~~FY 83-87 Five Year Lending Program — By Regional Sector~~ an Committee
1970 (Jan.-Febr.)

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/70-5

February 9, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Tanzania - Second Education Project" (149-TA) held on February 5, 1970 in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

LM/M/70-5

February 9, 1970

Minutes of Special Loan Meeting to discuss "Tanzania - Second Education Project" (149-TA) held at 10:15 a.m. on February 5, 1970 in Conference Room b.

1. Present: Messrs. Knapp (Chairman), Cope, Chadenet, Ballantine, Burt, J.H. Williams, Clements, Eigen and Pearce (Secretary).

2. Issue: The meeting had been called to consider a memorandum dated February 2 from Mr. Williams to the Chairman recommending IDA's acceptance of certain changes, proposed in June, 1969 by the Tanzanian Government, to the second education project for which a $5 million credit had been signed on May 29, 1969 (149-TA). These changes, which would permit higher utilization of Tanzania's scarce secondary school teaching resources and increase the output of skilled manpower in accordance with a new survey of the country's needs, had been reviewed by a Bank mission in September, 1969 which had concluded that the Tanzanians' proposals would strengthen the project and, with one exception, should be accepted.

3. Discussion: The Chairman, noting that the Eastern Africa and Education Projects Departments were agreed that the Tanzanians' proposals, with the exception referred to above, should be accepted, said that they should now consider how the consequential amendment to the Credit Agreement, which would require approval at a meeting of the Executive Directors, could be presented and justified - specifically, the fact that the Tanzanians had proposed the changes so soon after the credit signing.

4. The Education Projects Department, drawing attention to the one year delay which had occurred between project approval and credit signing owing to the Government's wish to secure Nordic Group financing for part of the project, said that two of the proposed changes had been suggested originally by the appraisal mission in November 1968 and rejected by the Tanzanians at that time. Their later acceptance of the mission's advice was procedurally unfortunate in that it had occurred just after credit signing; on the other hand, the changes were substantively important and would improve the project. The absence of an adequate planning base for education was a fact of life in countries like Tanzania and, in negotiating loans and credits, the Bank Group was not always able to secure the borrower's timely agreement to particular proposals. The result in this case was the Government's request to make changes in the project.

5. <u>Decision</u>: The Chairman approved the Eastern Africa and Education Projects Departments' recommendation that IDA should inform the Government of its agreement to the proposed changes outlined in Mr. Williams' memorandum. In due course, a memorandum from the President which should state frankly the circumstances in which the changes to the project were necessary, should be presented to the Executive Directors for approval.

David Pearce
Secretary

Cleared by: Messrs. Knapp
Ballantine/Burt
J.H. Williams

cc: Loan Committee
Participants

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

lbhlan

CONFIDENTIAL

LOAN COMMITTEE

February 9, 1970

MEMORANDUM TO THE LOAN COMMITTEE

East Africa - East African Railways Corporation

Attached for information is a memorandum from the Deputy Director of the Eastern Africa Department to the Chairman of the Committee, dated February 6, 1970, transmitting for approval the draft Report and Recommendation of the President on a proposed loan to the East African Railways Corporation.

David Pearce
Secretary
Loan Committee

\- DISTRIBUTION -

Committee:

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

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

TO: Mr. J. Burke Knapp February 6, 1970

FROM: J. H. Williams

SUBJECT: East Africa - Proposed Bank Loan to the East African Railways Corporation

1. I attach for your approval a copy of the draft Report and Recommendations of the President on a proposed Bank loan of $42.4 million to the East African Railways Corporation (EARC) to help finance the Corporation's 1969-72 development program. Also attached is a copy of the draft Loan Agreement with EARC; the draft Guarantee Agreements which provide for the joint and several guarantees of the proposed loan by the Governments of Kenya, Tanzania and Uganda; and a draft letter Agreement between the East African Community and the Bank.

2. In addition to the documents referred to in paragraph 1, the loan documents include supplementary letters on (i) Representations; (ii) Personnel Policies and Management; (iii) Restriction on Capital Expenditure; (iv) Negative Pledge between the United Republic of Tanzania and the Bank; and (v)Economic Feasibility Studies of Railway lines and Services. These letters,copies of which are attached together with the external debt letters, do not involve new policy issues and it is not intended to distribute them to the Executive Directors.

