ability to raise resources and on industrial investment.

13. BNDE's interest rate level, which in past discussions with Morocco has been linked with the low rates of interest generally practiced in Morocco, is not a new concern for the Bank. A year ago when the Loan Committee discussed the implications of BNDE's low rate (7 per cent) prior to negotiations of the fourth loan to BNDE, it was agreed that the Bank would proceed with the loan provided that the Government was willing to cooperate in a study of the interest rate structure and discuss its findings with the Bank. (The Moroccans had confirmed their readiness that such a study be undertaken at the 1969 Annual Meeting). When the fourth BNDE loan was presented to the Board in January, 1970, several Executive Directors also raised questions as to the appropriateness of BNDE's rate. Accordingly, the Bank Economic Mission that visited Morocco in April, 1970 looked into the general question of interest rates as part of the annual economic review of Morocco. The Mission concluded that the influence of Moroccan interest rates on the overall level of investment and economic activity was apparently marginal, and that private investment decisions were primarily affected by market opportunities, the efficiency of Government administration or the availability of managerial talent and experience. Moreover, other investment incentives were often more important in investor's decisions than the interest rate itself. Consequently, in the Mission's view, it was crucial that the whole package of Government incentives be reconsidered and gradually readjusted in such a way as to encourage a rational allocation of scarce investment resources. An opportunity for such a review will come soon when we initiate discussions with the Government over the recommendations contained in the Bank's report on Moroccan industry.

14. It must be stressed that within the time available to it, the economic mission did not make a complete study of supply and demand of capital in Morocco and did not make any recommendation as to the general level of interest rates which would be justified for Morocco at the present stage of its development. Such a study could be made by the Moroccan authorities and the Bank has informed them of its readiness to help. The arguments for or against Morocco's general policy in keeping interest rates low are, therefore, in the present state of our knowledge, not decisive enough either for the Bank to use as an indicator of unsatisfactory economic performance or for the Bank to commend Morocco on its exemplary stability. Of much more immediate consequence, both for the Bank's lending program in the next twelve months and for its general posture towards Morocco are two matters: first, whether the present rate of interest charged by BNDE to its borrowers is an obstacle to its obtaining resources from potential sources other than the Bank Group and second, whether Moroccan entrepreneurs, if BNDE's rate were raised, would require special incentives in order to invest in industry and tourism, and, if so, whether such incentives should include subsidized interest rates.

15. With regard to the first of these questions, I believe that the answer is positive. By BNDE's own admission, the present rate of interest charged by BNDE and the limited State subsidy on its borrowings prevent it from diversifying the sources of its capital and shut it off from borrowing in the United States and most of Europe. The dependence of BNDE on the World Bank is becoming excessive and the small amount of capital available at relatively low rates of interest from public sources in Europe would not change that situation sufficiently. Also, the growing dependence of BNDE on the Government subsidy for its income is a feature of concern to the Bank; we should like BNDE increasingly to generate earnings from its own operations to pay for borrowings which it has to contract, including those from the World Bank. For these reasons, and as long as European and American interest rates are at their present levels, there is a strong case for raising BNDE's interest rate to 9 percent.

16. On the second point, as to whether some incentives are still needed to attract the tradition bound Moroccan business community into industry, I think the answer is equally positive. Moroccan industrial growth has been sluggish, notwithstanding a recent burst of activity, and there is a contrast with tourism, where incentives to investors have been considerably more generous than to industry. Investment in tourism is now booming and the incentives required by the Government now seem to be too generous. On the other hand, it would appear justified that the Government should continue to provide special incentives or subsidies to certain industrial investors promoting desirable and economically viable projects which would not be undertaken in the absence of incentives. The present incentives furnished include a variety of techniques of which the subsidized interest rate of BNDE is a relatively minor - though not unimportant - one. While a rebate on interest rate may in the end turn out to be an acceptable form of subsidy, it would normally be bad for a development finance company to be involved with the provision of such subsidies, by itself making rebate payments to its investors. Whatever incentives are appropriate should be provided by the Government, through a suitable channel of its own. Also, it should be admitted that subsidies ought to be selective and be linked to priority project categories.

17. The attached appraisal report recommends, and I agree, that before the proposed loan is presented to the Executive Directors, BNDE and the Government should agree to raise BNDE's lending rate by 2 percent, to discontinue the Government's subsidy to BNDE on its new borrowings and to set up, as an interim measure pending the results of the review mentioned above, a rebate to BNDE's borrowers executing priority projects to mitigate the effects of such a raise on investors. This would bring BNDE's rate into line with that of CIH (8.75%), which also practices a system of rebates, although on what appears to be an unduly generous scale.

The system of incentives to industry should subsequently be reviewed on the basis of the recommendations contained in the Bank's report on industry, recently submitted to the Government. During negotiations, a timetable should be agreed upon for this review which would determine the appropriate amounts and selective criteria for such Government incentives.

Recommendation

18. I propose that the Bank invite the Moroccan Government and BNDE to negotiate a loan of $25 million, along the recommendations in paragraphs 73-76 of the appraisal report and paragraph 17 of this memorandum.

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

Attachment

Population: 14.1 m
GNP Per Cap: $190

IVa. MOROCCO - 5 YEAR LENDING PROGRAM

		($ millions)							
		Fiscal Year						Total	Total
		1971	1972	1973	1974	1975	1976	1964-68	1969-73
Agricultural Credit II	IBRD	10.0							
Agricultural Credit III	IBRD			10.0					
Agricultural Credit IV	IBRD					15.0			
Agriculture Unidentified I	IDA			15.0					
Agriculture Unidentified II	IDA				20.0				
Agriculture Unidentified III	IDA					20.0			
DFC - BNDE V	IBRD	25.0							
DFC - BNDE VI	IBRD			20.0					
DFC - BNDE VII	IBRD					25.0			
DFC - CIH Hotel Financing I	IBRD	10.0							
DFC - CIH Hotel Financing II	IBRD		15.0						
DFC - CIH Hotel Financing III	IBRD				20.0				
DFC - CIH Hotel Financing IV	IBRD						20.0		
Education II	IBRD	5.0							
"	IDA	5.0							
Education III	IBRD				10.0				
Power I - Sidi-Cheho Hydro	IBRD		10.0						
Power II - Roches Noires	IBRD				15.0				
Power III	IBRD						15.0		
Roads II	IBRD			10.0					
Roads III	IDA						15.0		
Port - Safi	IBRD		5.0						
Casablanca Water Supply	IBRD		10.0						
" " "	IDA		10.0						
Water Supply II	IBRD			10.0					
Water Supply III	IBRD						10.0		
	IBRD	50.0	40.0	50.0	45.0	40.0	45.0	45.0	223.3
	IDA	5.0	10.0	15.0	20.0	20.0	15.0	11.0	37.3
	Total	55.0	50.0	65.0	65.0	60.0	60.0	56.0	260.[illegible]
	No.	4	4	5	4	3	4	4	17

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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December 18, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Ireland - Tarbert 3 Thermal Power Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 18, 1970 from the Europe, Middle East and North Africa Department, entitled "Ireland - Proposed $17.5 Million Loan to the Electricity Supply Board for the Tarbert 3 Thermal Power Project" (LC/0/70-129).

2. Comments, if any, should be sent to reach Mr. Riedl (ext. 4724) by 5:00 p.m. on Tuesday, December 22.

3. It is planned then, if the Committee approves, to inform the Government and representatives of the Electricity Supply Board 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)

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LC/O/70-129

December 18, 1970

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

IRELAND - Proposed $17.5 Million Loan to the Electricity Supply Board for the Tarbert 3 Thermal Power Project

1. An appraisal report entitled "Ireland - Appraisal of the 250 MW Tarbert 3 Thermal Project" (PU-56), dated November 10, 1970, is attached hereto for consideration by the Loan Committee.

Background

2. Heretofore the only Bank loan made in Ireland was in FY 1969, also to the Electricity Supply Board (ESB) for the Turlough Hill pumped storage project. Amounting to US $14.5 million, $11.7 million was undisbursed on October 31, 1970. Performance under this loan has been satisfactory, and there are no outstanding problems.

3. The Bank has one other loan under consideration for Ireland in FY 1971. This would be to the Industrial Credit Company, a development finance company, for which a loan of approximately $10 million will be proposed for relending to Irish industry. The two loans under consideration, totalling $27.5 million, are expected to be ready for consideration by the Executive Directors at about the same time. The Bank's Five-Year Lending Program for FY 1971-75 is attached. On the basis of most recent information about project cost, the amounts shown for FY 1971 should be read as $10 million for ICC and $17.5 million for the power project.

The Project

4. An appraisal mission from the Public Utilities Projects Department visited Ireland in August 1970. Its report is attached and recommends a loan of $17.5 million for 20 years including a five-year period of grace. Although these terms are justified on project grounds, I recommend, and the Public Utilities Department would not object, that the term of the loan be reduced from 20 to 17 years in order to conform with the Bank practice of requiring shorter terms for its more developed members.

5. The proposed project consists in constructing a 250 MW extension to the Tarbert generating station which is situated at the mouth of the Shannon River in Western Ireland. A single oil-fired generating unit would be connected to the main 220 KV grid system by a 65 km transmission line which would form part of the project. The cost of the project would be $26.9 million equivalent of which the foreign exchange component would be

$18.2 million. Thus the proposed loan would cover about 65 percent of the total cost of the project and 96 percent of its foreign exchange cost. The remaining 4 percent represents the foreign exchange component of the civil works which will not be submitted for international competitive bidding and therefore will not be financed from the proceeds of the Bank loan. ESB has considerable experience in designing and supervising the construction of large thermal stations and will perform these functions without the assistance of outside consultants. The project is technically sound and represents the least-cost solution of the alternative plant installation sites considered. It is also the next logical step in ESB's expansion program and is needed to maintain satisfactory service standards consistent with load growth.

6. The Electricity Supply Board was established in 1927 to reorganize and regulate the generation, transmission and distribution of electric power throughout the country. An autonomous Government agency, it is the sole agency providing public electricity supply, and is one of Ireland's largest enterprises. The expansion of its power system has matched a demand growing at over 10 percent a year. The Board's financial performance is satisfactory.

7. ESB has requested, and the Bank has agreed to, a preference for domestic suppliers equal to the protective tariff or 15 percent, whichever is lower. For all orders, however, disbursements will be made from the loan account only for the clearly identifiable foreign costs involved. Retroactive financing is not proposed and any surplus funds will be cancelled.

8. The usual tariff and debt service covenants were not included in the previous loan to ESB, nor are they proposed now, since the Electricity (Supply) Act of 1927 regulating ESB's activity stipulates that the Board's revenues should be sufficient to meet operational expenses (including interest), sinking fund payments and allowances for depreciation, extension, renewals and reserve funds. This Act had proved effective in ensuring that tariffs were sufficient to maintain the sound financial position which has characterized ESB's operations. However, it was thought prudent to include in the previous loan agreement a provision that any change made in the Act, which, in the opinion of the Bank, would adversely affect the carrying out of the project or the financial condition of the Board, would constitute an event of default. A similar condition will be included in the loan documents for this project.

9. The previous loan agreement also included a covenant stipulating that in order to maintain tariffs at appropriate levels (since sinking fund allocations are one of the expenses to be covered by revenues), ESB would make adequate provision for the repayment of any stock issue by the latest applicable redemption date. In common with other such entities

over the past year, ESB has been experiencing considerable difficulty in raising sufficient long-term money on the Irish capital market. Thus they have had to supplement two long-term issues with two medium-term issues which they hope to refinance on better conditions in the future. The Bank has therefore waived the application of this covenant on the understanding that there be sinking fund provisions for the medium-term issues on a 20-year basis.

10. Since the Irish capital market will probably remain tight for the immediate future, it is likely that ESB will again be forced to depend partially on medium-term issues. While this was not recognized in the previous loan, further consideration of the matter and discussion with ESB lead me to suggest the Bank now accept this probability. Therefore, I recommend, and the Projects Department agrees, to modify the recommendation in the appraisal report that the ESB should, prior to future stock issues, demonstrate to the Bank's satisfaction that the provisions made for allocating part of the annual revenues to the sinking fund are sufficient for the respective stock issues timely amortization. Instead the proposed loan documents would include a covenant allowing medium-term issues but requiring ESB to seek prior Bank approval for the related sinking fund provisions.

11. ESB's firm development plans include construction of a second similar 250 MW power plant at Pigeon House B (an existing site in Dublin) to be commenced a year after starting Tarbert. It has informed the Bank that at the appropriate time it will request Bank financing for the Pigeon House B project which is included in the Five-Year Lending Program. ESB has, with the Bank's concurrence, invited bids this summer under international competitive bidding allowing several options including the simultaneous ordering of identical generating units for both plants. ESB believes that it can expect to gain financial advantage by placing definite orders for more than one unit at the same time. This means that ESB will have entered into a supply contract for Pigeon House B before the Executive Directors could consider the project. The Executive Directors have been informed of this possibility through the Monthly Operational Summary of Bank and IDA proposed projects. It is also discussed fully in the appraisal report and will be mentioned in the President's Report. I propose that, while the Bank can make no commitments on the proposed Pigeon House B project at this time, the Irish authorities should be told that this procedure will not hinder further Bank consideration of the project.

The Economy

12. A report "Current Economic Prospects of Ireland" (EMA-2), dated November 29, 1968, and an updating memorandum (EMA-23a) dated July 2, 1970 pointed out the satisfactory growth performance of the Irish economy after the adoption in 1958 of the First Program of Economic Expansion and of

outward-looking economic policies. These policies are based on industrial development geared to export markets and a system of grants and tax incentives to attract foreign enterprises. The Anglo Irish Free Trade Agreement signed in 1965 provides for free trade with the United Kingdom by 1975. The Government has also applied for membership of the EEC. Domestically, the Government is implementing a policy of modernization and reorganization of Irish industry to increase its competitiveness in the enlarged market which may emerge.

13. Since 1958 Ireland's GNP in real terms has grown at an average annual rate of about 4 percent: its GNP per capita is now about $1,000 which is substantially lower than that for the majority of OECD countries. Industrial output has been increasing by 6-7 percent each year and industrial exports by nearly 18 percent per year. Investment has been rising rapidly and its ratio to GNP increased from 13.3 percent in 1958 to 23.6 percent in 1969. Unemployment and emigration have been falling. Since the early sixties total population has ceased to decline.

14. Fluctuations during the process of expansion have created balance of payments problems. A restrictive credit and budgetary policy restored external equilibrium following the inflationary pressures of the mid-60's. With relaxation of the policy in 1966 the economy regained momentum. The rising level of economic activity generated again an upward pressure on wages and prices and an increase in the balance of payments deficit on current account from £22 million in 1968 to £69 million in 1969. Credit restrictions were again imposed and the deficit in 1970 is expected to be reduced to around £50 million. The Government has recently announced strict wage and price controls as well as tax increases and expenditure reduction in a supplementary budget. The full impact of these measures cannot be gauged at present. They do, however, indicate that the Government is firmly committed to re-establishing economic stability in the interests of long-term growth.

15. The demand for investment capital, both in the public and private sectors, is rising faster than savings could reasonably be expected to increase. Gross national investment as a percentage of GDP rose from 15.9 percent in 1960 to an estimated 21.7 percent in 1970 while the percentage of gross national savings only increased from 15.8 percent (1960) to an estimated 20.0 (1970). The proportion of foreign savings to GDP is expected to remain about 1.6 percent during the next five years. Future gross borrowing requirements are likely to average about $100 million a year. The total outstanding external public debt was $272 million on September 30, 1969 and the debt service in 1970 is expected to be only about 4 percent of exports of goods and services. It is estimated that if disbursements of foreign borrowings average about $100 million a year during 1970-75, the debt service ratio in 1975 would be less than 5 percent. Ireland has an excellent debt service record and is creditworthy for Bank loans.

Recommendation

16. I recommend that the Bank invite the Government of Ireland and the Electricity Supply Board to send representatives to Washington to negotiate a loan of $17.5 million for the Tarbert 3 thermal power project substantially on the conditions set forth in Section 6 of the appraisal report, except that (a) the term of the loan would be 17 years including five years of grace, as discussed in paragraph 4 of this memorandum, and (b) a new covenant would allow medium-term stock issues but would require ESB to seek prior Bank approval for the related sinking fund provisions, as discussed in paragraphs 9-10 of this memorandum.

M.P. Benjenk
Director

Attachment

Annex

Population: 2.9 m.
GNP per Cap.: $980

IRELAND - ACTUAL AND PROPOSED LENDING PROGRAM THROUGH FY 1975

($ millions)

		Through 1968	1969	1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73	Total 1971-75
					Fiscal Years							
Livestock I	IBRD						10.0					
Livestock II	IBRD								10.0			
Education I	IBRD					10.0						
Education II	IBRD							10.0				
DFC - ICC I	IBRD				15.0							
DFC - ICC II	IBRD						15.0					
Power-Turlough Hill	IBRD		14.5									
Power-Tarbert 3	IBRD				10.0							
Power-Pigeon House B	IBRD					15.0						
	IBRD	-	14.5	-	25.0	25.0	25.0	10.0	10.0	-	89.5	95.0
	No.		1		2	2	2	1	1		7	8

EME&NA
December 15, 1970

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

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LM/M/70-48

December 16, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Pakistan - Proposed Credit for a Reconstruction Project for the Cyclone Damaged Costal Areas of East Pakistan" held at 10:30 a.m. on Friday, December 11, 1970 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

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/70-48

December 16, 1970

Minutes of Special Loan Meeting to discuss "Pakistan - Proposed Credit for a Reconstruction Project for the Cyclone Damaged Costal Areas of East Pakistan" held at 10:30 a.m. on Friday, December 11, 1970 in Conference Room B.

1. Present: Messrs. Knapp (Chairman), Cope, Broches, Chadenet, Sadove, Gabriel, Votaw, Sella, Wiehen, Casson, McCulloch, Moreau, Venkateswaran and Pearce (Secretary).

2. Issues: The meeting had been called to consider issues raised by a proposed $25 million credit to Pakistan to finance part of the Government's $180 million Reconstruction Program for the cyclone-affected areas of East Pakistan.

3. Discussion: The meeting reviewed a draft appraisal report (PS-3 dated December 8, 1970) and a draft credit agreement dated December 10, 1970 as the basis for negotiations of the proposed credit, which, in view of the urgency of the reconstruction task, would take place in Pakistan in the following week. Discussion followed the order of issues raised in Mr. Wiehen's memorandum of December 11, 1970 to the Chairman, which had been distributed just before the meeting.

4. The meeting noted and agreed that:

(a) The proposed credit would finance sub-projects to be selected from the categories described in paras. 3.02-11 of the draft appraisal report.

(b) As detailed assessment of reconstruction requirements was made, items selected for IDA financing would be defined in sub-projects, the execution of which (including definition, procurement and disbursement procedures and other conditions) would be arranged on the basis of subsidiary agreements within the overall framework of the draft credit agreement. While most of the preparation and evaluation would necessarily be undertaken in the field, to expedite the work of reconstruction with minimum delay, each sub-project would have to be approved by headquarters staff in Washington. To ensure rapid authorization of sub-projects, special procedures for approval and signature of subsidiary agreements would be considered.

(c) The proposed credit would be used to finance foreign exchange costs and half of local currency expenditures on selected sub-projects. Imports purchased off the shelf in Pakistan would be considered foreign exchange items to the extent of their c.i.f. value.

(d) Regarding procurement, international competition would be followed where practicable but, in view of the exceptional circumstances of this project, very little formal international competitive bidding was expected.

(e) It was undesirable in presenting the proposed credit to the Executive Directors for approval, to burden the proposal with substantial provision for retroactive financing. However, reimbursement of payments made for specific purposes such as surveys and studies related to the project and possibly other items - if expenditures could be clearly identified and were not too large - could be considered for inclusion in the proposed credit.