3. We have now received approvals to the draft loan documents from the Kenya, Tanzania and Uganda Governments and from the Communications Council of the East African Community. We have still to receive: (a) approval of the Board of Directors of EARC: (b) approval by the Finance Council of the Community of the financial terms and arrangements contained in the Loan Documents and (c) approval by the Kenya and Uganda Parliaments of the respective Guarantee Agreements.

4. We understand that the Board of Directors of EARC approved the draft loan documents last December. We have again cabled for the official notification. The approval of the East African Finance Council, which is due to meet next on February 25,is expected to be a formality and could be a condition of signing. The approvals by the Kenya and Uganda Parliaments are similarly essential only before signature.

5. The Appraisal Report (PTR-30) was distributed to the Loan Committee on September 17, 1969, for consideration without meeting. The scope and nature of the project as described in the Appraisal Report did not undergo any substantial alteration during negotiations. At its recent meeting the Communications Council of the Community agreed to various additions to the railways development program for construction of workshops and other items in Uganda. Provided these

additions are not substantial, they would not involve any amendment to the Appraisal Report or the arrangements for the loan as negotiated, but we cannot be sure, of course, until we have full details. We have cabled for details and are pressing for an early reply.

6. Mr.McNamara, who was informed of the situation outlined in paragraphs 3-5 by Mr. Lejeune in a memorandum dated January 29, copy to you, has directed that we should aim at being ready to present the loan to the Executive Directors at their February 24 meeting. That will be possible only if details of the additions to the railways development program are received in sufficient time for review before February 12 and are found to be insubstantial. We will inform you as soon as we have received details of the proposed changes and have assessed their significance, and will in any event advise you of the situation by the 12th.

7. The theme of the Board presentation will be the significance of the proposed loan arrangements for transport policy in East Africa. The presentation will be made by Mr. Jaycox.

8. The papers mentioned in this memorandum have been cleared by the Departments concerned.

9. I would appreciate your giving your comments on these papers to Mr. Clements (extension 3564).

Attachments

cc: Mr. McNamara
Mr. Cope
Loan Committee (without attachments)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

February 5, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Uganda - Smallholder Tobacco Project

1. The Committee is requested to consider, without meeting the attached memorandum of February 5, 1970 from the Eastern Africa Department, entitled "Uganda - Smallholder Tobacco Project" (LC/0/70-11).

2. Comments, if any, should be sent to reach Mr. Kaji (ext. 2794) by 1:00 p.m. on Tuesday, February 10.

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, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
Directors, Area Departments
Director, Projects Department
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Executive Vice President (IFC)
Vice President (IFC)

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LC/O/70-11 SEP 09 2014

February 5, 1970 WBG ARCHIVES

LOAN COMMITTEE

Memorandum from the Eastern Africa Department

UGANDA - Smallholder Tobacco Project

I. INTRODUCTION

1. After several years of abortive preparation of an over ambitious project, the Government of Uganda submitted an agricultural credit project in March 1968 that an appraisal in October 1968 showed was still short on preparation and concentrated excessively on short term credit requirements. The Government was persuaded to focus on a much narrower front and, with assistance from the Permanent Mission in Eastern Africa, a project was worked out that was basically limited to credit for tobacco production. That project was appraised in August 1969 and is the subject of this memorandum.

2. The proposed credit would be the third operation in the agricultural sector in Uganda. The two earlier projects - Smallholder Tea Project (Credit No. 109 UG) and the Beef Ranching Project (Credit No. 130 UG) are progressing generally satisfactorily. Both contain a substantial credit component.

II. THE PROJECT

3. Attached is an appraisal report entitled "Smallholder Tobacco Project," (PA 33). The report recommends an IDA credit of US$4.0 million equivalent on standard terms for financing the proposed smallholder tobacco project, total cost of which is estimated at US$7.26 million. The total foreign exchange cost component of the project is estimated at US$2.6 million (about 36%). IDA financing would be in the order of 55% of the total project cost, the balance being provided by the farmers and cooperatives (29%) and the Government of Uganda (16%).