(f) The Government would employ consultants acceptable to IDA for the immediate supervision of project works, which would be supplemented by regular IDA supervision missions. Provision for consultant services, including auditing services, would be made in the proposed credit. In the circumstances, it was desirable that auditing arrangements be extended to cover the whole Reconstruction Program, and the credit should be usable for this purpose.

(g) Internal procedures for reporting to the Executive Directors on the application of IDA credit proceeds - for example, in the semi-monthly report of Bank/IDA operations - could be decided later.

5. Decision: The Chairman authorized the commencement of negotiations for the proposed credit on the basis of the recommendations contained in the draft appraisal report as modified by the points noted above.

David Pearce
Secretary

Cleared by: Messrs. Knapp
Sadove
Gabriel
Votaw/Wiehen
Sella

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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December 15, 1970

MEMORANDUM TO THE LOAN COMMITTEE

New Zealand - Railway Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 15, 1970 from the East Asia and Pacific Department, entitled "New Zealand - Proposed US$16.4 Million Loan for a Railway Project" (LC/O/70-128).

2. Comments, if any, should be sent to reach Mr. Riddell (ext. 2227) by 5:00 p.m. on Thursday, December 17.

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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Vice President (IFC)

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LC/0/70-128

December 15, 1970

LOAN COMMITTEE

Memorandum from East Asia and Pacific Department

New Zealand - Proposed US$16.4 million Loan for a Railway Project

1. Attached is an appraisal report PTR 67 dated December 1, 1970 on a railway project in New Zealand comprising three years of the New Zealand Railways six year investment plan. The New Zealand Government has requested Bank finance for the overseas cost of certain items in the project including purchase of rolling stock, modernization of equipment and technical assistance. If approved this would be the first Bank loan to New Zealand since December 1965, and the second to the New Zealand Railways.

2. New Zealand joined the Bank in 1962 and Bank loans were made in 1963 for a Port Project (US$7.8 million), in 1964 for a Power Project (US$32.5 million) and in 1965 for a Second Power Project (US$20.5 million) and a Railway Project (US$42.0 million). The rate of interest was, in the last two cases, 1 percent above the then ruling rate, in accordance with the provisions for lending to "market eligible" countries. These four loans to New Zealand, amounting after cancellations to US$97 million, have been fully disbursed and the projects successfully executed.

3. After 1965 the case for Bank lending to New Zealand with its high per capita income and alternative sources of finance in the world's capital markets, could not easily be made. In 1967 falling exports and balance of trade difficulties precipitated a 19.45 percent currency devaluation. The New Zealand government again approached the Bank, but Mr. Woods in 1967 and Mr. McNamara in 1968 declined to resume Bank lending on the grounds that New Zealand's need for foreign capital (which was not disputed) could be satisfied in their traditional markets. In 1969, however, New Zealand's inability to raise adequate capital in world markets for the high level of investment required to enable her to escape from a declining rate of growth, persuaded Mr. McNamara that a limited amount of lending by the Bank to New Zealand - US$40 million over three years - could be justified. This amount of lending would on the whole maintain the present level of Bank loans outstanding to New Zealand over the next five years. The projects to be financed would be addressed to the restructuring of New Zealand's economy by encouraging growth and adding to the competitiveness of its exports, particularly in the manufacturing sector. The lending program proposed for New Zealand by the Bank is attached as Annex I. It provides for commitments of US$40 million over the four years to FY 1974, as suggested by Mr. McNamara on his agreement to resume lending.

The Economy

4. An economic mission visited New Zealand from October 4 to 23, 1970 to update the last economic report, which was distributed to the Executive Directors on August 20, 1969. (A copy of the Back to Office Report is attached). The New Zealand economy has recovered from the recession of 1967, which was accompanied by balance of payments difficulties and a decline in the growth rate of the GNP, and indications are that the expansion will continue with money GNP likely to grow by over 13 percent in FY 1971, though of this it is thought 6-7 percent will be attributable to price increases. The short term problem of the New Zealand economy now appears to be labor shortages and wage cost inflation and the Government has recently taken fiscal measures to combat this. The recovery in the New Zealand economy was led by a sharp increase in the value and volume of exports to a record level of NZ$1.2 billion in the year to June 1970. The highest percentage increase over the previous year was in manufactured exports (41 percent) but these only accounted for 11 percent of the total. Export earnings remain dependent on the agricultural sector, which account for 85 percent of export receipts. Furthermore, historical dependence on the United Kingdom which still takes 44 percent of New Zealand's farm products, and agricultural protection amongst the developed countries, makes the market for these products vulnerable. This vulnerability is underlined by the threat to key agricultural industries, particularly dairying, from the proposed enlargement of the European Economic Community. New Zealand is, in face of this threat, developing the market for meat and dairy products in Asia and North America. At the same time she is committed to promoting investment in industry to increase, where possible, the domestic value added to her exports and to exploit natural resources such as forests, ironsands and natural gas.

5. The efforts which the Government is making to diversify out of vulnerable markets and products present capital investment needs which cannot be satisfied domestically and every opportunity is being taken by the Government to borrow abroad. In FY 1970 conditions overseas did not permit any borrowing at all by New Zealand. Projected new borrowings for FY 1971, however, amount to approximately US$75 million in the U.S., Germany and Switzerland. In FY 1971 a NZ$31.6 million maturity in London will probably be rolled over and a small loan is being negotiated in Holland.

The Project

6. The proposed project consists of the first three years of the New Zealand Railways six year investment plan to 1975/76, in which the Bank will finance the overseas cost of the purchase of specialized rolling stock and the modernization of workshop and signalling equipment. The program places heavy emphasis on containerization to improve the efficiency of foreign trade and thereby to enhance the competitiveness of New Zealand exports. The rolling stock to be financed will include 670 flatcars for the transport of containers. The remaining rolling stock will be for the transport of pulp and paper, steel, timber and other bulk traffic for which

the railways are well suited and on which returns of 18 percent are expected. Bank financed items will be acquired through international competitive bidding. It is proposed, however, that the Bank should agree to the local manufacture of freight cars from imported components (to be Bank financed) which will make full use of existing workshop capacity. The future of these workshops will however be discussed at the time of negotiations. Since the appraisal mission left New Zealand changes have been proposed in the project though the overall six year investment plan is not modified; justification for these changes has been sought from the Railways and will be discussed at the time of negotiations.

7. At the time of the first Railway Loan the New Zealand Government agreed (in a side letter) that an operating ratio of 85 percent was a reasonable financial target for the Railways to achieve by 1970/71. The actual ratio in 1969/70 was 94.4 and recent wage increases and rising costs make the outlook for the current year poor. In order to ensure that the financial viability of the railway is maintained it is proposed to seek agreement to a covenant in the Loan Agreement under which rate increases would compensate increases in costs so that a rate of return of 4 percent on the fixed assets be achieved in 1973/74 and of 5 percent by 1975/76. This level of return is derived from estimates of the financial resources that will have to be generated by the NZR to fulfill an acceptable cash flow in the future. Rate increases have already been announced by the Government to take effect in December 1970 and January 1971. Agreement on the further increases required in 1971 will be sought at negotiations.

8. The New Zealand Railways has always been protected from competition by statutory limitation on the distance over which commercial truckers are permitted to carry most goods. The railway modernization program, started in the 1960s, has increased the efficiency of the NZR which should no longer need this protection in order to maintain its financial feasibility or to fulfill its economic role in New Zealand. It is also clear that such regulations are likely to distort transport usage from the least cost pattern. However, no overall study of the transport system in New Zealand has been undertaken with a view to determining the effect of the regulatory laws and to spelling out the objectives and appropriate criteria for a balanced national transport policy. Such a study should be a condition for our lending. The Government has expressed enthusiasm for an overall study and the foreign exchange cost of hiring consultants to carry out the work has been included, as a Bank financed item, in the Project.

Financing

9. The total cost of the project is estimated at US$85.78 million (NZ$76.45 million) and the foreign exchange cost at US$43.03 (NZ$38.42 million) of which the proposed Bank loan would provide US$16.40 million (NZ$14.64 million). A further US$14.34 million (NZ$12.8 million) of the foreign exchange cost is to be suppliers' credit and the balance will be provided by the New Zealand Government. Savings in foreign expenditure

resulting from favorable prices in competitive bidding would be used to finance foreign exchange costs of additional but similar items subject to review and agreement with the Bank.

10. The Appraisal Report recommends a loan of US$16.4 million to the New Zealand Government which would make US$15.9 available to the New Zealand Railways. $500,000 would be used for the cost of foreign consultants to carry out the transport survey. The loan would be fully disbursed by June 30, 1973. The amortization period is set in the Appraisal Report at 20 years including a four year grace period which is the estimated life of the assets to be financed. However, the term of the last Bank loan to the New Zealand Government was shortened in line with the Bank's intent to reduce the term of loans to countries which can handle more rapid repayment. For the same reason I recommend that the amortization period be set at 15 years including a 2-½ year grace period, slightly longer than the disbursement period. The repercussions of this reduction on the Railway's cash flow requirements will be discussed with the Government at the time of negotiations.

11. I recommend that the Government of New Zealand be invited to send representatives to Washington to negotiate a Bank loan of US$16.4 million for a term of 15 years for the railway project.

Raymond J. Goodman
Director
East Asia and Pacific Department

Population ('000): 2,820 (1970)
Per Capita GNP: US$1,890 (1969)

ATTACHMENT 1

NEW ZEALAND - PAST AND PROPOSED LENDING THROUGH FY 1976
(US$ million)

		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
Industrial Finance I	IBRD																	
Industrial Finance II	IBRD										8.0		15.0					
Power I	IBRD		32.5															
Power II	IBRD				20.5													
Ports	IBRD		7.8															
Railways I	IBRD				42.0													
Railways II	IBRD									16.4								
Total	IBRD		40.3		62.5					16.4	8.0		15.0			102.8	24.4	23.0
No.			2		2					1	1		1			4	2	2
Net										16.4	8.0		15.0				24.4	23.0
IBRD Loans Outstanding																		
- including undisbursed			35.1	33.6	96.1	96.1	96.1	90.5	85.5	95.9	98.3	92.1	100.7	93.9	85.7			
- excluding undisbursed			0.0	18.8	41.5	59.5	74.0	81.5	83.5	81.3	83.4	88.3	89.1	88.9	85.7			

East Asia and Pacific Department
December 15, 1970

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

OFFICE MEMORANDUM

TO: Mr. Raymond J. Goodman DATE: November 12, 1970

FROM: Guenter H. Reif

SUBJECT: NEW ZEALAND: Back-to-Office Report on Economic Mission

1. An economic mission consisting of Messrs. G.H. Reif (Chief), J.R. Bumgarner and G.C. Maniatis visited New Zealand from October 4 to October 23. Mr. P. Hasan joined the mission during the final week of its stay. The principal purpose of the mission was to review the current economic position, especially developments since the last Bank economic mission in early 1969, and to assess future economic problems and prospects. During its visit the mission had meetings with Finance Minister Muldoon and Reserve Bank Governor Low.

Economic Growth

2. New Zealand's economy has recovered fairly rapidly from the recession in 1967 and early 1968 when balance of payments difficulties led to a slowdown in economic activity and a slight decline in real GNP. In most sectors of the economy the trough in the level of activity was reached about mid-1968. Since then expenditures both for consumption and investment have been rising at an accelerating pace accompanied by marked expansion in production, especially in manufacturing. Agricultural production, on the other hand, was affected by a serious, widespread drought during the 1969/70 farming season resulting in lower dairy and lamb production. Farm production in all commodities is expected to recover strongly in the current 1970/71 year. The substantial overall growth has been stimulated by a notable increase in export earnings, promoted partly by the monetary effects of New Zealand's devaluation in 1967, but largely as a result of substantially increased volume of exports (including some reduction in stocks, e.g. wool) and higher market prices for meat. GNP increased by 9.3 percent in money terms during fiscal year 1969/70 (April 1 - March 31) as against increases of 6.9 percent in 1968/69 and 4.0 percent in 1967/68. Real output in 1969/70 rose by 5.2 percent (1967/68:-0.6%; 1968/69:+1.6%). Per capita GNP is currently about US$1,890 equivalent.

3. Almost all indicators point to a continued and strong expansion of the economy in the current fiscal year (1970/71) with money GNP likely to grow by over 13 percent. During the last six months, inflationary pressures have been building up rapidly as a result of soaring prices for imported goods, overall buoyant economic activity, and especially by sharp

wage increases, brought about by an acute labor shortage. Large export earnings, higher personal incomes, restored business confidence in industry and commerce, and a liquid financial sector combined to raise significantly private consumption and investment. The increase was apparently in excess of the economy's ability to satisfy the aggregate demand from domestic resources of manpower and industrial capacity. During April-September, 1970 prices rose by about 3.4 percent and for FY 1970/71 as a whole a price rise of between 6 to 7 percent (GNP deflator) is now considered likely. Real GNP growth in FY 1970/71 would thus be around 6 percent, which is well above the annual 4.5 percent growth targeted by the National Development Conference.

Labor Shortage

4. Since the last economic mission the economy has moved, for the time being at least, from a situation where the prime constraint on economic growth was the shortage of foreign exchange to a situation where a serious labor shortage, particularly of professional, technical, and managerial skills, is a major growth constraint. One contributing factor has been the emergence of a considerable net emigration (10,000 persons a year during FY's 1967/68 and 1968/69), largely to Australia. The New Zealand Government has recently stepped up considerably its immigration promotion policy and net emigration has been, at least temporarily, substantially reduced. However, the brain and skill drain from New Zealand, attracted by higher salaries and greater opportunities elswhere will continue to be a major problem, especially because of the proximity of Australia's booming economy with its rapidly rising wage level.

Wage-Cost Inflation and Anti-Inflationary Measures

5. During the first half of FY 1970/71, salary and wage payments are estimated to have grown at an annual rate of about 15 percent. The Government was obviously surprised by the extent of the present wage-cost inflation, which threatens to erode the competitiveness of export industries. In addition, there apparently was a breakdown of the arbitration machinery and of the communication between Government and the unions, whose unusually high wage demands were well in excess of productivity and even price increases.

6. Earlier anti-inflationary fiscal and monetary measures taken when the 1970/71 budget was introduced proved inadequate. Government expenditures in FY 1970/71 are now forecast to be 16.4 percent above the 1969/70 figure (as compared to a 9.2 percent increase in the original budget) mainly on account of higher wages and salaries in the public sector. Shortly after the mission left the Government announced a series of more stringent anti-inflationary measures. The main fiscal measure is a temporary surcharge of 3-1/3 percent on all personal income tax, payable on income derived during FY 1970/71 and FY 1971/72. For taxpayers subject to PAYE deductions this will be in the form of a 10 percent surcharge effective from December 1, 1970 until July 31, 1971. The Government also

announced a stiffer posture on the wage issue and initiated discussions with employers and employees on methods to avoid future excessive wage movements. Other measures include increases in tobacco taxes, a 7 cent per gallon increase in gasoline prices, nationwide controls in building construction, higher minimum deposits on hire purchase of most consumer goods, and an increase to 15 percent, as of FY 1971/72, in the required Government stock ratio for finance companies. Also, trading bank lending to the non-export sector was further restricted. As previously announced railway freight rates will be raised 12 percent from December 1, 1970 and fares 10 percent from February 1, 1971. Also postal charges will be increased as of December 1, 1970, so as to yield NZ$20 million additional revenue in a full year to meet rising costs.

7. It is a matter of regret that the Government did not follow suggestions (e.g. from the reputable Monetary and Economic Council) to remove more rapidly import and exchange controls or at least to permit additional imports under the existing quotas. Government continues to repeat in general terms, its intention to follow a trade liberalization policy. Augmenting domestic supplies by imports would have been, under present conditions, an effective anti-inflationary instrument by mopping up excessive domestic demand. More rapid trade liberalization also would have increased competitive pressures in the New Zealand market and thus contributed to a faster restructuring of the manufacturing sector. In general, the dismantling of import controls, after considerable progress having been made in the past, is currently bogged down in detailed studies on individual items purportedly to ensure adequate tariff protection after the quotas are discontinued. The Government could, however, use the current good balance of payments position to move more expeditiously towards the removal of most remaining controls while still providing for adequate protection of efficient domestic industries. With such action, efficient industries should be able to obtain an increasing share of available labor and capital resources.

8. In this context, it is questionable whether the promotion of immigration should be the major policy to alleviate the labor shortage, which is concentrated largely among the higher skills, considering current recruitment difficulties of skilled labor overseas and particularly the large-scale investment in housing required to settle the immigrants. Removal of protection from labor-intensive industries (e.g. textiles) and the abolition of employment restrictions (e.g. for female workers, additional shifts, overtime, etc.) would contribute to a better allocation of the available labor resources.

Balance of Payments

9. New Zealand's balance of external transactions has improved in the last two years, although the terms of trade have been deteriorating more rapidly due to rising import prices, quite apart from the impact of the devaluation. During the trading year 1969/70 (July 1 - June 30), merchandise exports increased by 16 percent to a total of NZ$1.16 billion, mainly because of a 31 percent rise in meat exports. These gains more than

offset a substantial rise in imports and also a large NZ$214 million deficit on invisible transactions. The current account showed a NZ$62 million surplus for trading year 1969/70 compared to a surplus of NZ$50 million in 1968/69. Figures on a yearly basis for July and August 1969/70 showed a sharp decline in this surplus due to strongly rising imports. For September, however, external transactions on current account again had a surplus of around NZ$30 million. The capital account ended the year to June 1970 with a deficit of NZ$32 million because of Government net capital repayments of NZ$39 million and net Government investment abroad of NZ$6 million. International reserves reached NZ$345 million at the end of June 1970, compared with NZ$325 million a year before, and only NZ$182 million in June 1967. The current level of reserves would finance about 4½ months worth of imports, at the 1969/70 rate.

10. Overseas private direct investment in New Zealand has shown no definite trend but has fluctuated quite sharply. The peak inflow of NZ$62.8 million during FY 1965/66 fell to about half of this figure during the following three years due to U.K. and U.S. restrictions on capital outflow and the economic downturn in New Zealand. There was some improvement in FY 1968/69 and preliminary figures for FY 1969/70 show a further uptrend with overseas investments concentrated in manufacturing and wholesale and retail trade.

11. Balance of payments prospects for the next one or two years appear relatively favorable despite some further likely deterioration of the terms of trade. Short-term prospects for agricultural exports, which still account for 85 percent of export earnings, have improved with the exception of wool. In dairying, markets for skim milk powder and casein look buoyant after recent cuts in EEC subsidies and prospects for butter appear considerably better after two recent and substantial price increases on the U.K. market. The U.K. market for cheese is likely to remain stable and gains in the Japanese cheese market may offset possible quota reduction in the U.S. Meat production continues to increase with more farmers diversifying into beef, or emphasizing sheep meat production rather than wool. Meat export markets are currently good and should remain so, assuming that quota and sanitary restrictions do not further restrict the U.S. market and new markets in Asia, Europe and the Middle East can be successfully penetrated. In addition, manufacturing and forestry exports have been expanding very fast, although the absolute amounts are still relatively small. The financing of a relatively small current account deficit should not pose serious difficulties for New Zealand even though it has sizeable repayment obligations in the next few years. New Zealand's creditworthiness is not in question with a current debt service ratio of about 5 percent of export earnings on total public and government guaranteed debt.

Government Overseas Borrowing

12. The New Zealand Government did not borrow from abroad during FY 1969/70 largely because of the favorable balance on current account, but also because it considered the international interest rate level too

high. A planned 100 million Deutschmark loan was shelved when the German capital market was closed temporarily in late 1969 after the DM revaluation. On the contrary, the Government was able to repay the bulk of short-term official debt incurred during the balance of payments crisis in 1967/68 and borrowing prospects for the near future have improved.