4. The proceeds of the proposed credit would be utilized for:

(a) provision of credit to tobacco growers for seasonal production inputs and construction of tobacco curing barns;

(b) financing the capital requirements of the cooperatives for construction of bailing centers, office and storage facilities and establishment of wood fuel plantations;

(c) financing the cost of project administration;

(d) provision of loans to the Produce Marketing Board for construction of tobacco storage facilities at Kampala; and

(e) retention of consultants to prepare further projects in the field of agricultural credit.

The proposed project would benefit not only existing tobacco farmers but bring in 6,000 new growers of tobacco. It is expected almost to double the quantity of flue-cured tobacco produced in Uganda by expansion of acreage and improved productivity. The bulk of the increased production would be exported and would augment the country's foreign exchange earnings by about US$2.8 million per annum.

5. The economic rate of return of the project, based on current estimates of tobacco prices, would be about 22%, assuming a zero shadow price for presently under employed rural labor not at present employed on tobacco production.

6. The project would be administered by a Project Director with the assistance of a Project Committee. Consideration was given to the possibility of setting up an autonomous project entity, as was done in the case of the Smallholder Tea Project (Credit No. 109 UG). The Government believes, and we concur, that the tobacco project of the size and scope proposed does not justify setting up a separate entity and that the project should be built around the existing structure of Cooperative Unions and their constituent societies, a separate marketing organization and privately owned processing facilities. We believe that satisfactory administration can be achieved through a combination of this structure with the Project Director/Project Committee mechanism set forth in the appraisal report (para. 6.03). The satisfactory performance of a comparable mechanism used in the Beef Ranching Project supports that conclusion.

7. In view of the vital role the Project Director is required to play, it is proposed that a suitable person, acceptable to IDA, be selected prior to presentation to the Executive Directors and be appointed prior to effectiveness. We also plan to reach agreement during negotiations on the composition and the functions of the Project Committee which will assist the Project Director. In order to ensure that the Committee functions effectively and has sufficient authority to have its recommendations carried out, we shall obtain the Government's agreement that the representatives of the various ministries and agencies on the Committee would be of appropriate rank.

8. The day to day management of the field part of the project would be the responsibility of the three tobacco cooperative unions, one for each area, and their constituent primary societies. For the purposes of the project the primary societies would operate under the control of their parent unions as local branches. Cooperative management in Uganda has suffered various weaknesses and the Government has taken considerable control over their operations. The Government has already indicated its willingness to invoke its powers to appoint the managers of the three cooperative unions. Their appointment would be subject to IDA approval.

9. Marketing would be handled by the two-year old Produce Marketing Board (PMB). So far the Board is only involved in the marketing of tobacco, for which it has a monopoly, but can be expected to go into other crops. It is not intended to control the use of surpluses accruing to PMB from its operations, but PMB would be required to keep separate and identifiable accounts for its tobacco operations.

10. The key to the execution of the proposed project would be a detailed plan of operations setting out the program for planting tobacco and wood fuel plantations, construction of barns, housing and storage, provision of extension staff and services by the ministries and agencies involved and delineating the responsibilities of the Project Director, Union Managers and other project administration staff. The contents of the plan of operations will be discussed with the Government during negotiations. However, to work out the details of the plan the Government will require the services of the Project Director and the Project Committee. Since the appointment of the Director and the establishment of the Committee would be conditions of effectiveness, Uganda would be allowed a further two months after effectiveness to submit the plan of operations for the Association's approval.

11. In view of the past history of unsatisfactory project preparation, the proposed credit also provides funds for retention of consultants who would first investigate a short list of possible sub-projects for a further agricultural credit operation and, after agreement between the Association and the Government, would work up in detail those considered likely to be eligible for a possible second credit project.

IV. THE ECONOMY

12. The last Economic Report on Uganda (No. AE2 of June 9, 1969) concluded that since the economy is greatly dependent on coffee and cotton, which do not have very good long-run growth prospects, the terms of lending should be kept as soft as possible. It also pointed out that investment by Uganda during the 1966/71 development plan will substantially exceed the available domestic savings so that development needs to be assisted by a sustained capital inflow from abroad. Since most priority projects, particularly in agriculture, have a low foreign exchange component, external assistance must cover a portion of the local costs. The proposed IDA credit and the financing of local expenditure equivalent to approximately 35% of the credit is therefore justifiable.