13. Borrowing has successfully been resumed in FY 1970/71. In July 1970, a US$40 million revolving credit facility was arranged for seven years by the New Zealand Government with a consortium of European banks,[1] under which the interest is reviewable every six months and the currency drawn is at the borrower's option. Half of the credit was drawn in July, the other half in September 1970. The interest was 8-9/16 percent for the first and 7-9/16 percent for the second tranche. Another Swiss franc 40-50 million loan (7½ percent; 15 years) is firmly expected for the last calendar quarter of 1970. The German capital market is likely to be open for a DM 80-100 million loan (NZ$20-23 million) in the first quarter of calendar 1971. This means that the projected borrowings (excluding IBRD) of NZ$44 million in FY 1970/71 have not only been secured but even part of the planned borrowing for FY 1971/72 may already be covered. A small Dutch guilder loan is under negotiation. In addition, the U.K. Government has tentatively assured New Zealand that, barring extraordinary strains on the U.K. balance of payments, it will permit conversion of loans falling due in FY 1971/72 in the amount of NZ$31.6 million. This would considerably increase Government net borrowing in 1971/72.

Prospects

14. The New Zealand Government appears greatly preoccupied at the moment with the problems arising from the wage-cost inflation. The focus of the measures taken to deal with these problems is clearly on the short-run. It is difficult to escape the impression that judgments on long term economic policies are being kept somewhat suspended until the outcome of the U.K.'s negotiations on entry into the E.E.C. To some extent this is understandable because the outcome of these negotiatons is highly uncertain and New Zealand does not wish to jeopardize its economic relations with the U.K. until confronted with the certain need for change. On the other hand, there is a growing awareness of the need for a re-structuring and re-orientation of New Zealand's exports irrespective of the outcome of the Brussels negotiations because such a heavy dependence on the U.K. market and a limited number of agricultural exports is inherently too risky.

15. In addition to a diversification of agricultural exports and markets the expansion of export-oriented manufacturing output has clearly good prospects. Manufactured goods exports, though still small, have been growing rapidly. Positive economic policies to encourage the shift towards industrial exports, new agricultural products and non-traditional markets

1/ Eurodollars, Dutch guilders, Deutschmarks, and Swiss francs.

are clearly indicated. A cornerstone of these policies should be the elimination of reliance on import controls as soon as possible, thus exposing industry to international competition. Import liberalization would also help dampen domestic price increases by squeezing the profits of domestic manufacturers and encouraging them to resist wage increases. Finally, it would result in a generally better allocation of resources, especially labor.

16. Provided the Government shows determination in reducing the hold of inefficient industry on domestic markets, and provides encouragement for new economic initiatives and drives, the annual growth target of 4.5 percent set by the National Development Conference may be attained even though labor supply is very much more of a constraint than originally envisaged. A critical element in reaching this target would be an increase in private investment to exploit new opportunities for exports. This in turn would require a substantially larger net external capital inflow than at present.

Cleared with & cc: Messrs. Gilmartin
Hasan

cc: Messrs. Fontein
Street
Tims
Bumgarner
Maniatis

Messrs. McNamara
Chenery
Kamarck/Stevenson
Adler

GHReif:vcm

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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December 11, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Colombia - Second Telecommunications Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 11, 1970 from the South America Department, entitled "Colombia - Proposed Loan for the Second Telecommunications Project" (LC/O/70-127).

2. Comments, if any, should be sent to reach Mr. Roessler (ext. 2192) by 5:00 p.m. on Wednesday, December 16.

3. It is planned then, if the Committee approves, to inform the Government and representatives of TELECOM 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)

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LC/O/70-127

December 1?, 1970

LOAN COMMITTEE

Memorandum from South America Department

COLOMBIA - Proposed Loan for the Second Telecommunications Project

1. Attached is the draft Appraisal Report No. PU-57 recommending a Bank loan of US$13 million to the Empresa Nacional de Telecommunicaciones (TELECOM) to help finance the Second Telecommunications Project.

Lending Program

2. The proposed loan would be the second made to Colombia as part of the FY 1971 lending program, which comprises eight projects. (See attached five-year lending program.) Loan negotiations for the proposed Caqueta Land Colonization Project are expected to begin in January. Negotiations for the following projects were initiated but not concluded in FY 1970 because of unresolved project problems: Palmira Water Supply (US$2 million), Bucaramanga Sewerage and Erosion Control (US$6 million), and Development Finance Institute (US$5 million). Steps are being taken to bring about a resumption of these negotiations in the near future.

3. Appraisal Reports for the Development Finance Companies Project (US$30 million) and the Second Atlantico Irrigation Project (US$3.8 million) are in preparation. The appraisal mission for the Second Bogota Water Supply Project (loan amount to be determined) is presently in the field.

The Economy

4. The Colombian economy continued to perform satisfactorily, under prudent management by the authorities. The rate of growth of GDP was 6.5 percent in 1969, and is expected to be at least 7 percent in 1970. With respect to fiscal performance, total public savings increased in real terms at an average rate of 10.6 percent in 1966-69. The central government surplus on current account, which represents three-quarters of public savings, increased by 21 percent in the first semester of 1970. Total public investment increased in real terms at an average annual rate of 21 percent in 1966-69, and the increase planned for 1970 was 35 percent. Central government investment, which accounts for about half of total public investment, increased by 24 percent in the first three quarters of 1970. The Government is aiming to increase minor exports (other than coffee and petroleum) by 25 percent annually, and this target was exceeded

in 1968 and 1969. However, in the first eight months of 1970, these exports were only 8 percent higher than in the same period of 1969. The Government is responding to this by adopting a policy of moving the exchange rate faster than the cost of living index, and is seriously considering an increase in the extent of the subsidy to minor exports granted through tax relief certificates. With respect to monetary policy, the net credit of the central bank remains consistently well below the credit ceilings agreed with the IMF as conditions of their standby.

The Project

5. The proposed loan would be the Bank's second lending operation in the Colombian telecommunications sector. The first was the US$16.0 million loan made in 1967 to TELECOM. It helped finance a modern long-distance network and the improvement and expansion of local and international telephone, telegraph and telex services. The full amount of this loan has now been committed and is expected to be disbursed by December 1971, one year after the original Closing Date. The proposed project would help finance part of TELECOM's next four-year expansion program. Its total cost is estimated at US$28.2 million and its foreign exchange cost at US$16.2 million. The proposed Bank loan of US$13 million would finance part of the foreign exchange costs, with the balance to be covered by suppliers credits. The latter will be attached to a small amount of long-distance and telex equipment which for reasons of standardization has to be procured from specific sources. The Bank funds would be used mainly to provide for 30,000 local service lines in areas where little or no local services exist and for the expansion of the long-distance network to alleviate present congestion and to cover the estimated demand until 1975. The project, which is expected to have an internal rate of return of 26 percent, would make an important contribution to the economic development of Colombia by increasing the efficiency of operations in administration, industry and commerce. By continuing its association with the Colombian telecommunications sector, the Bank would have the opportunity to further strengthen the proposed Borrower's management and to support the consolidation of the sector in which 61 local telephone companies serve a total of only 564,000 subscribers.

6. The financial projections in the Appraisal Report assume that during the foreseeable future no tariff increase will be necessary to meet the financial requirements of the enterprise and to produce an adequate rate of return. Nevertheless, TELECOM will be seeking such an increase shortly. In any event, the loan documents will contain a rate covenant providing for a minimum rate of return of 10 percent based on properly revalued assets and for Bank approval of any reduction in tariffs during the construction period.

7. After the return of the appraisal mission, TELECOM purchased, with the concurrence of the Bank, the North Santander Departmental Telephone Company, In order to meet requirements in the Santander Depart-

ment, TELECOM plans to initiate an expansion program consisting principally of a new 12,000-line exchange which would replace the existing, largely antiquated, 5,800-line equipment (the salvable portion of which would be used for expansion of other small exchanges). TELECOM has requested us to increase the amount of the loan by US$1.6 million to finance the estimated foreign exchange costs of the program. The proposal appears feasible, but its technical and financial aspects still have to be reviewed in detail. Should the outcome of this review be positive, which we expect to know before the completion of loan negotiations, I shall so inform the Chairman of the Loan Committee and recommend an increase of the proposed loan to include the foreign exchange cost of the Santander program.

Recommendation

8. I recommend that the Government and TELECOM be invited to send representatives to negotiate a loan of US$13 million for the Second Telecommunications Project on the terms and conditions set forth in the draft Appraisal Report.

Gunter K. Wiese
Deputy Director

Attachment

COLOMBIA: Bank/IDA Lending Program, FY 1967-75

(US$ Millions)

	1967	1968	1969	1970	Total FY 1949 through FY 1970	1971	1972	1973	1974	1975	Total FY 1971 to 1975
AGRICULTURE	1/9.0		1/17.0	1/18.3	6/71.0						6/61.3
Livestock III								15.0			
Livestock IV											
Agricultural Credit II										15.0	
Agricultural Credit III											
Caqueta Land Colonization						7.5					
Atlantico Irrigation II						3.8					
Cesar Irrigation I							10.0				
Cesar Irrigation II										10.0	
EDUCATION			1/7.6	1/6.5	2/14.1						2/20.0
Education III								10.0			
Education IV										10.0	
POWER		1/18.0	1/18.0	1/52.3	18/294.1						1/15.0
Interconnection Hydro								15.0			
TRANSPORTATION			2/35.5	1/32.0	11/230.2						3/57.0
Highways VII							27.0				
Highways VIII									20.0		
Railways VI							10.0				
WATER SUPPLY AND SEWERAGE		1/14.0		1/18.5	2/32.5						5/98.0
Bucaramanga Sewerage and Erosion Control						6.0					
Medium-Sized Cities I							20.0				
Palmira Water Supply						2.0					
Medium-sized Cities II									25.0		
Bogota II						45.0					
DEVELOPMENT FINANCE COMPANIES		1/12.5	1/25.0		3/62.5						4/95.0
Development Finance Institute						5.0					
DFC IV						30.0					
DFC V								30.0			
DFC VI										30.0	
INDUSTRIES AND MINING					1/30.0						
TELECOMMUNICATIONS	1/16.0				1/16.0						1/13.0
Telecommunications II						13.0					
UNALLOCATED							19.0	10.0	35.0	15.0	4/79.0
TOTAL	25.0	44.5	103.1	127.6	44/750.4	112.3	86.0	80.0	80.0	80.0	26/438.3
(Of which IDA)					(1/19.5)						

South America Department

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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December 11, 1970

MEMORANDUM TO THE LOAN COMMITTEE

United Arab Republic - Railways Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 11, 1970 from the Europe, Middle East and North Africa Department, entitled "United Arab Republic - Proposed Credit for a Railways Project" (LC/O/70-126).

2. Comments, if any, should be sent to reach Mr. Upper (ext. 4721) by 1:00 p.m. on Wednesday, December 16.

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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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)

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LC/O/70-126

December 11, 1970

LOAN COMMITTEE

Memorandum from the Europe, Middle East and North Africa Department

UNITED ARAB REPUBLIC -- Proposed Credit for a Railways Project

I. Introduction

1. Attached for consideration by the Loan Committee is Appraisal Report No. PTR-69 entitled "Appraisal of Railways Project" which recommends an IDA credit of US$24.0 million to help finance the track renewal and telecommunications and signalling part of the investment program of the Egyptian Railways.

2. The proposed credit would be the third Bank Group operation in the United Arab Republic. In 1959, a loan of $56.5 million (243-UAR) was made to the Suez Canal Authority primarily for widening and deepening of the Canal. In 1970, the Executive Directors approved a $26 million credit (181-UAR) to cover the foreign exchange costs of a tile drainage program designed to lower the water table and reduce salinity on approximately one million acres of irrigated land in the Nile Delta. The credit is not yet effective due to difficulties in selecting a suitable team of consultants to assist in carrying out the project. Negotiations with the consultants are now nearly completed. In the meantime, preparation of bidding documents and other items required for project implementation are proceeding satisfactorily.

3. The long interval between the 1959 and 1970 operations was due to a variety of circumstances. In the early 1960's, most foreign and local commercial, industrial and financial enterprises were nationalized, and compensation questions took some time to resolve. In 1966 the UAR defaulted on its debt obligations to Western countries and the IMF (although it maintained its payments to the Bank). In 1967 at a time when most of these arrears were about to be rescheduled, including those with the IMF and the US, the June war intervened. Since then, rescheduling agreements have been concluded with all but one of the UAR's Western creditors, the exception being the United States.

4. The Nile Delta Drainage Credit was presented to the Executive Directors in March 1970 in the expectation that a debt rescheduling agreement between the UAR and the United States would soon be concluded. In Spring 1970 the US agreed to a UAR proposal which provided for payments of the rescheduled debt (which would then have amounted to about

$123 million) to begin July 1, 1970. The UAR failed to sign an agreement, however, citing severe balance of payments problems as the reason. It proposed instead to begin payments on July 1, 1971, an offer which the United States found unacceptable. The UAR has so far not made another offer but contacts between the two governments have been continuing. Meanwhile, the Association has informed the UAR Government that preparation of the Railways project is progressing but that the presentation of the proposed credit to the Executive Directors could only take place if the debt rescheduling issue is settled. The project is now being presented to the Loan Committee in order to enable us to proceed to negotiations soon, in the hope of early progress on debt rescheduling.

5. Future lending activities will depend in part on the degree of cooperation and communication established with the new Government formed in November 1970. A new Minister and Deputy Minister of Economy and Foreign Trade have been appointed and a new post of Deputy Prime Minister for Economic and Financial Affairs introduced and assigned to the Minister of Industry, who retains that portfolio. Until this relationship has been clarified the lending program (Attachment 2) can only be considered as tentative. The program is concentrated in the priority sectors of transportation and agriculture for which the prospects of achieving policy improvements over time are somewhat more promising than in other sectors.

II. The Economy

6. An economic report entitled "Current Economic Position and Prospects of the United Arab Republic" (EMA 10a) was distributed to the Executive Directors in August 1969. The report of the mission which visited the UAR in May/June 1970 has been reviewed by the Economic Committee and sent to the Government for comments by December 15. The findings of the 1970 mission indicate that the economy of the UAR has performed moderately well in the short term. In both 1969 and 1970, real GDP rose by 4.4 percent and export earnings by 23.4 percent in 1969 and 7.5 percent in 1970. The expansion of economic activity was accompanied by a substantial reduction of unused capacity in the industrial sector. The main factors in the growth of export earnings were an expansion of oil production, favorable cotton prices, an increase in non-traditional exports such as fruits and vegetables and some revival of tourism. Improved foreign exchange budgeting made possible a further reduction of imports without much affecting the availability of essential raw materials.

7. Nevertheless, the longer term prospects are somewhat less encouraging. A shift in priorities to defense has resulted in a decline in total investment from 16 percent of GDP in 1967 to 12 percent in 1970 while at the same time defense expenditures have risen from 8 percent of GDP to 19 percent in the 1971 budget, or from $480 million to $1,265 million equivalent. Considerable efforts have been made to mobilize additional

resources, both within the country and abroad. However, since internal mobilization had already reached a high level before the war -- the ratio of government revenue to GDP was 24 percent in 1967 -- the margin which could be added to budgetary income is rather small. The difficulties in mobilizing resources for investment and the general political uncertainty have led to deferment of the almost completed 1971-75 Development Plan and adoption of an unrelated one-year plan with significantly lower growth targets. If public consumption continues to receive priority over investment, and if foreign aid cannot be significantly increased, per capita GDP could fall after 1973, bearing in mind that the growth of population has not slowed down perceptibly in recent years (2.5 percent). On the other hand, if a reallocation of resources from public consumption to investment occurs, prospects are likely to be rather more favorable. Nevertheless, to achieve a growth rate of even 5 percent in 1975, the UAR would have to achieve a marginal savings rate of 35 percent and foreign loans would have to increase by about 50 percent assuming that Arab assistance under the Khartoum Agreement of about $250 million annually will be maintained in lieu of lost Suez Canal and tourist earnings.

8. Apart from Arab assistance, recent capital flows to the UAR, including aid from Eastern Europe, have been limited. As a result the capital account on the balance of payments (excluding Arab aid) has changed from a net inflow of over $150 million in 1967 to a net outflow of some $30 million in 1969. The debt structure is unfavorable and three quarters of the existing debt (95 percent of the debt to Western creditors and 55 percent of the debt to Eastern Europe and China) falls due by July 1975. As a result the debt service ratio is about 23 percent and unlikely to decline significantly in the near future.

9. It is not clear how the death of President Nasser will affect economic prospects in the UAR. The new Government of President Anwar Sadat and Premier Mahmoud Fawzi has publicly stated its intentions to prosecute the war effort with full vigor. At the same time, measures have been taken to deal with urgent development problems, including municipal water supplies, urban transportation and the railways. The Cabinet formed in November 1970 has been reorganized in an attempt to improve the efficiency of government and its responsiveness to public needs.

III. The Project

10. The deterioration in the overall rate of investment is particularly serious for the Railways which has already suffered from underinvestment for over a decade. Due to lack of funds, the Railways' physical properties are run down and many are obsolete. Currently almost half of all tracks on main lines and three-quarters of sidings are over-age; sixty percent of all freight cars are more than twenty years old; marshalling yards have not been improved for sixty years; and signalling and telecommunications installations are generally obsolete and inefficient. Despite the high managerial and technical competence of the Railways organization, serious accidents have begun to occur and speed restrictions have been imposed on several major lines, further limiting capacity.

11. Despite these serious limitations, the Egyptian Railways is being asked to handle an increasing volume of traffic. Passenger traffic has increased by 33 percent since 1965. Freight traffic, after a steady decline from 1964 due primarily to completion of major earthworks for the Aswan Dam and loss of over 400 km of lines from the 1967 war, increased about 9 percent during 1970. Because of the unique geography of Egypt, the Railways can be expected to remain the most important long-distance carrier for some time. Agricultural, commercial and industrial activity is concentrated in the Nile Delta and along a narrow strip 2-6 miles wide following the River Nile 450 miles to Aswan. The relatively long distances which freight traffic in the UAR must move and the increasingly large proportion of bulk commodities being carried make the Railways especially important. Development of the industrial complexes at Aswan and Helwan and the fertilizer industry at Qena, as well as the exploitation of mineral deposits (especially iron ore, coal, bauxite, manganese and phosphates) will require substantially increased service from the Railways. However, without major rehabilitation and new investments, the Railways could become a serious bottleneck to further economic development. A comprehensive transport survey would be necessary to determine the economic role of the various modes of transport and a coherent investment strategy for the sector. Because of current difficulties in making long-term traffic projections, however, a survey could not be successfully undertaken at this time. Nevertheless, the proposed project can be justified without having the results of the survey as it aims at rehabilitating the system and assumes modest traffic increases.

12. The project itself as defined in the appraisal report comprises four years (1971/72-1974/75) of a six-year investment program for the Egyptian Railways. The proposed credit would finance the foreign exchange costs of:

a. the first three years of the track relaying investments included in the project and track work related to signalling and telecommunications; and

b. signalling and telecommunications equipment and installation on two heavily travelled railway sections (Cairo) -- Kobri El Leimoun-El Marg-Gabl El Asfar and the Cairo-Giza and Aussim.

The exact size and composition of the project is still to be discussed with the Government and the Railways (see Section IV below). Track relaying and signalling and telecommunications equipment which would be financed under the credit are the highest priority items in the Egyptian Railways' investment program.

13. Procurement would be through international competitive bidding. The borrower would be the UAR Government, which would relend the proceeds of the credit to Egyptian Railways at 4.5 percent, the standard borrowing

rate for public sector enterprises in Egypt, with repayment over 15 years. Egyptian Railways is competent to carry out the project, and all civil engineering works would be undertaken by Egyptian Railways' own work forces.