V. RECOMMENDATION

13. I recommend that the Association invite representatives of the Republic of Uganda to negotiate a development credit of US$4 million equivalent substantially on the terms and conditions set forth in paragraphs 9.01 and 9.02 of the appraisal report.

J. H. Williams
Deputy Director
Eastern Africa Department

Attachments: I : Uganda Past Lending Operations

II : Uganda Five Year Lending Program

Attachment 1

UGANDA - PAST LENDING OPERATIONS *

		($ millions)						
		Through 1963	1964	1965	1966	1967	1968	1969
Agric. (Tea Growers Corp.)	IDA						3.4	
Agric. (Beef Ranching)	IDA							3.0
Education I	IDA					10.0		
Power	IBRD	8.4						
Roads	IDA						5.0	
	IBRD	8.4						
	IDA					10.0	8.4	3.0
	No.	1				1	2	1
IBRD Loans Outstanding *								
- including undisbursed		0.1	0.1	0.1	0.1	0.1	0.1	0.1
- excluding undisbursed		0	0	0.1	0.1	0.1	0.1	0.1
IDA Credits Outstanding *								
- including undisbursed		-	-	-	-	10.0	18.4	21.4
- excluding undisbursed		-	-	-	-	0	0.8	4.2

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* Loans and credits for national projects only. Uganda is also a beneficiary under loans for the Common Services. Uganda's share (on a notional one-third basis) of loans for the Common Services amounted to $8.0 million through 1963 and $17.0 million during 1964-69.

February 4, 1970

Population: 9.5 million
Per Cap. Inc.: $95

Attachment 2

UGANDA - 5 YEAR LENDING PROGRAM*

		($ millions)							
		Fiscal years						Total	Total
		1970	1971	1972	1973	1974	1975	1964-68	1969-73
Agricultural Credit (Tobacco)	IDA	4.0							
Tobacco II	IDA						7.0		
Agricultural Credit II	IDA				7.0				
Smallholder Tea II	IBRD		6.0						
Smallholder Tea III	IBRD						8.0		
Livestock II	IDA			4.0					
Livestock III	IDA						5.0		
Agriculture, to be identified	IDA						5.0		
Education II	IDA		5.0						
Education III	IDA					12.0			
Murchison Falls Power	IBRD			30.0					
Tourism	IBRD					7.0			
Roads II	IDA	11.6							
Roads III	IDA			7.0					
Roads IV	IDA						5.0		
Kampala Water Supply	IDA				7.0				
	IBRD	-	6.0	30.0	-	7.0	8.0	-	36.0
	IDA	15.6	5.0	11.0	14.0	12.0	22.0	18.4	48.6
	Total	15.6	11.0	41.0	14.0	19.0	30.0	18.4	84.6
		2	2	3	2	2	5	3	10
IBRD Loans Outstanding*									
- including undisbursed		0.1	6.1	36.1	36.1	43.1	51.1		
- excluding undisbursed		0.1	0.1	1.1	9.1	21.1	34.1		
IDA Credits Outstanding*									
- including undisbursed		37.0	42.0	53.0	67.0	79.0	101.0		
- excluding undisbursed		10.0	20.5	33.0	44.1	54.6	65.6		

* The above figures represent Bank loans and IDA credits for national projects in Uganda. Uganda would also benefit from loans to the East African Community for the Common Services. During the period 1970-75, Uganda's share (on a one-third basis) of Bank lending for the Common Services would amount to $61.5 million and disbursements are estimated at $40-45 million.

February 4, 1970

FORM NO. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

February 5, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Mexico - Third Power Program

Attached for information is a memorandum from the Director of the Central America and Caribbean Department to the Chairman of the Committee, dated February 5, 1970, transmitting for approval the draft Report and Recommendation of the President on a proposed loan to Comision Federal de Electricidad and Nacional Financiera, S.A.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