14. The project is designed to enhance the efficient operation of the Railways by reducing present operating costs, and improving service levels and safety. An assessment of the part of the total economic benefits which would likely accrue to the Railways in the form of increased net revenues, based on conservative traffic forecasts, gives an economic return of about 14 percent on the modified investment program described in paragraph 16.

IV. Major Issues

15. When the proposed project was originally appraised in November 1968, the Railways had prepared a six-year investment program costing about $329 million. In mid-1970 Egyptian Railways submitted to the Government and sent to the Bank a revised six-year program covering the year 1970/71 and the five-year period 1971/72-1975/76 for incorporation in the UAR Five-Year Plan 1971-1975. The revised program was estimated to cost $505 million. The Government has not approved the investment program, probably on the same grounds that the Development Plan was deferred -- the unsettled political situation and the shortage of resources for investment. Consequently, there is no detailed financing plan for the $505 million program. However, the Egyptian Railways has estimated that if such a program were to be financed, it would be required to borrow $389 million over the six-year period (in addition to the proposed credit), almost tripling its total outstanding debt and resulting in debt payments of $61 million in 1977/78, equivalent to roughly 70 percent of its gross operating revenues for FY 1969.

16. For this reason the Association staff considers the program unrealistic and has prepared a modified investment program which it believes would be within the financial capabilities of the Railways and would, at the same time, represent approximately the minimum technical program necessary to break the cycle of under-investment. The modified program has not been discussed with the UAR Government or the Egyptian Railways. Agreement on an investment program and financing plan is, therefore, the major issue to be resolved before or during negotiations. The modified six-year program would require investments of US$201 million, with a foreign exchange component of $77 million. It reflects the stated priorities of the Railways and includes the full track renewal program (to which the Railways give highest priority) and the most important items of the signalling and telecommunications component proposed in the larger investment program. The major items deferred in the modified program include items of slightly lower priority such as motive power and rolling stock, maintenance and repair facilities, some signalling and telecommunications (SSTT) items and training and research facilities. The program could, of course, be expanded if and when additional investment funds become available on reasonable terms.

17. The project as defined in the draft appraisal report would comprise the four years 1971/72-1974/75 of the modified program plus a small amount of local currency expenditure for completion of SSTT installation in the fifth year. Total project cost would thus be $144.0 million with a foreign exchange component of $57.6 million. The proposed credit of $24 million would finance only 17 percent of total costs and 42 percent of the foreign exchange requirement. The balance of foreign exchange amounting to $33.6 million would have to come from suppliers' credits (about 54 percent) and from government reserves. The Government would also be required to provide about $47 million in local currency loans. During discussion of a modified investment program, there might be some advantage in redefining the proposed project to cover a somewhat shorter period of time than the four-year period presently proposed. This would increase the relative contribution of the IDA credit to total project investments and facilitate consideration of an additional project for the Railways about FY 1973.

18. Apart from the definition of the investment program, the other recommendations contained in the appraisal report, which relate mainly to the financial structure and position of the Railways, are not expected to pose unusual problems for negotiations. Implementation of these recommendations would have an important bearing on the financial autonomy of the Railways by seeking agreement on the charging of commercial rates for government traffic, clarifying the Government's position on appropriation of net revenues of the Railways, and the settlement of mutual debts by the Government and Railways. The recommendations would also seek agreement on the introduction of a more effective cost accounting system and traffic forecasting for the Railways, essential first steps for the eventual preparation of a full transport study in the UAR (see paragraph 11).

V. Recommendations

19. On the basis of the foregoing I recommend that:

a. as soon as the debt rescheduling question permits, the Association enter into negotiations for a credit of $24 million on terms and conditions as recommended in the appraisal report; and

b. in the meantime and in order to reduce the risk of protracted negotiations, discussions be held with the Government and the Railways authorities to agree on an investment program and financing plan for the project.

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

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

Population: 32.5 m.
Per Cap. Inc.: $173

UNITED ARAB REPUBLIC - ACTUAL AND PROPOSED LENDING THROUGH FY 1976

Attachment 2

($ millions)

		Through 1963	1964	1965	1966	1967	Fiscal Years 1968	1969	1970	1971	1972	1973	1974	1975	1976	Total 1964-68	Total 1969-73	Total 1972-76
Agricultural Credit	IDA													20.0				
Drainage I	IDA								26.0									
Drainage II	IDA												25.0					
Drainage III	IDA														25.0			
Reclamation I	IDA										20.0							
Reclamation II	IDA													30.0				
Industry I	IDA											20.0						
Industry II	IDA														25.0			
Population	IDA										3.0							
Tourism	IDA													10.0				
Railways I	IDA									24.0								
Railways II	IDA											25.0						
Inland Waterways	IDA										7.0							
Urban Transport	IDA												30.0					
Suez Canal Authority	IBRD	56.5																
GROSS PROGRAM	IDA									24.0	30.0	45.0	55.0	60.0	50.0	-	125.0	240.0
	No.									1	3	2	2	3	2	-	7	12
NET PROGRAM	IBRD	56.5																
	IDA	-							26.0	24.0	30.0	40.0	40.0	55.0	55.0	-	-	-
	Total	56.5							26.0	24.0	30.0	40.0	40.0	55.0	55.0	-	120.0	220.0
	No.	1							1	1	3	2	2	3	2	-	7	12
IBRD Loans Outstanding																		
- including undisbursed		51.0	49.2	45.2	41.2	37.5	33.5	29.5	25.0	19.0	14.0	8.0	3.0	-	-			
- excluding undisbursed		51.0	49.2	45.2	41.2	37.5	33.5	29.5	25.0	19.0	14.0	8.0	3.0	-	-			
IDA Credits Outstanding																		
- including undisbursed									26.0	50.0	80.0	120.0	160.0	215.0	270.0			
- excluding undisbursed									-	0.3	6.9	30.7	68.1	117.1	166.1			

Europe, Middle East and
North Africa Department
November 23, 1970

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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December 10, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Ethiopia - Second Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 10, 1970 from the Eastern Africa Department, entitled "Ethiopia - Second Education Project" (LC/O/70-125).

2. Comments, if any, should be sent to reach Mr. Gassner (ext. 4023) by 5:00 p.m. on Monday, December 14.

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)

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LC/0/70-125

December 10, 1970

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

ETHIOPIA - Second Education Project

1. The proposed project is designed to assist in replanning the Ethiopian education system to expand teacher training and agricultural education, and to provide extensions to some secondary schools in order to increase the scope for double shift working. If approved, this would be the second IDA credit for education in Ethiopia. The Association first assisted education in Ethiopia in 1966 when a credit of US$7.2 million was extended to help finance expansion of secondary education, teacher training and technical education. This project which is expected to be satisfactorily completed by the end of 1971, has also aided the introduction of comprehensive curricula and the teaching of practical subjects at the secondary level.

2. In December 1968 a UNESCO project preparation mission assisted the Imperial Ethiopian Government (IEG) in preparing a second project for Bank Group financing. In October 1969 a pre-appraisal mission visited Ethiopia to discuss the project with the government. In February-March 1970 the project was appraised. The Appraisal Report entitled "A Second Education Project in Ethiopia"(PE-22) dated December 4, 1970 is attached. It recommends that, subject to the conditions set forth in paragraphs 6.01-6.02, the proposed project is suitable as a basis for an IDA credit of US$8.0 million. I support this recommendation.

3. To date we have made eleven loans to Ethiopia totalling $97.8 million and five credits totalling $35 million. Seven loans are fully disbursed. A memorandum concerning a proposed IDA credit of $4.3 million for a dairy development project was approved by the Loan Committee on November 30, 1970. In addition a proposed IDA credit of $6 million for a coffee processing project and a proposed Bank Loan of $7 million for a water and sewerage project in Addis Ababa are expected to be considered by the Executive Directors in FY 1971. The 1972-76 lending program for Ethiopia reviewed with Mr.McNamara in October is being revised as a result of that review to provide for net lending at the increased level of $190 million and will be discussed again with Mr. McNamara in December. Since it is still being formulated the detailed program is not attached.

The Project

4. Lack of adequately trained manpower at all levels is one of the main constraints to Ethiopian economic growth. The situation is characterized by two contrasting features: (a) insufficient supply of qualified middle and high level manpower; and (b) growing unemployment

of general secondary and technical school graduates. These problems stem in part from an educational system which is not geared to meet the country's manpower needs. The educational system as a whole requires a critical examination. However, information on the existing labor force, wage employment and future manpower requirements is inadequate. Therefore, the project provides finance for both an education sector review and a manpower survey. The sector review would: (a) analyze the system's capacity to promote economic, social and cultural development; (b) recommend improvements and expansion of the system within the limits of the country's financial resources; and (c) identify priority investments in education. The manpower survey would provide the quantitative economic objectives to be fulfilled by the education and training system. The present project proposals are designed to assist in meeting obvious priority needs pending the results of these studies.

5. The proposed project would assist in meeting Ethiopia's need for trained teachers through the provision of two new primary teacher training institutes, an addition to one existing institute, and a new junior secondary teacher training institute. At the primary level, training requirements will amount to about 2,800 teachers per year by 1979/80, of which the existing teacher training institutes can supply only 1,400. At the junior secondary level, the new institute is expected to enable the percentage of qualified Ethiopian teachers to increase from 33% now to about 90% by 1979/80. In addition the project will finance an Academy of Pedagogy designed to train Ethiopian educators to staff the primary teacher training institutes, to train primary school supervisors, and to develop curriculum research so as to make primary education more relevant to Ethiopian needs.

6. Ethiopia's continuing economic development chiefly depends upon improving agricultural output and efficiency. Current government projects in agricultural education and training affect only a small proportion of the four million farm families in the subsistence sector. The proposed project provides finance for (a) three new agricultural training centers each of which would train 40 field assistants at a time in nine-month practical courses; and (b) additional facilities at two existing agricultural institutes, permitting enrollment to increase from 300 to 390 students. While the above represents only a beginning in meeting Ethiopia's needs for expansion of agricultural education and training, it is all that can be done at this time without delaying other project items. A project in agricultural education has been added to the FY72 lending program and arrangements for preparation of this project are currently under review.

7. The Ethiopian Government requested that IDA finance 5,960 school places in new secondary schools in addition to 4,240 places to be provided through extensions to existing schools. However, it was decided at a Special Loan Committee meeting on November 20, 1970 that pending the results of the manpower survey and educational sector review

(a) the present project should contain only 4,240 secondary places as recommended in the attached appraisal report, but (b) the necessary project preparation should be started to permit the FY72 agricultural education project to include the provision of post-primary practical training (emphasizing agricultural training) for about the same number of students in about the same areas where new secondary schools had been requested.

8. The total cost of the project is estimated at US$11.2 million equivalent with a foreign exchange component of US$6.1 million or 55% of the total. The proposed loan of US$8.0 million would finance 71% of the total cost which would provide for the foreign exchange component and US$1.9 million of local expenditure. The proposed financing of local expenditure is considered to be justified since even given a reasonable increase in Ethiopia's efforts to mobilize domestic resources at least half of its public investment program should be financed externally. Since parts of the program are not suitable for foreign assistance, those projects that can be assisted externally must include a percentage of financing high enough so as to maintain the 50% average for the total investment program. In addition financing of local expenditure is also required in some cases to permit a balanced investment program since otherwise a number of priority projects with low direct foreign exchange requirements would have to be deferred.

9. As in the case of the previous Bank group financed education project, the administration of the project would be handled by a special unit within the Ministry of Education. In addition, a consultant firm of architects would be employed to design and supervise construction of those project items that would not be designed by the project unit. Contracts for construction, as well as for furniture and equipment, would be grouped in appropriate bid packages and awarded through international competitive bidding.

10. In order to avoid delays in project implementation the Government in July 1970 requested permission to proceed with the preparation of the designs for the Junior Secondary Teacher Training Institute and the Academy of Pedagogy, and the recruitment of experts to begin work on the manpower survey. With the concurrence of the Deputy Chairman of the Loan Committee, I informed the Government that, subject to the approval of the Executive Directors, we would be prepared to include in the proposed second education project provision for retroactive financing of expenditure on the above items.

Economic Situation

11. An Economic Report on Ethiopia (AE-9) was distributed to the Executive Directors on October 22, 1970, (Secretary's Memorandum R10-199). The main conclusions were summarized in my memorandum to the Loan Committee entitled "Ethiopia - Addis Ababa Dairy Development Project" dated November 24, 1970.

Recommendation

12. I recommend (a) that the Association invites representatives of the Government of Ethiopia to negotiate a proposed credit of $8.0 million equivalent for a second education project substantially on the terms and conditions set forth in paragraphs 6.01 and 6.02 of the appraisal report; and (b) that the proposed credit provide for retroactive financing of up to $100,000 for consultants services related to the manpower survey and for professional services related to the design of the Academy of Pedagogy and the Junior Secondary Teacher Training Institute.

Michael L. Lejeune
Director
Eastern Africa Department

Attachment

Last Economic Mission

January-February 1970

Attachment 1

ETHIOPIA

INDICATORS OF DEVELOPMENT

ECONOMIC AND STRUCTURAL INDICATORS	Unit	1951-60	1961-65	1966-69	1970-74
1. Gross Domestic Product (in 1961 prices)	% change		4.4	4.5	5.5
2. Manufacturing Output	% change		16.4	16.5	12.0
3. Agricultural Output	% change		2.0	2.2	2.8
4. Imports of Goods and NFS	% change		15.0	1.0	6.4
5. Exports of Goods and NFS	% change		12.6	3.2	6.0
6. Domestic Price Level	% change		3.7	1.5	
		1961	1966	1970[13]	1975[13]
7. Gross National Savings	% GDP	10.9	9.7	12.0	13.8
8. Resource Gap	% GDP	0.6	2.0	1.5	1.7
9. Net Factor Payments Abroad	% GDP	0.2	0.1	0.5	0.5
10. Gross Domestic Investment	% GDP	11.7	11.8	14.0	16.0
11. Debt Service	% Export	3.0	6.1	9.5	10.0
12. Central Government Current Revenue	% GDP	8.0	9.6	9.5	12.0
13. Central Government Current Surplus	% GDP	0.8	1.3	0.8	1.5
14. Public Expenditure on Social Services	% GDP	1.5	2.1	2.5	3.5
15. Military Expenditure	% GDP	1.8	2.1	2.2	2.0
16. Manufacturing Output	% GDP		16.5	12.0	12.0
17. Energy Consumption	million tons				
18. Fertilizer Consumption	.000 tons				
SOCIAL INDICATORS					
19. Population Growth Rate	%		1.8	2.1	2.3
20. Urban Population Growth Rate	%				
21. Birth Rate	per 1,000				
22. Family Planning	Acceptors '000				
23. Income of: Highest quintile	% Total income				
Lowest quintile	% Total income				
24. School Enrolment: Primary and Secondary	% school-age population			8.0	
25. Literacy Rate	% adult population				
26. Unemployment Rate	% labor force				
27. Population per hospital bed	Number			3,400	

Eastern Africa Department

September 25, 1970

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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December 4, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Nigeria - Western State Cocoa Project

1. The Committee is requested to consider, without meeting, the attached memorandum of December 4, 1970 from the Western Africa Department, entitled "Nigeria - Western State Cocoa Project" (LC/O/70-124).

2. Comments, if any, should be sent to reach Mr. Mirza (ext. 4521) by 1:00 p.m. on Wednesday, December 9.

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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Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

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LC/O/70-124

LOAN COMMITTEE

December 4, 1970

Memorandum from the Western Africa Department

Nigeria - Western State Cocoa Project

1. Attached is an Appraisal Report (No. PA-69) dated November 16, 1970, recommending a loan of $8.6 million equivalent to the Government of Nigeria to assist in the expansion and improvement of cocoa production in Western State. The proposed loan will be the first for agricultural development in Nigeria.

2. One loan, for $10 million equivalent, has been extended to Nigeria during FY1971 and this was made to the Nigerian Industrial Development Bank. The lending program for the balance of FY1971 includes a $25 million loan for federal and state highways; a mission was sent to Nigeria on November 23 to appraise this project. A Rehabilitation Program loan of up to $80 million is also included in the FY1971 lending program proposed to management for approval. This Lending Program through FY1976 is attached.

Background

3. Nigeria is the world's second largest producer of cocoa and over the last ten years has produced on average 17 percent of world production. This has represented about 18 percent of Nigeria's foreign exchange earnings; 95 percent of this cocoa has been produced in Western State.

4. In the early 1960's, production increased due to replantings and effective pest and disease control programs introduced by the government in the early 1950's. During the last five years, however, production has been fairly static reflecting lack of husbandry and new plantings during the latter half of the 1960's resulting from considerably reduced world and producer prices and from neglect during the civil war. Some 70 percent of Eastern State cocoa trees are now more than thirty years old and a substantial decline in yields can be expected unless new plantings and replanting schemes are instituted.

5. Nigeria has accorded high priority to agriculture in its Second National Development Plan, 1970-74, and in order to retain its share of the expanding world cocoa market it recognizes the need to offer inducements to encourage substantial replantings and new plantings by smallholder farmers. The proposed project is designed to help achieve these objectives.

The Economy

6. Nigeria has emerged from the civil war with her unity and resources base intact; with the petroleum bonanza becoming a reality, the potential for economic development appears greater than ever before. Realization of

this potential will depend on continued political stability and on prudent use of the fast increasing fiscal and foreign exchange revenues in the face of the needs of reconstruction and development in what is still a large and poor country.

7. The war caused major losses in production and serious damage to the country's infrastructure. Growth of GDP is estimated to have dropped from about 5 percent per annum in the three years prior to the disturbances to minus 6.6 percent in 1967/68, resuming an upward trend in 1969/70 at 2.6 percent. Rehabilitation of damaged infrastructure is expected to cost about US$ 840 million. Sharp declines in investment, particularly in the private sector, resulted in substantial losses in terms of economic growth foregone. The sectors affected most by the war were petroleum, manufacturing and transport. Outside the war affected areas, however, economic activity continued much as usual and manufacturing production spurred by wartime import restrictions actually increased sharply.

8. The direct budgetary cost of the war is also estimated at about US$ 840 million, taking up virtually all of the Federal government's revenues over the war period. The government took stringent measures to increase taxes and reduce non-essential expenditures, and to curtail imports by raising tariffs and imposing direct controls. However, these measures did not suffice to raise all the resources required. The government increasingly resorted to deficit financing which beginning in 1969 was accompanied by rising money supply and the emergence of inflationary pressures. A substantial part of the sharp increase in money supply was associated with the remonetization of the formerly rebel-held areas. At the same time domestic food supplies and other goods had to be diverted to these areas. Consequently, the consumer price index for low income urban families - admittedly only partly representative of the general price level - since January 1969 has increased at an annual rate of 15 percent.

9. The government deliberately refrained from incurring long-term debt for financing military imports. All such imports apparently were paid for in cash. However, in order to make ends meet, the government resorted to delaying payments for commercial imports and barring remittances of investment income. Together, these two items amounted to about US$ 220 million by the end of April 1970. Foreign exchange reserves, already low at the beginning of the war, fluctuated but little throughout the emergency, having stabilized since then at a level barely equivalent to two months of current merchandise imports.

10. The government has just adopted a reconstruction and development plan covering the period April 1, 1970 to March 31, 1974. The plan anticipates total investment expenditures of $4.5 billion, of which about half would be in the public sector where transport, agriculture, industry and education are emphasized. While the Plan's strategy appears sound, its investment and saving targets, especially for the first two years, appear over-optimistic. However, even assuming considerable slippage in public investment expenditures, the foreign exchange gap during the first two years in

particular is likely to be higher than the $240 million projected in the Plan as private capital inflow has probably been overestimated and imports of consumer goods and raw materials probably underestimated.

11. Nigeria's external public debt currently is low and favourably structured: of the debt outstanding at the end of March 1970, only about 10 percent represented suppliers' credits. Debt service payments in 1970 are estimated at 7 percent of probable foreign exchange earnings. Hence, and in view of the expected rapid rise in foreign exchange revenues from petroleum, Nigeria is creditworthy for substantial amounts of borrowing on conventional terms.

<u>The Project</u>

12. In April 1965, a loan of $4.6 million for a cocoa planting and replanting scheme in the Western Region (now Western State) of Nigeria was negotiated but due to the outbreak of civil disturbances, culminating in the civil war the loan was deferred. The current project is a revision and extension of that project.

13. The project provides for the planting of 24,000 acres of new cocoa, and replanting of 18,000 acres currently under old cocoa trees producing uneconomic yields, and the provision of pesticides, fertilizers and improved planting materials. Farmers engaged in new planting would be given credits and those replanting would receive grants.

14. A Project Unit to administer the project would be established within the Ministry of Agriculture and Natural Resources of the Western State government, and some 450 agricultural superintendants, agricultural assistants, and special labourers would be trained in modern methods of cocoa production. Vehicles and equipment required for the preparation of a second stage project for cocoa rehabilitation would also be provided.

15. The project is justified by the economic and financial benefits to be derived from the additional cocoa production and by the benefits accruing from improved administration, agricultural techniques, training, and credit facilities. By 1985, when the project plantings would be in full production, the resultant annual output is estimated at 15,000 tons which, based on an assumed average long term world price of $0.27 per pound spot N.Y., would provide about $9 million in foreign exchange ($7.7 million net).

16. The net income of the 17,000 participating farmers would be approximately doubled and the financial rate of return on investment to farmers engaged in new planting would be 27 percent calculated over a twenty-five year life. For replantings the rate would be 37 percent. Based upon current export duties, sales taxes, and marketing board surpluses the government would recover its investment by 1986 and over the twenty-five year project life would earn an estimated total cash surplus of $14 million equivalent, representing a yield of about 8 percent on its own contribution. Based on assumed yields and a cocoa price of $0.27 per pound, the return to the economy

would be 17 percent if the opportunity cost of farmers' family labour is taken at zero or 14 percent if it is valued at 3/6d per day, per head.

17. The existing cooperative structure would be considerably strengthened by its employment in the administration of the credit extended to farmers. The establishment of a Project Unit and training of extension workers would be of particular value in connection with a second cocoa project which is likely to develop from the studies and surveys to be carried out as part of this project.

18. The total cost of the project is estimated at $14.1 million equivalent. The proposed loan of $8.6 million would finance 61 percent of these costs. Western State government would provide $4.95 million (35.3%) and the farmers would provide the remaining $0.53 million (3.7%) in addition to family labour. In addition, the government would be required to spend a further $4.0 million over the four years following the completion of the project to bring to maturity the last acreage planted under the project. Subsidies on farm inputs and grants to farmers in the replanting scheme would be financed solely out of the government contribution and would absorb about 78 percent of it.

19. Vehicles, tractors, sprayers, tools, fertilizers and insecticides valued at about $2.2 million would be procured through international competitive bidding. All other purchases, largely planting materials and buildings too small to be suitable for international competition, would be procured by local competitive bidding in accordance with existing government regulations satisfactory to the Bank. About $1.84 million of the loan would be used to capitalize interest and other charges during the project period.

Issues

Local Cost Financing

20. The project has an estimated foreign exchange component of 41 percent; $5.8 million or 67 percent of the loan would cover these costs. The remaining 33 percent of the loan ($2.8 million) would finance one-third of the local costs or 20 percent of the total cost of the project. The size of the Bank's contribution is reasonable and necessary if the Bank is to make a significant financial and institution building contribution and ensure satisfactory organization and execution of the project. Such contribution is further justified by the fact that the project will serve as a pilot project which should ensure that an expanded project, currently under preparation, will benefit from improved management and operational techniques right from the start.

Conditions of Lending

21. The assurances to be obtained during negotiations and the conditions of Board presentation, effectiveness and disbursement relate to the provision of funds, maintenance of pesticides and disease control measures, provision

of extension services, auditing, the employment under terms satisfactory to the Bank of cooperatives for the extension of credit, and the establishment of a Project Unit, with staff acceptable to the Bank are similar to those agreed for the recent Ghana cocoa project and are normal conditions applied to similar loans necessary to ensure adequate performance and completion of the project.

Recommendation

22. I recommend that the Bank invite representatives of the Federal Republic of Nigeria to negotiate a loan of $8.6 million for a term of twenty years including eight years of grace substantially on the terms and conditions set out in paragraphs 10.01 through 10.04 of the Appraisal Report.

Attachment

Bruce M. Cheek
Deputy Director

Population: 66 m
Per Capita Income: US$ 65

NIGERIA - 5 YEAR LENDING PROGRAM

($ million)

		Fiscal Year						Total	Total
		1971	1972	1973	1974	1975	1976	1964-68	1969-73
Western Cocoa I	IBRD	8.6							
Western Cocoa II	IBRD				15.0				
Agricultural Credit I	IBRD			5.0					
Agricultural Credit II	IBRD					10.0			
Tree Crops	IBRD			20.0					
Agriculture Unidentified I	IBRD					25.0			
Agriculture Unidentified II	IBRD						20.0		
Livestock I	IBRD		5.0						
Livestock II	IBRD				10.0				
Livestock III	IBRD						15.0		
DFC - NIDB II	IBRD	10.0							
DFC - NIDB III	IBRD			12.0					
DFC - NIDB IV	IBRD					12.0			
Education II	IBRD		10.0						
Education III	IBRD			25.0					
Education IV	IBRD					20.0			
Small Industries	IBRD			3.0					
Industry Unidentified I	IBRD				10.0				
Industry Unidentified II	IBRD						10.0		
Power IV	IBRD		35.0						
Power V	IBRD				25.0				
Rehabilitation Program Loan	IBRD	80.0							
Railways II	IBRD				40.0				
Ports II	IBRD			15.0					
Roads V - Federal & State	IBRD	25.0							
Roads VI	IBRD		20.0						
Roads VII	IBRD			20.0					
Roads Unidentified VIII	IBRD					25.0			
Roads Unidentified IX	IBRD						30.0		
Airports	IBRD					5.0			
Unallocated	IBRD						25.0		
	IBRD	123.6	70.0	100.0	100.0	97.0	100.0	144.0	349.7
	IDA							35.5	
	Total	123.6	70.0	100.0	100.0	97.0	100.0	179.5	349.7
	No.	4	4	7	5	6	5	6	19

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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December 2, 1970

MEMORANDUM TO THE LOAN COMMITTEE

People's Republic of The Congo - First Education Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 2, 1970 from the Western Africa Department, entitled "People's Republic of The Congo - Proposed Credit for the First Education Project: (LC/O/70-123).

2. Comments, if any, should be sent to reach Mr. Leduc (ext. 4740) by 1:00 p.m. on Monday December 7.

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)

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LC/O/70-123

LOAN COMMITTEE December 2, 1970

Memorandum from the Western Africa Department

PEOPLE'S REPUBLIC OF THE CONGO - Proposed Credit for the First Education Project

Introduction

1. The Government of Congo has asked for IDA assistance in financing an education project including technical assistance for project implementation and curricula development. In January-February 1969 a UNESCO mission identified the proposed project, and in October 1969 another UNESCO mission assisted the Government in preparing it. The project was appraised in March 1970.

2. The project would be the fourth Bank/IDA operation in the country, and the only one proposed for FY 71. The past projects were: (i) a loan of US$30.0 million to the Compagnie des Potasses du Congo for the opening of a potash mine (Loan 480 COB, FY 67), (ii) a highway engineering credit of US$630,000 (Credit S-6 COB, FY 69), and (iii) a highway improvement credit of US$1.5 million (Credit 189 COB, FY 70). The current five-year lending program is attached.

3. Although large investments have been made in industry and mining, the economy is still service-oriented, particularly in the transport sector which services the inland countries of Chad and CAR. The public sector is also large. (See paras. 8 and 9 below). With the exception of forestry exploitation and sugar production, agriculture is of a subsistence type and has been unable to contribute significantly to export earnings or even to supply the national market with sufficient food crops. In the absence of a completed development plan, it is difficult to draw up a definite Bank strategy, but it is clear that our efforts in the coming five years will have to be concentrated in the transport sector, which will remain vital not only for the economy of Congo, but also for the CAR, Chad, Gabon and part of Cameroon. In the productive sector, our strategy aims at better organization of forestry, to make it contribute more effectively to the budget and to national investment. We also plan to assist in improving the local food supply through an extension program for traditional farmers. In education, we support efforts to adapt the manpower supply to the needs of industry, services and a more diversified and market-oriented agriculture.

The Project

4. The report "Appraisal of an Education Project, People's Republic of the Congo" (PE-21 dated November 9, 1970) is attached. As stated in this report, the project consists of:

(a) the construction of, and furniture and equipment for:

(i) an elementary vocational training center;
(ii) a technician training institute;

(iii) the addition of 10 laboratories to two senior secondary general schools; and
(iv) an elementary teacher training college.

(b) technical assistance for project implementation and curriculum development.

The total cost is estimated at US$4.1 million equivalent, with US$2.5 million, or 61 percent, of foreign exchange component, and the remaining US$1.6 million, or 39 percent, of local expenditures. The proposed credit of US$3.5 million equivalent includes the foreign exchange component and US$1.0 million, or 62 percent, of local expenditures.

5. The proposed project differs from the Government request for a number of reasons. By letter of November 3, the Government is aware of the changes we have proposed, and these are being discussed with officials in Brazzaville on December 3-4. For one project item, science and technology equipment for junior secondary general schools, the Government has already obtained assistance form UNICEF. In addition, the project has been changed to adapt it to labor market needs, to encourage education reforms and to reduce capital costs by US$2.4 million. The project would increase the number of rural artisans, industrial technicians and primary school teachers, thus reducing the manpower shortage in important economic sectors. This shortage is indicated by the lack of high- and middle-level trained Congolese in industry, and by the difficulties encountered by development projects in the agricultural and public sectors. Even after project implementation, the supply of manpower in these sectors will remain below the need. However, in view of the budgetary situation mentioned in paragraph 10, this is the largest project practicable. By increasing the annual supply of qualified primary school teachers, emphasizing curriculum development and providing science teaching facilities, the project would also improve the quality of primary and secondary education.

Execution of the Project

6. A Project Unit will be set up within the Ministry of Education. This Unit would be responsible for the financial and administrative control of the project and its proper execution. The Unit would consist of a senior officer of the Ministry as project director, and, subject to acceptance of the respective nominees by the Association, a project coordinator, an educational advisor and a project architect. The establishment of the Unit and the appointment of the project director, coordinator, advisor and architect would be a condition of effectiveness of the credit.

Assurances during Negotiations

7. In the last two weeks we have had further discussions with the Education Projects Department on simplifying the sequence of events required for project implementation, and have agreed on a timetable differing somewhat from that in the Green Cover Appraisal Report. Therefore, assuming that the proposed

Credit Agreement would be signed by February 1, 1971, it has been agreed that the Government should also provide assurances during negotiations that:

(a) architects should be appointed for consulting services, subject to acceptance of the nominees by the Association;

(b) a technical education and vocational training department would be set up in the Ministry of Education within one year of signing of the Credit Agreement, i.e. by February 1, 1972;

(c) two advisory committees for the elementary vocational training center and the technician training institute, respectively, would be set up within one year of signing of the Credit Agreement, i.e. by February 1, 1972;

(d) sites for all project schools would be acquired within one year of signing of the Credit Agreement, i.e. by February 1, 1972;

(e) the respective curricula for the elementary vocational training center and the technician training institute would be sent to the Association for comment within two years of signing of the Credit Agreement, i.e. by February 1, 1973;

(f) programs for instructor training, student placement and refresher courses would be set up in the elementary vocational training center within two years of signing of the Credit Agreement, i.e. by February 1, 1973.

The Economy

8. Although unbalanced in its structure, the economy of Congo is reasonably well endowed with natural resources, particularly in relation to its population of slightly less than one million. The annual rate of growth of GDP during 1964 - 69 was 4 percent in real terms, or 2.4 percent per capita. The tertiary sector alone accounts for 57 percent of GDP. This is due to the fact that Brazzaville was the administrative center for French Equatorial Africa, to the development of government services after independence, and even more so to the regional scale of the services provided by Congo in the transport sector. The bulk of the Transequatorial Route, a road-river-rail network from Chad through the Central African Republic to the sea-port of Pointe Noire, is located in Congo.

9. Although 57 percent of the population is rural, commercial agriculture is little developed. However, wood and wood products are a major and growing source of export earnings. Other exports consist of large quantities of sugar and small quantities of coffee and cocoa. Manufacturing is 15 percent of GDP, and has been encouraged by considerable private investments and the Government's policy of creating state enterprises, notably for production of cement and glass, and processing of textiles and wood.

10. The June 1970 economic mission stated that the principal problems were:

(a) an excessive rate of urbanization, with consequent increase of urban unemployment, despite an economically unjustified Government policy of developing employment in the administration and the state enterprises;

(b) low public savings, except in a few profit-making organizations, such as the Agence Transcongolaise des Communications (ATC) which now operates the Congolese portion of the Transequatorial Route;

(c) recent deterioration of the budget, caused by rising expenditures for wages and salaries, and a decline in revenues from import duties, caused by import substitution;

(d) the condition of state enterprises, the managerial and financial situation of which should be improved; and

(e) the absence of a development plan.

11. Because of severe budgetary constraints, we propose that the Government finance only 15 percent of project costs, or 38 percent of local expenditures. Current receipts already amount to 25 percent of GDP, which is exceptionally high for Africa. In recent years, tax measures have just been sufficient to prevent major current deficits, but have not generated substantial budgetary savings. Public sector investment expenditures have accordingly been financed largely by foreign aid, and autonomous and semi-autonomous public institutions. The Congo's public finance situation cannot be expected to improve considerably in the next few years. Even if the expansion of the number of civil servants can be stopped, and if expenditure growth were kept down to the unusually low level of 4 or 5 percent per annum, budgetary savings will not be larger than 10 to 15 percent of government revenue for some years to come.

Legal Issues

12. Since 1967, the Government has nationalized the main infrastructure facilities, i.e. a power (UNELCO), a water supply and a river transport company (CGTAE). Discussions are underway with UNELCO and CGTAE. In 1969, the Government also took over the assets of an inter-governmental regional transport agency (ATEC). Agreements have been signed with CAR and Gabon, two major members of the former ATEC.

13. In September 1970, following social conflicts in the respective companies, the Government nationalized a private and a semi-public sugar and related food complex, all under the same management (SIAN). According to the Government, this act followed an expected decision by management to cease operation. According to management, interference by unions made continuation of operations increasingly difficult.

14. We intend to ask the Congolese negotiating team for information on further developments of the UNELCO, CGTAE, ATEC and SIAN issues. Since we know that discussions are underway on these issues, I propose that they should not delay the proposed education project.

Recommendation

15. I recommend that the Government of the People's Republic of the Congo be invited to send representatives to Washington to negotiate a credit of US$3.5 million on the terms and conditions summarized in paragraphs 6.01 and 6.02 of the Appraisal Report, subject to the reformulation of the calendar of implementation proposed in paragraph 7 above.

Bruce M. Cheek
Deputy Director

Population: 0.9 m
GNP Per Cap: $190

IVa. CONGO B - 5 YEAR LENDING PROGRAM

		($ millions)							
		Fiscal Year						Total	Total
		1971	1972	1973	1974	1975	1976	1964-68	1969-73
Livestock	IDA		2.0						
Agriculture Unidentified	IDA				3.0				
Education	IDA	3.0[1]							
Power	IBRD			2.0					
Roads - Sibiti-Zanaga	IDA		5.0						
Roads II	IDA					4.0			
Railroad Engineering	IBRD		5.0						
Railroad Construction	IBRD			6.0					
" "	IDA			6.0					
IBRD			5.0	8.0				30.0	13.0
IDA		3.0	7.0	6.0	3.0	4.0			18.1
Total		3.0	12.0	14.0	3.0	4.0		30.0	31.1
No.		1	3	2	1	1		1	8

1/ Subsequently changed to the original amount of $3.5 million.

P & B 10/16/70.

FORM NO. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

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December 2, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Finland - Third Road Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated December 2, 1970 from the Europe, Middle East and North Africa Department, entitled "Finland - Proposed $13 Million Bank Loan for the Third Road Project" (LC/O/70-122).

2. Comments, if any, should be sent to reach Mr. I.M. Wright (ext. 4719) by 1:00 p.m. on Monday, December 7.

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
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)

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LC/O/70-122

December 2, 1970

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

FINLAND - Proposed $13 Million Bank Loan
for the Third Road Project

1. The appraisal report on the Third Road Project (PTR-37a), dated November 23, 1970, is attached hereto for consideration by the Loan Committee.

Background

2. The present total of Bank lending to Finland is $263.5 million (net of cancellations). Between 1949 and 1962 the Bank made nine loans (all fully disbursed) mainly for power and industry. Since then we have made two loans for roads totalling $48.5 million (both fully disbursed) and, following IFC's equity investment of about $160,000 in 1963, four loans totalling $63 million to the Industrialization Fund of Finland (IFF), of which $35.3 million had been disbursed as of October 31, 1970. There are no outstanding problems, and performance under the road and IFF loans has been very satisfactory.

3. There are no further loans under consideration for FY 1971. The Five-Year Lending Program envisages total lending of $107.5 million in FY 1971-75 (see Annex). The Bank's net lending (disbursements less repayments of principal) to Finland over these five years would be only about $4 million. In this period, however, the Bank's net contribution would be negative, since estimated total debt service including interest will exceed disbursements by $40 million, giving an average annual outflow of almost $8 million.

4. Through the previous two road loans, the Bank has played an important role in assisting the Government in its efforts to improve transport and modernize the organization responsible for roads, the National Board of Roads and Waterways (NBR). Prior to the first loan, road design and construction works were executed by NBR's own forces and only a limited amount of specialized construction was carried out by contract. As a result, the works were carried out at high cost and over unduly long periods. The Bank's first road project introduced the principle of competitive bidding on relatively large contracts and the use of consultants for road design and construction supervision. Since then NBR has adopted these procedures for all its works, and it has reorganized its internal operations accordingly.

5. The first loan also provided for a study of the transport sector, including recommendations for improving each transport mode, transport policy and coordination, and for a ten-year investment program. The recommendations resulting from this study have been used effectively by the Government to formulate its investment programs and to take steps toward improving transport coordination. The significant institutional reforms resulting from previous Bank loans culminated in the recent establishment of a Ministry of Communications.

The Project

6. The project was first appraised in May 1969. Construction was originally planned to start in 1970 at the beginning of Finland's short summer construction season, but unexpected delays in completing detailed engineering and bidding documents made the Government realize near the end of 1969 that construction could only start late in 1970. The Government considered it advisable to postpone construction until 1971 in order to take advantage of a full construction season and asked the Bank to defer consideration of the project for about one year. In September/October 1970 a reappraisal mission visited Finland. Their report is attached and recommends a $13 million loan for 25 years including a three-year period of grace. Although these terms are reasonable on project grounds, I recommend that the term of the loan be reduced from 25 to 20 years in order to conform with Bank practice of granting shorter terms to its more developed members.

7. The total construction cost of the third road project is estimated as follows:

		(US $ million)
I.	Construction of 4-lane expressway Tattariharju-Jarvenpaa, including interchanges and approach roads	20.1
II.	Paving in 1971 of about 910 km of roads	10.4
III.	Contingencies	3.3
	Total	33.8

8. The proposed loan will finance the foreign exchange component of the construction costs, which has been estimated on the basis of detailed studies made by NBR. All construction contracts would be awarded on the basis of international competitive bidding. Depending upon whether contracts are won by local or foreign contractors, the foreign exchange component for the expressway would range from 22 to 47 percent, and for the paving program from 24 to 48 percent.

9. The appraisal mission estimates that about half the contracts for both the expressway and the paving program will be awarded to foreign contractors. For the expressway this is about the same proportion as for the

two previous projects, but for the paving program the proportion of contracts awarded to foreign contractors is expected to be higher (half as against one-quarter previously) because of the growing interest of foreign contractors and because domestic paving contractors are already heavily engaged. The estimated participation of foreign and local contractors results in a weighted average foreign exchange component for the project of about 39 percent, or $13 million. The proposed loan would cover this amount which is slightly above the $12.5 million shown in the present lending program. Any larger proportion of contracts won by local contractors would lead to some local currency financing; however, their actual participation is not expected to vary significantly from the estimate. It is proposed, therefore, that disbursement will be effected on the basis of 39 percent of payments to construction contractors, even though there might be a possibility that the Bank might thus finance a small part of local costs. Upon completion of the project, any surplus funds in the loan account will be cancelled.

10. In addition to financing the balance of construction costs, i.e., $20.8 million, the Government will finance the total cost of land acquisition and of construction supervision. The cost of engineering and preparatory works has already been borne by the Government.

The Economy

11. A "Memorandum on the Economic Situation of Finland" (EMA-20) was distributed to the Executive Directors on April 9, 1970. An economic mission visited Finland in September-October 1970 and its report, now under preparation, is expected to be distributed to the Executive Directors at about the time of the presentation of the proposed loan to the Board.

12. There has been a sharp upswing in economic activity over the last two years following the devaluation in October 1967 and the subsequent stabilization program. The volume of GDP increased by 8.3 percent in 1969 as against 2.4 percent in 1968 and 2.7 percent in 1967. For 1970 a somewhat lower growth rate (6.5 percent) is expected mainly because output has reached capacity in certain sectors. Stable costs and prices have been maintained, despite the boom, through a successful incomes policy. Stabilization agreements reached in April 1968 and September 1969 between the central trade unions and employers' organizations with the agreement of political parties, the Government and the farm producers have limited the growth of wage rates to the average growth of productivity. A new agreement for 1971 is now being negotiated.

13. The boom has emphasized again the structural nature of the country's balance of payments problem. In Finland, a high rate of growth of GDP while generally associated with a high rate of growth of exports, also leads to a rapid increase in imports of investment goods, raw materials and consumption goods. Exports increased by 21 percent in 1969 and are expected to increase

by 17-19 percent this year. However, the current account has moved from a surplus of $64 million in 1968 and $20 million in 1969 to an expected deficit of $190 million in 1970. Finland will therefore need further capital inflows to sustain its growth over the next several years. Gross external capital requirements during the next five years may be expected to be around $275 million a year. Amortization on existing debt due during 1970-74 averages over $200 million a year. Government policy has been to raise as much long-term capital as possible through bond issues in the international market. Five bond loans totalling about $70 million were issued in 1969. However, no issues were made in the first eight months of 1970 because of the stringent situation in the market. A DM 60 million loan by three Finnish paper companies in September, guaranteed by the two largest commercial banks, had a poor response partly because other more attractive loans were floated at the same time in the German market. The country's geopolitical situation still remains a special problem for foreign investors and Finland has to pay a premium for funds from the capital market. In the current year, the debt service ratio is estimated to be 3.7 percent for public debt, and 9.4 percent for public and private debt. Finland's performance has been good, and it is considered creditworthy for Bank loans.

Recommendation

14. I recommend that the Bank invite the Government of Finland to send representatives to Washington to negotiate a loan of $13 million for the Third Road Project substantially on the conditions set forth in Section 6 of the appraisal report except for the term of the loan, which would be 20 years as discussed above in paragraph 6 of this memorandum.

M. P. Benjenk
Director

Attachment

Population: 4.7 m.
GNP Per Cap.: $1,720

FINLAND LENDING PROGRAM: PAST AND PROPOSED

ANNEX

		($ millions) Fiscal Years													Totals		
		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1964-1968	1969-1973	1971-1975
Industry	IBRD	2.3															
Bank of Finland (4)	IBRD	48.0															
Mortgage Bank of Finland (4)	IBRD	102.0															
DFC - IFF I	IBRD		7.0														
DFC - IFF II	IBRD			14.0													
DFC - IFF III	IBRD							22.0									
DFC - IFF IV	IBRD									20.0							
DFC - IFF V	IBRD											25.0					
Forestry	IBRD											20.0					
Agriculture - Unidentified	IBRD												10.0				
Highways I	IBRD		28.5														
Highways II	IBRD				20.0												
Highways III	IBRD									12.5							
Unallocated	IBRD													20.0			
Total	IBRD	152.3	35.5	14.0	20.0	-	-	22.0	-	32.5	-	45.0	10.0	20.0	69.5	99.5	107.5
	No.	9	2	1	1	-	-	1	-	2	-	2	1	1	4	5	6

Europe, Middle East and
North Africa Department
November 30, 1970

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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LM/M/70-47

December 1, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Ethiopia - Proposed Second Education Project" held at 3:00 p.m. on Friday, November 20, 1970 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
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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/70-47

December 1, 1970

Minutes of Special Loan Meeting to discuss "Ethiopia - Proposed Second Education Project" held at 3:00 p.m. on Friday, November 20, 1970 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Aldewereld, Chadenet, Ballantine, Lejeune, Burt, Tolley, Gassher, Pennisi and Pearce (Secretary).

2. Issue: The meeting had been called to consider Mr. Lejeune's memorandum of November 20, 1970 which reviewed the background of a proposed second education project in Ethiopia, described the differing views of the Eastern Africa and Education Projects Departments regarding the extent of the secondary school component to be included in the proposed project pending the completion of a manpower and education sector survey, and outlined possible alternative courses of action. The main issue for discussion was the number of secondary school places to be provided and whether 23 new junior secondary schools should be included in the proposed project.

3. Discussion: The meeting noted that:

(a) The Ethiopian Minister of Education, in consultation with a Bank education mission, had agreed that, on both educational and budgetary grounds, the rate of expansion in secondary schools should be slowed down pending a comprehensive study of Ethiopia's manpower and educational needs. He had proposed that general secondary enrollment should be limited to 115,000 pupils by 1972/73.

(b) The Minister had also agreed that the number of new secondary school places in the proposed second education project should be reduced from 38,000 to 10,200, comprising 4,240 in extensions to existing schools and 5,960 in new schools together with 23 study halls for certain schools to permit double shift working. The revised proposal represented the Minister's estimate of the minimum investment required to reduce overcrowding in junior secondary schools pending the next phase of expansion, which would be determined on the basis of the manpower and education studies.

(c) Following appraisal of the revised project however, the Education Projects Department had concluded that additional secondary places should be limited to the extensions proposed in existing schools (i.e. 4,240 places) together with 23 study halls, and that the 5,960 places in new schools should be excluded from the project. The reasons for the Department's recommendation to exclude investment in new schools at this stage were described fully in Mr. Ballantine's memoranda to Mr. Cope of November 4 and 16.

(d) The Eastern Africa Department felt that confining all new places to extensions of existing schools, while possibly a cheaper educational solution, would only exacerbate existing rural/urban imbalance in educational opportunity and make it more difficult to attract competent manpower to the rural areas. New places in the new schools proposed by the Ethiopians, on the other hand, would permit students receiving secondary education in primary school facilities to transfer to schools equipped for the teaching of science and practical subjects, and thus make their education more relevant to Ethiopia's manpower requirements.

4. The meeting considered alternative approaches to the problem, including specifically a separate project to provide vocational training and basic skills appropriate for employment in rural areas. The post-primary vocational training centers to be included in a proposed education project in the Congo (Brazzaville) were cited as an example: courses of varying durations for boys in agriculture, carpentry and mechanics and for girls in home economics. The Eastern Africa Department agreed that an additional project along these lines would be an acceptable substitute for the new secondary schools which the Education Projects Department wished to exclude from the second education project, provided that this additional project could be identified, appraised and approved very shortly after the proposed second education project had received Board approval, i.e. before the end of FY 1972. The Education Projects Department said that this could be done within 18 months.

5. Decision: It was agreed (i) that negotiations for the proposed second education project would proceed on the basis of excluding the 5,960 places in new secondary schools and (ii) that appropriate action would be taken to arrange for the preparation of an additional project to provide post-primary practical training (emphasizing agricultural training) in the areas where new secondary schools had been requested, in time to have the new project ready for approval within 18 months.

David Pearce
Secretary

Cleared by: Messrs. Cope
Lejeune/Gassner
Ballantine/Burt

cc: Participants
Loan Committee

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

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November 30, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Tunisia - Gas Pipeline Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 30, 1970 from the Europe, Middle East and North Africa Department, entitled "Tunisia - Proposed Loan for a Gas Pipeline Project" (LC/0/70-121).

2. Comments, if any, should be sent to reach Mr. Siebeck (ext. 4805) by 1:00 p.m. on Thursday, December 3.

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
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)

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LC/0/70-121

November 30, 1970

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

Tunisia - Proposed Loan for a Gas Pipeline Project

1. Attached is the appraisal report No. PTR-66 dated November 10, 1970 concerning a proposed loan to Société Tunisienne de l'Electricité et du Gaz (STEG) for the construction of a gas pipeline from the El Borma oil field in southern Tunisia to the 300 Kms. distant thermal power plant being built by STEG near the port of Gabes. It recommends a Bank loan of $7.5 million, to be made in conjunction with a $2.5 million loan from the Kuwait Fund for Arab Economic Development under a joint financing arrangement with the Bank. The two loans of together $10 million would cover the foreign exchange cost of the project. Its total cost is estimated at $13.6 million.

Background

2. Bank and IDA lending to Tunisia to date consists of nine loans and five credits amounting to, respectively, $71.5 million and $40 million net of cancellations and refundings; the proposed loan would bring the total to $119 million. Besides the present project, a credit for a population project and loans for an agricultural and a highway construction project are included in the present fiscal year's lending program, which totals $36.5 million. The lending program for 1971-1976 is attached.

The Economy

3. The last economic mission visited Tunisia in January/February 1970, and its report was circulated to the Executive Directors on May 5, 1970. The next economic mission was planned for November/December, but at the request of the Government has been postponed from November 1970 to March 1971, by which time the budget will have been completed and further progress made in reconsidering economic policies. A small mission will visit the country in December, and an updating memorandum on recent economic developments and prospects will be issued early next year.

4. In 1969, real growth of GDP was 4 percent, compared with a projected 7.6 percent. This shortfall was mainly attributable to basic changes in agricultural policies, adverse weather conditions and floods. For 1970, the Government has projected a 7.5 percent increase of GDP, principally based on a recovery of output in agriculture and mining and a higher level of activity in manufacturing, construction and public services (mainly education). Despite a likely further deterioration of the external current account, and lower agricultural production than originally expected, the balance of payments is expected to show a surplus close to projections resulting from increased public capital inflows.

5. Tunisia's internal and external financial position calls for further efforts to improve economic performance, particularly with regard to domestic savings, exports and investment productivity. At the last CPP review, the Economic Committee expressed concern about Tunisia's external debt position. Furthermore, it felt that, on the basis of the Government's inability to keep down the rate of growth of current expenditure and improve domestic savings performance, there was no justification for local currency financing. However, the new Prime Minister has announced that he is determined to limit the increase of the recurrent budget to a maximum of five percent and bring about increased savings in the public sector

The Borrower

6. STEG is a state-owned company created in 1962 to take over and operate the assets of seven foreign utility companies which were nationalized in that year. Mr Woods served as conciliator in the ensuing compensation dispute which was settled in 1967. Payments of the agreed amounts were initially delayed, but are now being made on schedule. STEG has a monopoly on the generation, transportation and distribution of electric power. This would be the first Bank loan to STEG, the Bank having declined to consider a loan in the mid-sixties because of the compensation dispute. The Kuwait Fund has made two previous loans to STEG, the first in 1963 for $11.2 million and the second in 1967, for $12.9 million. Both loans, which have been fully disbursed, were for the purchase and installation of electricity generating equipment and transmission lines. STEG's performance under both loans has been satisfactory to the Kuwait Fund.

7. While STEG is now an efficiently managed institution, it is beset by longstanding problems relating to staffing and to accounting procedures. Excessive recruiting in the early years of its existence led to a situation of overstaffing which, until recent times, has proved difficult to come to grips with. Moreover, since records, particularly accounting records, were inadequately kept, the management has not had at its disposal the statistical and accounting information required for efficient conduct of the company's affairs. STEG's present management is, however, determined to resolve these problems. A recently developed program of retraining, early retirement and a change in recruitment policies is already showing results, although it will not be until 1975 that a satisfactory staffing position will have been reached. Furthermore, STEG retained qualified auditors in 1969 and has made arrangements for the secondment

of a senior accountant from Electricite de France. Conditions regarding improvement in manpower utilization and collection of management control data would be attached to the proposed loan.

The Project

8. The project will essentially consist of the procurement and installation of: (a) compressors and a gas treatment station as well as ancillary facilities at the El Borma oil field; and (b) a 294 Km transmission pipeline to the Gabes power plant now under construction with bilateral French financing. The plant will consist of two 30 MW thermal generators, and is required to meet the increase in power demand expected by the 1972-73 winter season. The works, including the proposed project, have been scheduled accordingly.

9. The internal economic return of the plant and pipeline taken together is estimated to be well in excess of 25 percent. The proposed project would permit almost entire reliance on natural gas as fuel until 1979, but the declining supply of natural gas and the growing electricity demand will necessitate a substantial use of fuel oil from 1981 onward. It is estimated that by 1986 the El Borma field will have reached its economic limit of production. This, in turn, defines the life of the project although it is not excluded that gas operation could continue beyond that date.

10. The natural gas produced at El Borma in association with oil extraction is presently being flared, but can be profitably used as fuel for the Gabes power station. Without the proposed project, investments for fuel oil storage and pumping facilities would have to be made much earlier and the gas pipeline will provide the least cost method of supplying fuel to STEG's generating plant at Gabes. This is demonstrated by the following analysis. Based on an economic life of 16 years and a minimum price for fuel oil, the difference in costs between fuel oil and natural gas is reduced to zero at a discount rate of 10.6 percent. Several factors could cause an increase of this rate, e.g. availability of gas for a further three years would increase the discount rate to 12 percent, and an increase of 10 percent in the cost of fuel oil to 12.6 percent.

11. No domestic suppliers exist for the goods to be procured under the proposed loan. The proposed Bank and Kuwait Fund loans would include retroactive financing of engineering studies with a foreign exchange cost of $380,000. Retroactive financing of the pipes (already on order) or construction of the pipeline (bids to be opened on December 9, 1970) might also become needed if presentation of the loan to the Executive Directors (presently scheduled for January 26, 1971) was delayed, but the Kuwait Fund has indicated its willingness to finance payments on goods and services (other than the studies) to be made prior to approval of the Bank loan.

12. The Tunisian-Algerian border adjoining the El Borma oil field is presented as undemarcated in the map annexed to the appraisal report. However, the border was recently demarcated in implementation of a treaty concluded between the two countries in January 1970, which left the Tunisian side of the oil field intact. This will be reflected in the map to be attached to the grey cover appraisal report.

Financial Situation

13. STEG's long-term financial position is basically sound, but it will face a cash squeeze, particularly in 1971 and 1972, as a result of its expansion program. To overcome this situation, STEG and the Government have suggested that either: (a) the grace period of the Bank/Kuwait Fund loans be extended beyond the disbursement period; (b) the repayment period be extended beyond the life of the project; or (c) the Bank and the Kuwait Fund finance part of the project's local costs. The first two proposals would not solve the problem in 1971 and 1972. The third one is not acceptable since it would result in a lowering of the contribution of domestic savings to this investment, at a time when the general economic situation clearly demands an improvement in such savings (para 5).

14. The appraisal report recommends a 5 percent increase in the electricity tariff which would be a step in the right direction, but would not be sufficient. A larger increase does not seem appropriate because it would have to be immediate and very large to cover the needs of 1971 and 1972, and a reduction in tariffs might then become necessary in 1973 or later. In these circumstances, we would explore during negotiations which of the following solutions could be acceptable (alone or in combination): (i) an increase of STEG's capital; (ii) a Government medium-term loan to STEG; and (iii) the provision of overdraft facilities for STEG.

Joint Financing Arrangements

15. The proposed loan would be the first made by the Bank under a joint financing arrangement with the Kuwait Fund. A preliminary agreement has been reached regarding the modalities of this arrangement. They are hereby submitted to the Loan Committee for consideration and would, subject to the Loan Committee's approval, form the basis for a formal understanding to be agreed upon during loan negotiations:

a) The Bank would finance 75 percent and the Kuwait Fund 25 percent of the project's foreign exchange element, which is estimated at $10 million. No local cost financing is envisaged. The loans would have identical repayment periods (16 years, including 3 years of grace), but the rate of interest on the Kuwait Fund loan would be 4 percent.

b) Both parties would share responsibility for project supervision. Whenever feasible, the timing of supervision missions would be coordinated and, under all circumstances, full exchange of information regarding the findings of the respective supervision missions would take place. In view of the Bank's larger share in the loan and the Kuwait Fund's more limited staff resources, it would be reasonable to expect that the Bank will assume the largest part of the supervision work.

c) The Bank's guidelines with respect to procurement would be followed.

d) As to disbursements, the Kuwait Fund has requested that its payments be made pari passu with those of the Bank. Each lender would examine withdrawal requests and disburse separately on the basis of a statement from the Borrower that there is no basis for the other lender to refuse disbursing its share. A period of 15 days from the date of withdrawal requests would be provided to permit consultation between the lenders in cases where an objection to disbursement might exist. On each withdrawal request the Bank would disburse 75 percent and the Kuwait Fund 25 percent.

e) The exchange of information and consultation, would be similar to that provided for in the Administration Letter exchanged between the Bank and Sweden in connection with the first Tunisia Water Supply Project (581-TUN). In essence, it stipulates that both parties shall keep each other currently informed of the progress of the project and consult with each other before taking any action which is outside the normal course of loan administration. Each party retains its right to continue disbursements under its respective Loan Agreement in case of suspension or cancellation under the other Agreement, but both parties shall afford each other opportunity to consult with respect to intentions for modifications in the Loan Agreement, or suspension or termination of the Loan.

Recommendation

16. I recommend that the Bank enter into negotiations along the lines and on such conditions as proposed in Chapter 7 of the Appraisal Report and in this memorandum. If the Committee agrees, I propose to invite STEG and the Government of Tunisia to start negotiations on December 10, 1970. The Kuwait Fund would also be invited to participate in the negotiations.

Munir P. Benjenk
Director

Attachments

Population: 4.9 m
GNP Per Cap: $230

TUNISIA - 5 YEAR LENDING PROGRAM

		($ millions)							
		Fiscal Year						Total	Total
		1971	1972	1973	1974	1975	1976	1964-68	1969-73
Agricultural Credit I	IBRD	4.0							
" "	IDA	3.0							
Agricultural Credit II	IDA				15.0				
Irrigation	IBRD					10.0			
Fisheries	IBRD		3.0						
DFC - SNI IV	IBRD		10.0						
DFC - SNI V	IBRD				10.0				
DFC - SNI VI	IBRD						10.0		
Education III	IDA			9.0					
Education IV	IDA					10.0			
Phosphate Mining	IBRD		5.0						
" "	IDA		5.0						
Family Planning	IDA	4.0							
Power	IBRD			10.0					
Road Construction I	IBRD	18.0							
Road Construction II	IDA						15.0		
Pipeline	IBRD	6.0							
Railroads II	IBRD			10.0					
Water Supply III	IBRD			4.0					
" "	IDA			4.0					
Water Supply IV	IBRD					5.0			
" "	IDA					5.0			
Sewerage & Tourism Infrastructure I	IDA		7.0						
Sewerage & Tourism Infrastructure II	IBRD				10.0				
	IBRD	28.0	18.0	24.0	20.0	15.0	10.0	34.0	112.8
	IDA	7.0	12.0	13.0	15.0	15.0	15.0	19.0	51.0
	Total	35.0	30.0	37.0	35.0	30.0	25.0	53.0	163.8
	No.	4	4	4	3	3	2	5	18

FORM No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

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LOAN COMMITTEE

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November 24, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Ethiopia - Addis Ababa Dairy Development Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 24, 1970 from the Eastern Africa Department, entitled "Ethiopia - Addis Ababa Dairy Development Project" (LC/O/70-120).

2. Comments, if any, should be sent to reach Mr. Gassner (ext. 4023) by 5:00 p.m. on Monday, November 30.

3. It is planned then, if the Committee approves, to inform the Government, in due course, 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)

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LC/O/70-120

November 24, 1970

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

Ethiopia: Addis Ababa Dairy Development Project

1. In January 1970, the Imperial Ethiopian Government applied for an IDA credit to assist in financing a Dairy Development Project designed to increase the supply of milk in the Addis Ababa area. If approved, this will be the third IDA credit for agricultural development in Ethiopia. The previous credits were for the Wolamo Agricultural Development Project (US$3.5 million) made in November 1969, and the Humera Agricultural Development Project (US$3.1 million) made in May 1970.

2. This project, which was prepared by a Project Preparation Commission of the Imperial Ethiopian Government with the assistance of our Permanent Mission in Eastern Africa, was appraised in April 1970. The Appraisal Report entitled "Addis Ababa Dairy Development Project (PA-68) dated November 12, 1970 is attached. It recommends that, subject to the conditions set forth in paragraphs 6.01 to 6.04, the project is suitable for an IDA credit of US$4.3 million equivalent. This would bring our total lending to Ethiopia to US$137.1 million, including US$97.8 million Bank loans and US$39.3 million IDA credits.

The Project

3. The proposed project is aimed at increasing dairy production in the Addis Ababa area, by providing for development of approximately 110 large and 240 small dairy farms, with a total of approximately 7,000 dairy cows. The project work would consist of: importing and breeding dairy cattle for these farms, providing technical, veterinary and artificial insemination services to participating farmers, providing credit to farmers for improved cattle and on-farm development, as well as developing additional facilities for the collection, processing and marketing of milk in the area. In addition it would provide for employment of consultants to carry out feasibility studies and to help the Government prepare a second comprehensive livestock development project, which is included in the Five-Year Lending Program for FY 1972. The 1972-76 lending program is being revised to provide for increased net lending of $190 million and will be reviewed again with Mr. McNamara in December.

4. A fully autonomous corporation, the Addis Ababa Dairy Development Corporation (ADDC), would be established to handle the administration of the project and the credit operations under the project. The draft charter of ADDC is being prepared, based on suggestions made by the Bank, and we intend to hold negotiations immediately after receiving the draft charter

from the Government. The corporation would be legally established before Board presentation. The recruitment of six senior management and professional staff for ADDC would be a condition of effectiveness. In order to facilitate this recruitment and reduce the likelihood of delay in effectiveness of the proposed credit, it is proposed that retroactive financing of up to $20,000 be provided to permit early recruiting for these positions. Of the six positions we will suggest that at least the General Manager and the Production Manager be recruited by the time of Board presentation. Looking further into the future, it is proposed that when the new Agricultural and Industrial Development Bank (AIDB) has gained sufficient experience, an assessment will be made as to the desirability of transferring credit operations under the dairy project from ADDC to AIDB.

5. The Appraisal Report recommends that the legal documents should provide that "a Production Manager, acceptable to IDA, would be recruited internationally on terms and conditions acceptable to IDA" (see paragraphs 3.30 and 6.02(g) of the Appraisal Report). It may well be that no suitable Ethiopians will be found and an expatriate will have to be recruited. The Ethiopians usually have no reluctance about having foreigners, so there seems little reason to use language which may irritate officials or the members of Parliament who have to ratify the agreement. IDA's interest can be adequately protected with a provision that "a qualified and experienced Production Manager, mutually acceptable to the Borrower, ADDC and IDA be recruited and appointed on terms and conditions acceptable to IDA", backed up by a clear understanding with the Ethiopians that this means that a foreigner may have to be recruited. I propose to negotiate this matter in this way.

6. The total cost of the project is estimated at US$6.3 million. The proposed credit of US$4.3 million would finance approximately 68% of the total cost; the Government and ADDC would provide US$1.5 million equivalent and the farmers would contribute the remaining US$0.5 million.

7. The foreign exchange component of the project cost is estimated at US$3.3 million or 53% of the total. It is proposed that the credit cover this amount plus US$1.0 million of local expenditure. The main justification for local currency financing in Ethiopia is given below in the section on the Economic Situation (particularly paragraph 13). The project is of high priority; it provides the beginnings of a modern dairy industry, and its success is crucial both to the expansion of an industry with high potential and to raising the supply of needed high protein food in Addis Ababa in the near short run, and later on, in other parts of the country.

8. The estimated financial rates of return to participating farmers are estimated to range from about 17% for breeding ranches to 21% for small dairy farms. These estimates are based on retail milk prices of US$0.20 equivalent per liter in the initial years of the project, declining gradually to US$0.16 equivalent after 10 years. This latter price is

no higher than the retail milk price in most West European countries and it is considerably below the price in most other African cities. On the basis of a US$0.16 retail milk price the economic rate of return on the project is estimated at approximately 12%. The above figures are based upon the assumption that the dairy cattle needed for the project will have to be purchased at European prices. If it turns out to be possible to purchase all or some of the cattle from Kenya, the economic and financial return on the project will be higher.

9. Demand for milk in Addis Ababa exceeds supply, and a rationing system for retail sales is in effect. Daily milk sales vary between 13,000 to 25,000 liters due to seasonal fluctuation in supply. Average per capita milk consumption in Addis Ababa is only about 10% of the level in Nairobi and 20% of the level in Asmara. The proposed project is estimated to increase milk supply by 31,000 liters by 1980, compared with a conservatively estimated 1980 demand of 59,000 liters.

10. After completion of the Appraisal Report, we were informed that the Government has already started preparatory work on the next livestock development project based on recommendations of a livestock sector review mission organized by PMEA which visited Ethiopia in April/May 1970. The Government needs assistance in carrying out the preparatory work, and in order to avoid possible delays in the progress of this work, I recommend that retroactive financing of up to $50,000 be provided to reimburse the foreign exchange cost of consulting services for this purpose as from January 1, 1971.

Possible Future Operations

11. Additional projects likely to be presented to the Executive Directors in fiscal year 1971 are an Education project (estimated at US$8 million IDA), a Water and Sewerage project for Addis Ababa (estimated at US$7 million Bank) and a Coffee Processing project (estimated at US$6 million Bank).

Economic Situation

12. An Economic Report on Ethiopia (AE-9) was distributed to the Executive Directors on October 22, 1970 (Secretary's memorandum R 70-199) and the following are some of its main conclusions. The Ethiopian economy started to recover towards the end of 1969 from the depression of the late 1960's. The recovery was due to increases in coffee prices which started in July 1969 and coffee prices are forecast to remain high for about three to four years. Ethiopia can therefore be expected to have favorable economic conditions during this period. However, sustained long-term higher rates of growth than in the recent past will be likely only if there are higher government savings and investment; the tariff structure is changed to encourage more efficient industrialization; fiscal incentives for non-traditional exports are given; improved marketing and a bigger extension effort in agriculture are undertaken; and there are some organizational and institutional changes including land reform.

13. The level of government investment needed to help realize an attainable annual growth rate of 5.5% to 6% would require higher levels of government savings. These could be achieved by controlling recurrent expenditures on defence and security and increasing government revenues. However, the control of recurrent defence and security expenditures appears difficult as long as the country's border and internal security problems persist. On the revenue side the rather narrow monetary income base of the economy limits the country's taxable capacity. However, the revival of economic activity due to the boom in coffee prices is having a favorable effect on government revenues. In addition the Government recently levied an education tax on urban property and personal incomes, as well as an income tax on the hitherto untaxed incomes of military personnel. Nevertheless there is still scope for further efforts to increase revenues.

14. Until exports can be diversified to reduce the relative importance of coffee substantially, the economy will continue to be subject to periods of instability as a result of the coffee cycle. Efforts should be made to neutralize this tendency by adopting policies aimed at building up reserves in good years, for drawing down in years of low export earnings.

15. The balance-of-payments and debt outlook emphasize Ethiopia's need to obtain foreign aid on a scale sufficient, as at present, to finance about half its public investment program. In the circumstances and because parts of the program are not suitable for foreign assistance, aid donors should provide well over half the cost of the projects eligible for external financing. In particular some financing of local expenditure is necessary to carry out a balanced program since a number of projects have low, direct foreign exchange requirements and the government's capacity to mobilize domestic resources is limited.

Recommendation

16. I recommend a) that we be authorized to invite the Government of Ethiopia to send representatives to negotiate a proposed credit of US$4.3 million equivalent for the Addis Ababa Dairy Development Project substantially on the terms and conditions set forth in paragraphs 6.01 to 6.04 of the Appraisal Report; the Government would be informed that negotiations would be held as soon as a draft charter of the ADDC is available;

b) that the proposed credit provide for retroactive financing of up to (i) US$20,000 to permit early recruiting of management and professional staff for ADDC, and (ii) US$50,000 to allow for financing of foreign exchange cost of consulting services of a preparation of the next livestock development project; and

c) that the provision concerning the requirements for recruitment of the Production Manager of ADDC be as in paragraph 5 above.

Michael L. Lejeune
Director
Eastern Africa Department

Attachment

Last Economic Mission

January-February 1970

Attachment 1

ETHIOPIA

INDICATORS OF DEVELOPMENT

ECONOMIC AND STRUCTURAL INDICATORS	Unit	1951-60	1961-65	1966-69	1970-74
1. Gross Domestic Product (in 1961 prices)	% change		4.4	4.5	5.5
2. Manufacturing Output	% change		16.4	16.5	12.0
3. Agricultural Output	% change		2.0	2.2	2.8
4. Imports of Goods and NFS	% change		15.0	1.0	6.4
5. Exports of Goods and NFS	% change		12.6	3.2	6.0
6. Domestic Price Level	% change		3.7	1.5	
		1961	1966	1970[13]	1975[13]
7. Gross National Savings	% GDP	10.9	9.7	12.0	13.8
8. Resource Gap	% GDP	0.6	2.0	1.5	1.7
9. Net Factor Payments Abroad	% GDP	0.2	0.1	0.5	0.5
10. Gross Domestic Investment	% GDP	11.7	11.8	14.0	16.0
11. Debt Service	% Export	3.0	6.1	9.5	10.0
12. Central Government Current Revenue	% GDP	8.0	9.6	9.5	12.0
13. Central Government Current Surplus	% GDP	0.8	1.3	0.8	1.5
14. Public Expenditure on Social Services	% GDP	1.5	2.1	2.5	3.5
15. Military Expenditure	% GDP	1.8	2.1	2.2	2.0
16. Manufacturing Output	% GDP		16.5	12.0	12.0
17. Energy Consumption	million tons				
18. Fertilizer Consumption	.000 tons				
SOCIAL INDICATORS					
19. Population Growth Rate	%		1.8	2.1	2.3
20. Urban Population Growth Rate	%				
21. Birth Rate	per 1,000				
22. Family Planning	Acceptors '000				
23. Income of: Highest quintile	% Total income				
Lowest quintile	% Total income				
24. School Enrolment: Primary and Secondary	% school-age population			8.0	
25. Literacy Rate	% adult population				
26. Unemployment Rate	% labor force				
27. Population per hospital bed	Number			3,400	

Eastern Africa Department

September 25, 1970

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

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LM/M/70-46

November 23, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "India - Wheat Storage Project" held at 4:30 p.m. on Monday, November 9, 1970 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

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/70-46

November 23, 1970

Minutes of Special Loan Meeting to discuss "India - Wheat Storage Project" held at 4:30 p.m. on Monday, November 9, 1970 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Baum, Cargill, Scott, Wapenhans, Helmers, Kirk, Clevenger, Dunn and Pearce (Secretary).

2. Issue: The meeting had been called to consider whether construction of 10 godowns in a forthcoming \$15.9 million wheat storage project in India, for which a \$5 million IDA credit was contemplated, should be contracted under international competitive bidding.

3. Discussion: The South Asia Department stated that, in its view, international competitive bidding for godown construction in this project was inappropriate for the following reasons:

(a) The cost of godowns was small and those in this project would be scattered over four states in India.

(b) Experience in godown construction was widespread in India and the local construction industry should be encouraged.

4. The Agriculture Projects Department and the Associate Director, Projects, on the other hand, argued that international competitive bidding was necessary for these reasons:

(a) It was the general policy of the Bank and IDA to require procurement to be financed from a loan or credit through international competitive bidding when such bidding was appropriate to the execution of the project.

(b) Exceptions, on grounds of project execution, had been confined in the past (i) to certain sectors/projects such as agricultural credit, livestock and development finance companies, where local procurement through normal trade channels (in which foreign firms were adequately represented) was necessary or (ii) to certain civil works, where seasonal or labor-intensive considerations were decisive and where local contractors or force account was the only appropriate method. It could not be concluded that international competitive bidding was inappropriate for godowns.

(c) In the proposed wheat storage project, foreign firms were expected to bid for silo construction contracts and might therefore also bid for godown construction contracts. Even if this were not the case, the Bank should not decide a priori that foreign contractors were not interested in bidding; it should allow the contractors to decide for themselves.

5. Decision: The Chairman said, and the South Asia and Agriculture Projects Departments agreed, that it was desirable to encourage international competition but that the procedures applicable in individual cases had to be adapted to circumstances, as was envisaged in the Bank/IDA Guidelines. It was therefore agreed that in this case local advertisements in Indian newspapers sent to the embassies of Bank member countries in India would provide them with adequate notice.

David Pearce
Secretary

Cleared by: Messrs. Cope
Baum
Wapenhans
Dunn

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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LM/M/70-45

November 23, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Botswana - Shashe Infrastructure Project" held at 3:30 p.m. on Monday, November 9, 1970 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
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Mr. M. Shoaib, Vice President
Directors, other Departments
Executive Vice President (IFC)
Vice President (IFC)

LM/M/70-45

November 23, 1970

Minutes of Special Loan Meeting to discuss "Botswana - Shashe Infrastructure Project" held at 3:30 p.m. on Monday, November 9, 1970 in Conference Room B.

1. Present: Messrs. Cope (Chairman), Fuchs, Scott, J.H. Williams, Dean, Bailey, Loh, Poncia and Pearce (Secretary).

2. Issues: The meeting had been called to consider a memorandum dated November 9 from Mr. Williams to Mr. Cope which, together with supporting memoranda from Messrs. Dean and Loh, reviewed the status of discussions with the various parties concerned in the proposed Shashe mining and infrastructure project. The memorandum raised three issues for discussion: (a) Bamangwato Concessions Limited's (BCL) financing plan, (b) the proposed Guarantee Agreement and (c) the proposed Trust Agreement.

3. Discussion - Issue(a): In considering BCL's request that its power and water costs be reduced partly by a decrease in the required rate of return on assets, from 10 per cent to 8 per cent, the meeting noted that:

(a) While construction of power and water facilities would be undertaken by Canadian and American contractors at prices expected to be about 25 per cent higher than those obtainable under international competitive bidding, the Canadian and American Governments had offered to finance this work on very favorable terms, which more than offset the higher capital costs. The Government of Botswana, rather than BCL, was the appropriate principal beneficiary of these arrangements.

(b) BCL would enter into 25-year power and water supply contracts, in which the rate of return on the capital costs would be fixed on a commercial basis; BCL would effectively finance the cost of power and water facilities required for the mining project by that part of its annual payments for power and water which represented the amortization of the Government's investment plus a rate of return.

(c) If it were assumed that the power and water facilities were to be constructed through international competitive bidding (i.e. at lower cost) financed at normal commercial rates (i.e. on terms less favorable than Canadian and American financing), there would be an annual cost which could be expressed as an interest rate on a 25-year annuity on the higher (Canadian and American) actual costs. On various assumptions about terms and cost of capital to BCL, this interest rate would range from 9.6 per cent to 6.8 per cent. It was therefore reasonable for the Bank to accept power and water contracts to BCL with tariffs calculated on the basis of an 8 per cent rate of return on assets.

4. Discussion - Issues (b) and (c): The meeting reviewed briefly proposed modifications to the draft Guarantee and Trust Agreements and, on the basis of recommendations contained in Mr. Loh's memorandum of November 2, agreed that:

(a) While the Bank preferred joint and several guarantee obligations, it would be prepared to accept a several guarantee obligation from each shareholder-guarantor.

(b) Eventual restrictions on the export of copper and nickel by the Government of Botswana would be included as a political risk, thus relieving Metalgesellschaft (the purchaser of the metals) of its guarantee obligations (Section 3.04).

(c) Amax's guarantee obligation would, at its request, be subordinated to an existing $60 million loan obligation.

(d) The Bank could not accept Kalahari, a holding company whose main asset was a shareholding in BCL, as a guarantor.

(e) The Trust Agreement could be considered primarily a payment mechanism and only secondarily a form of additional security. As such, the proposed changes in the Trust Agreement were acceptable.

5. The Chairman approved the recommendations contained in Mr. Williams' memorandum and attachments as the basis for forthcoming discussions with the parties concerned.

David Pearce
Secretary

Cleared by: Messrs. Cope
H. Scott
Dean
Bailey

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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November 17, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Colombia - Caqueta Land Colonization Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 17, 1970 from the South America Department, entitled "Colombia - Proposed Loan for the Caqueta Land Colonization Project" (LC/O/70-119).

2. Comments, if any, should be sent to reach Mr. Flood (ext. 2191) by 1:00 p.m. on Friday, November 20.

3. It is planned then, if the Committee approves, to inform the Government and representatives of INCORA 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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LC/O/70-119

November 17, 1970

LOAN COMMITTEE

Memorandum from South America Department

COLOMBIA: Proposed Loan for the Caqueta Land Colonization Project

1. Attached is the draft Appraisal Report No. PA-60 recommending a Bank loan of US$7.5 million to the Republic of Colombia to help finance the Caqueta Land Colonization Project. The loan funds would be administered by the Colombian Institute for Agrarian Reform (INCORA).

Lending Program

2. The proposed loan would be the first made to Colombia as part of the FY 1971 lending program, which comprises eight projects. (See attached five-year lending program.) Loan negotiations for the following projects were initiated but not concluded in FY 1970 because of unresolved project problems - Palmira Water Supply ($2 million), Bucaramanga Sewerage and Erosion Control ($6 million), and Development Finance Institute ($5 million). Steps are being taken to bring about a resumption of these negotiations.

3. Appraisal reports for the following projects are in preparation: Telecommunications II ($13 million), Development Finance Companies IV ($30 million), and Atlantico Irrigation II ($3.8 million). The appraisal mission for the Bogota Water Supply II project ($40 - $50 million) has been scheduled for December.

The Economy

4. The Colombian economy continued to perform satisfactorily, under prudent management by the authorities. The rate of growth of GDP was 6.5 percent in 1969, and is expected to be at least 7 percent in 1970. With respect to fiscal performance, total public savings increased in real terms at an average rate of 10.6 percent in 1966-69. The central government surplus on current account, which represents three-quarters of public savings, increased by 21 percent in the first semester of 1970. Total public investment increased in real terms at an average annual rate of 21 percent in 1966-69, and the increase planned for 1970 was 35 percent. Central government investment, which accounts for about half of total public investment, increased by 35 percent in the first semester of 1970. The Government is aiming to increase minor exports (other than coffee and petroleum) by 25 percent annually, and this target was exceeded in 1968

and 1969. However, in the first eight months of 1970, these exports were only 8 percent higher than in the same period of 1969. The Government is responding to this by adopting a policy of moving the exchange rate faster than the cost of living index, and is seriously considering an increase in the extent of the subsidy to minor exports granted through tax relief certificates. With respect to monetary policy, the net credit of the central bank remains consistently well below the credit ceilings agreed with the IMF as conditions of their standby.[1]

Background of Project

5. The proposed loan would be the seventh for agriculture in Colombia and the third to be administered by INCORA. The first Bank loan for an INCORA project was the $9 million Atlantico Irrigation loan made in 1967. In 1969, the Bank loaned $17 million for agricultural credit to medium-sized farmers in INCORA project areas. Both this project and the proposed Caqueta Project were developed in accordance with recommendations made by a Bank mission which evaluated INCORA's agricultural development program in Report No. TO-611, of October 1967.

The Project

6. The Caqueta Project, located along the eastern foothills of the Andes mountains, is designed to consolidate and expand the largely spontaneous colonization already underway in the area. It forms an important part of INCORA's land settlement activities, the main purpose of which is to provide small farmers with an alternative to either continued existence in one of the traditional rural areas of Colombia where subsistence farming predominates, or migration to one of the already overcrowded cities, where unemployment has reached an average of 14 percent of the urban work force. About 3,500 partially established settlers and 2,800 new settlers would benefit directly from the Project. They would operate farms averaging 75 hectares when fully cleared, and would produce mainly beef, and also some rice and pork, for the Colombian domestic market. Each settler could expect to reach a net cash surplus level

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1/ There may have been a technical breach in the standby agreement in that preliminary figures for import registrations have fallen $7 million short of the target agreed with the IMF for the 6 months ended September, and this means that Colombia cannot draw until next February, if she makes up this deficiency by that date. No drawing is likely to be needed.

(above subsistence costs) of about $1,000 per annum at full development. The investment costs per settler to the Government of achieving these income levels are estimated at US$2,200 and the Project would yield an economic rate of return of 17 percent.

7. Total costs of the Project are $20.7 million, of which the Bank would finance the estimated foreign costs of $5.1 million and $2.4 million of local costs (which represents about 32 percent of the Bank loan and 15 percent of total local costs of the Project). With this amount of local cost financing, the Bank's share of total Project costs would still be only 36 percent, which I consider the minimum necessary for the Bank to make a significant contribution to the Project. A country case for local currency financing is presented in the latest draft economic report (WH 200). The external financing plan requires gross annual disbursements of $270 million under project loans in the six years 1970-75, and this is not likely to be achieved through financing only the foreign costs of projects to which external financing can be attached. As for public sector finances, public savings are expected to rise, with some new tax measures probably being necessary in 1972. Financing of some local costs and program lending in Colombia has been handled in such a way as to complement domestic efforts to increase public savings.

8. About $4.0 million of the proposed loan would help finance the construction of approximately 380 km. of penetration and access roads, and $0.6 million would assist in financing the construction of primary schools, health centers and administration buildings and the procurement of a small amount of vehicles and equipment. This portion of the Bank loan would be made available to INCORA by the Borrower on a grant basis. The remaining $2.9 million of the loan would finance medium and long-term credits to about 3,500 partially established and 1,000 (of the 2,800) new settlers in the Project area for farm investments (fencing, livestock, etc.) and would be on-lent by the Borrower to INCORA at 4 percent interest. INCORA, in turn, would on-lend these funds to the Colombian Livestock Bank (Banco Ganadero), also at 4 percent interest. The Banco Ganadero would lend them to farmers at an interest rate to be determined (see discussion beginning paragraph 11 below) for terms ranging from seven to twelve years with grace periods between three and seven years. The exchange risk on these funds would be borne by the Borrower and the credit risk by the Banco Ganadero. Seasonal credit (to be financed entirely by the Borrower) would be made available through the Caja Agraria, Industrial y Minero ("Caja") at 8 percent interest to the farmers but with INCORA assuming the credit risk. The appraisal report states that funds from the Bank and the Borrower to be used for farm credit would be made available to INCORA in the form of a permanent loan. In agreement with Agricultural Projects Department, however, I recommend that this be changed to provide that, unless the Borrower and INCORA agree to a longer term, repayment to the Borrower would coincide with repayments actually received by INCORA from the Banco Ganadero and the Caja.

9. Highway construction contracts would be awarded on the basis of international competitive bidding, but are expected to go all to Colombian firms as an adequate number of qualified local contractors is available and the contracts are likely to be too small to attract foreign firms. Schools would be built on a self-help basis with materials obtained by INCORA in accordance with its local bidding procedures. Health centers and administration buildings would be built by local contractors selected in accordance with INCORA's local bidding procedures. Goods for on-farm investment would be procured through normal commerical channels except for livestock which would be procured either through normal commercial channels, with the approval of the Banco Ganadero, or through the Banco's livestock purchase scheme currently in effect in the area. The normal commercial channels and the procedures of INCORA and the Banco Ganadero are considered adequate to insure competitively-priced goods and services for the Project.

10. The term of the proposed loan would be 20 years, including four years grace. The term on Bank credit projects for Colombia has usually been based on the estimated date of the final repayment of the last sub-loan expected to be made with Bank funds. On this basis, the term of the proposed loan would be about 15 years (without allowing for slippage). The loan, however, would also include a substantial amount of highway and building construction, and we have agreed to make loans to Colombia for infrastructure projects at a minimum of 25 years. The proposed 20-year term results from a blending of the normal terms for the two types of projects.

Interest Rate to Sub-Borrowers

11. The interest rate proposed for all medium and long-term farm credit in the Project is 8 percent. This is the rate currently applicable to supervised credit for small farmers in all INCORA projects except colonization projects and is at the low end of the (8 to 14 percent) scale of interest rates generally charged for agricultural credit in Colombia. The present system of supervised credit in INCORA colonization projects is to charge the settlers 8 percent, but not collect the interest in the three-year grace period presently prevailing. Instead, simple interest is accumulated and paid in the fourth year and then paid currently through the remainder of the seven year-term presently offered; and this brings down the effective nominal interest rate to only 5 percent, which is negative in real terms as compared with a current and expected rate of price increases of 7 percent. Under the proposed project, 8 percent would be both charged and collected starting in the first year, so that the actual and effective nominal rate would be the same. This would yield an interest rate that would be just positive in real terms. This is not really satisfactory. Some increase in interest rate above the 8 percent level would appear to be in order.

12. We have, therefore, projected alternative cash flows for settlers, with alternative interest rates and patterns of interest capitalization, creating a steady annual increase in his net cash surplus which should offer an adequate incentive to develop his holding. Regardless of what the settler's cash flow may demonstrate, however, I recognize that it may be difficult for him to accept a rate higher than 8 percent. The settlers who would participate in the Project are accustomed to an effective nominal interest rate of 5 percent on long-term loans, and even at this rate, according to the appraisal report, only 45 percent borrow at all. The appraisal mission believes that there will not be a significant reduction in the demand for credit at an 8 percent rate collected on a current basis, primarily because the rate charged is already 8 percent. The mission believes, however, from its review in the field and discussions with INCORA, that any higher rate would be - perhaps irrationally - unacceptable to most of the settlers. They are small, unsophisticated farmers facing the risks associated with the development of a new farm over an 8-year period in a frontier area, and in the view of the mission, most of them are unlikely to be impressed by, or even understand, cash flow projections showing that they can afford higher rates of interest.

13. Under these circumstances, and because (1) the proposed interest rate would be substantially higher than the existing effective rate, (2) the period of the subsidy is limited to 10 years, after which the settlers must move to commercial sources of credit, (3) I see little likelihood of any significant distortion in the investment patterns of the individual farmers in this particular case, and (4) the beneficiaries will be low income farmers, I believe there is an acceptable basis for supporting the 8 percent rate in this case. Nevertheless, the effect on the settler's cash flow of interest rates higher than 8 percent, with interest capitalized for varying periods, has not yet been discussed with the Colombian authorities. In agreement with the Agricultural Projects Department, therefore, I have invited the Manager of INCORA to Washington on November 16 to review the interest rate question with him. If as a result of these discussions I am satisfied that we would be unable to negotiate a higher rate, I will so inform the Chairman of the Loan Committee and recommend approval of the 8 percent interest rate.

Recommendation

I recommend that the Government and INCORA be invited to send representatives to negotiate a loan of $7.5 million for the Caqueta Land Colonization Project on the terms and conditions set forth in the appraisal

report except that:

(1) The term of relending from the proposed Borrower to INCORA would be as stated in paragraph 8 above; and

(2) The interest rate on medium and long-term loans to settlers should be determined following consultations with the Chairman of the Loan Committee after the discussions referred to in paragraph 13 above.

Gerald Alter
Director

Attachment

COLOMBIA: Bank/IDA Lending Program, FY 1967-75

(US$ Millions)

	1967	1968	1969	1970	Total FY 1949 through FY 1970	1971	1972	1973	1974	1975	Total FY 1971 to 1975
AGRICULTURE	1/9.0		1/17.0	1/18.3	6/71.0						6/61.3
Livestock III								15.0			
Livestock IV											
Agricultural Credit II										15.0	
Agricultural Credit III											
Caqueta Land Colonization						7.5					
Atlantico Irrigation II						3.8					
Cesar Irrigation I							10.0				
Cesar Irrigation II										10.0	
EDUCATION			1/7.6	1/6.5	2/14.1						2/20.0
Education III								10.0			
Education IV										10.0	
POWER		1/18.0	1/18.0	1/52.3	18/294.1						1/15.0
Interconnection Hydro								15.0			
TRANSPORTATION			2/35.5	1/32.0	11/230.2						3/57.0
Highways VII							27.0				
Highways VIII									20.0		
Railways VI							10.0				
WATER SUPPLY AND SEWERAGE		1/14.0		1/18.5	2/32.5						5/98.0
Bucaramanga Sewerage and Erosion Control						6.0					
Medium-Sized Cities I							20.0				
Palmira Water Supply						2.0					
Medium-sized Cities II									25.0		
Bogota II						45.0					
DEVELOPMENT FINANCE COMPANIES		1/12.5	1/25.0		3/62.5						4/95.0
Development Finance Institute						5.0					
DFC IV						30.0					
DFC V								30.0			
DFC VI										30.0	
INDUSTRIES AND MINING					1/30.0						
TELECOMMUNICATIONS	1/16.0				1/16.0						1/13.0
Telecommunications II						13.0					
UNALLOCATED							19.0	10.0	35.0	15.0	4/79.0
TOTAL	25.0	44.5	103.1	127.6	44/750.4	112.3	86.0	80.0	80.0	80.0	26/438.3
(Of which IDA)					(1/19.5)						

South America Department

Form No. 60
(3-70)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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November 18, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Guatemala - Livestock Development Project (LC/0/70-118)

After discussions with the Government and the Central Bank of Guatemala it is proposed that the Livestock Development Credit Loan be made to the Government and not to the Central Bank. The terms and conditions referred to in the memorandum to the Loan Committee dated November 16, 1970 would remain unchanged. The Appraisal Report would be appropriately amended when it is put into grey cover.

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
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FORM No. 60
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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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SEP 05 2014
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November 16, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Guatemala - Livestock Development Project

1. The Committee is requested to consider, without meeting, the attached memorandum dated November 16, 1970 from the Central America and Caribbean Department, entitled "Guatemala - Proposed Bank Loan for Livestock Development Project" (LC/O/70-118).

2. Comments, if any, should be sent to reach Mr. Lari (ext. 3877) by 1:00 pm. on Thursday, November 19.

3. It is planned then, if the Committee approves, to inform the Government and representatives of the Central Bank 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:

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Mr. S.R. Cope, Deputy Chairman
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CONFIDENTIAL

LC/0/70-118

November 16, 1970

LOAN COMMITTEE

Memorandum from Central America and Caribbean Department

GUATEMALA - Proposed Bank Loan for Livestock Development Project

1. I attach Report No. PA-39 "Appraisal of Livestock Development Project" dated March 17, 1970, recommending a Bank loan of US$4.0 million to the Bank of Guatemala (Central Bank) with the guarantee of the Government. Negotiation of the proposed loan has been held up because of the change of government which took place in the summer.

Background

2. This would be the fifth loan to Guatemala and would increase total lending to US$50.5 million (net of cancellations). The last loan, for secondary education, was signed in December 1968. For FY1971 the lending program includes also a loan for telecommunications of US$4 million (amount still tentative), the appraisal of which is to take place later this month. A loan for highways of US$10 million (amount likely to be reduced), originally scheduled for FY1971, has just been slipped into early FY1972. The five-year lending program which is to be reviewed by Mr. McNamara in December, is attached.

3. On October 31, 1970, a total of US$15.0 million remained to be disbursed on three loans, two for power and one for education. No disbursements have been made on the latter due to several factors, namely: delays in the selection of consultants, lack of detailed guidelines and adequate follow-up with regard to the preparation of the Master Plan, disagreement with the approach of the UNDP-UNESCO Technical Assistance mission as to the concept of the Secondary Teacher Training School which is included in our project and lack of coordination among the Ministries involved and between Government and University. After a combined Area/Projects mission discussed this project with the new Government in September 1970, we now expect that project execution will be accelerated.

The Economy

4. An economic mission visited Guatemala in April 1970. Its findings are contained in an economic report which is to be distributed to the Economic Committee in late-November. The report observes that Guatemala's recent economic growth has fallen short of its potential, mainly because of the narrow basis of the agricultural, export-oriented economy, political instability and incapacity on the part of

the Government to mount a development policy which would deal effectively with the pressing economic and social problems and bring about the required structural reforms. Gross National Product has increased during the 1960's at about 5 percent per year on average, but with wide fluctuations in line with export developments. Monetary policy has been cautious, the balance of payments has been kept in equilibrium - albeit precarious - and domestic prices have stayed about constant. Public expenditures, both current and capital, have remained at low levels, with taxes absorbing only 8 percent of GDP. Large segments of the population, which grows at over 3 percent per year, have been left in conditions of severe poverty, plagued by disease and illiteracy. The Indians, who represent some 55 percent of the total population, remain at the margin of the monetary economy. There will be need for vigorous diversification policy, supported by institutional changes and greatly increased public investment, if the economy is to grow at an adequate and sustained rate.

5. Following elections in March, Colonel Arana became President of Guatemala on July 1, 1970. The new Government, which was elected on a law-and-order platform and was expected to lean to the right in its economic policy, is instead showing interest in promoting a program of social reforms. It has adopted the 1971-75 development plan prepared for the previous Government by an able Planning Council and has kept the Council intact, giving it so far considerable authority in the formulation and execution of economic policies. The Plan proposes a set of institutional and legislative reforms - in good part already initiated by the new Government - and a substantial increase in public investment. Our economic mission endorsed its goals and general strategy, but cautioned that the financing requirements will eventually entail measures going beyond the administrative improvements and minor tax adjustments recommended in the Plan. During our discussions of the draft report, the Government accepted most of its conclusions but maintained that, if the administrative measures were fully effective, no new tax legislation would be needed. It is difficult to press for ambitious fiscal reforms right away; tax administration seems in fact to be improving, revenues are quite buoyant - partly as a result of high coffee prices - and major financial shortfalls are not likely before 1972. Moreover, the Plan may well overestimate the speed with which public investments can be increased; given the substantial institutional reforms which the Plan itself prescribes for the main public spending agencies - especially in agriculture - as a prerequisite for enabling them to carry out larger programs, the pace at which justifiable demands on public funds expands may well be slower than the Planning Agency expects.

6. The Plan is well designed to serve two important objectives of the Government: the acceleration of growth and a broader distribution of its benefits. However, the obstacles are formidable: sporadic acts of terrorism continue, the opposition of domestic vested interests to meaningful reform is bitter and the competence of Government personnel at all levels is quite limited. Thus, it is far from certain how much of these objectives will be achieved. Nevertheless, Guatemala

still has a margin of creditworthiness: the debt service ratio is around 9 percent, balance of payments prospects for the next few years are quite favorable, not only because of high coffee prices for the next year or two but also because of the possibility of a US$200-250 million project with International Nickel going forward (perhaps with IFC participation). Moreover, some progress is being made with the diversification, e.g. livestock, products, some manufacturing, cotton.

The Project

7. The loan under consideration, to be reimbursed in 16 years including a 5-year grace period, would be the first agricultural operation of the Bank Group in Guatemala. The project would provide financial and technical assistance to about 300 commercial beef breeding/fattening ranchers on the Pacific coast to raise Guatemala's current low levels of productivity to modern standards. The objective of the project is to help Guatemala retain its share of the beef export market without further sacrificing domestic consumption, which in recent years has dropped considerably. The total estimated project cost of US$7.8 million would be jointly financed by the Bank (52 percent), Government (20 percent, in the form of an interest-free contribution), participating credit institutions (8 percent in the form of short-term loans for working capital) and ranchers (20 percent).

8. The proposed Bank loan and the interest-free contribution from the Government would be channeled to ranchers through the overall banking system by a Livestock Development Fund located in the Bank of Guatemala (the Central Bank). Besides the Central Bank, the banking system of Guatemala consists of three State Banks, ten Private Banks, two of which are foreign, and two Development Finance Companies. The Central Bank would carry out its financing with part of the proceeds of the Bank loan and an interest-free Government contribution. The blend interest of Bank and Government funds would be about 5 percent per annum. On-ranch development sub-loans would be extended to ranchers for a term of 12 years, including a 4-year grace period, at a 10 percent interest rate and these sub-loans would be refunded in full by the Central Bank at 7 percent. The 2 percent interest spread would be required to cover the Central Bank's operating expenses and pay for Technical Services. A Technical Service Unit, which is one of the essential features of the project, would be established in the Ministry of Agriculture, with two agencies located outside the capital city, to provide project-related technical services.

9. The proposed Bank loan of US$4 million would finance the foreign exchange component of about US$2.6 million and US$1.5 million of local costs. Bank financing of a relatively large amount of local costs is justified in view of the high priority of this project in the diversification of the Guatemalan economy. The Bank's share of total project costs is in line with what we have been doing in similar projects in other countries, and if the Bank's contribution were to be any smaller it would be difficult to persuade either the Government or the commercial banks to support the project.

Limitation of Beneficiaries

10. During recent discussions with the Government in Washington, various alternatives were explored with a view to satisfying a Government's request that the project should exclude a few very large farmers who already have access to long-term credit and technical assistance. A tentative agreement was reached to the effect that sub-loans to very large ranchers - defined in terms of the size of the loans - would carry additional charges for technical services. This would most likely result in excluding from the project the larger ranchers, who reportedly have other and cheaper sources of funds and technical assistance and would not be interested in small-size loans. We expect to further discuss this as well as other criteria during negotiations. In any case, we would leave open the possibility of periodic revisions of the criteria finally chosen with a view to reconciling the basic aims of the Government with an early disbursement of project funds.

Recommendation

11. I recommend that representatives of the Government and the Central Bank be invited to negotiate a loan of US$4.0 million on the terms and conditions indicated in paragraph 6.01 of the Appraisal Report.

Edgar Gutierrez
Director

Population: 4.7 m
GNP Per Cap: $310

IVa. GUATEMALA - 5 YEAR LENDING PROGRAM

		($ millions)							
				Fiscal Year				Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Livestock I	IBRD		4.0						
Livestock II	IBRD					5.0			
Agriculture Unidentified	IBRD					5.0			
Communications I	IBRD		4.0						
Communications II	IBRD						10.0		
Education II	IBRD				6.0				
Education III	IBRD						6.0		
Power III - Distribution	IBRD			5.0					
Power IV - Atitlan	IBRD			25.0					
Power V - Distribution	IBRD						5.0		
Tourism Unidentified	IBRD				5.0				
Highways II - Northern T	IBRD		6.0						
Highways Unidentified	IBRD					10.0			
Port	IBRD				5.0				
	IBRD		14.0	30.0	16.0	20.0	21.0	22.0	66.3
	No.		3	2	3	3	3	2	9

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