OFFICE MEMORANDUM

TO: Mr. J. Burke Knapp

DATE: February ~~4~~ 5, 1970

FROM: Edgar Gutierrez

SUBJECT: MEXICO - Third Power Program Loan

1. I attach for your approval a copy of the draft Report and Recommendation of the President on a proposed loan of $125 million to Comision Federal de Electricidad and Nacional Financiera, S.A., together with a copy of the draft Appraisal Report and the draft Loan and Guarantee Agreements. It is planned to distribute these documents to the Executive Directors on February 11 for consideration on February 24. Two preconditions still exist for their consideration of the loan. One is the issuance by the Mexican Minister of Industry and Commerce of regulations concerning the frequency changeover. A draft of these regulations is being considered by the Minister and will be reviewed by Bank staff later this week. The other is the completion of arrangements for Joint Financing. Eight out of ten major supplying countries which would need to agree to participate have confirmed in writing their agreement to do so. In the case of Italy, approval by the Minister of Finance is still needed and is expected momentarily. In the case of Canada, a substantive question has existed regarding establishing a minimum interest rate on joint loans but we hope to get a favorable Canadian reply on February 9. While some uncertainty exists with regard to both the frequency unification decree and joint financing, we are submitting the above drafts for your clearance at this time in the hope that we can still make our target for Board consideration of the loan on February 24.

2. The green cover Appraisal Report and the memorandum from the Western Hemisphere Department of December 3, 1969 (LC/O/69-105) were considered at a Loan Committee Meeting on December 12, 1969 (LC/M/69-15) and the problem of frequency unification was subsequently considered at two Special Loan Meetings on January 9 and 13, 1970 (LM/M/70-2 & 3). The major revision in the Appraisal Report is to reflect the revised Mexican plan for frequency unification which was accepted at the Special Loan Meeting on January 13.

3. In addition to the Loan and Guarantee Agreements the documentation will include two routine letters on working capital and the expansion program and the usual letter on external debt. The letters are not attached and it is not intended to distribute them to the Executive Directors.

4. During negotiations it was agreed, with your approval, to increase the ceiling on retroactive financing from $10 to $15 million.

5. An Economic Report entitled "Current Economic Position and Prospects of Mexico" (WH-194a) was distributed to the Executive Directors in December, 1969. The conclusions of the Economic Report are summarized in Part V of the draft President's Report.

6. This memorandum and the papers mentioned have been cleared with the departments concerned.

7. The theme for the oral presentation, to be made by Mr. Nelson, would be the heavy financial requirements of the Mexican power sector and the related arrangements for Joint Financing.

8. I would appreciate your giving your comments to Mr. Nelson (Ext. 2473-74) at your earliest convenience.

Attachments

cc: Mr. McNamara
Mr. Cope
Loan Committee (without attachments)
RNelson/eg

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

LOAN COMMITTEE

LM/M/70-4

February 4, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Brazil - Proposed Second Highway Project" held on January 26, 1970, in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

LM/M/70-4

February 4, 1970

Minutes of Special Loan Meeting to discuss "Brazil - Proposed Second Highway Project" held at 3:00 p.m. on January 26, 1970, in Conference Room B.

1. Present: Messrs. Cope (Chairman), Chadenet, Poore, Gabriel, Geolot Wiese, Sella, Cancio, Hussain, Keltie, North, Whyte, Kanaan and Pearce (Secretary).

2. Issue: The meeting had been called to consider a memorandum from the South America Department (LC/0/70-4 dated January 21, 1970) and the accompanying appraisal report (PTR-36 dated January 14, 1970) which recommended negotiation of a proposed $100 million loan, including $47.5 million of local expenditure financing, to Brazil for a second highway project. The main issue for discussion concerned the proposed procedure for disbursement of the loan which, as under the $26 million first highway construction loan to Brazil signed in 1968 (567-BR), would be made on the basis of physical progress and unit costs expressed in US dollars at the official exchange rate prevailing on the date of bid opening; specifically, contractors would be paid in cruzeiros and the Government would, from time to time, request the Bank to reimburse the agreed percentage (in this case 40%) of expenditures, arrived at by the conversion of physical units of work into dollars at the appropriate dollar unit prices. In this connection, the meeting had before it a memorandum dated January 23, 1970 from Mr. Sella, the Chairman of an ad hoc committee set up on April 29, 1969 to study the question of exchange rates used in disbursements, and a draft paper dated May 13, 1969 which summarized the issues arising from the use of the above so-called Brazilian formula for disbursements against civil works contracts. The ad hoc committee had concluded that it was impossible practically to assess the merits or weaknesses of the Brazilian formula until experience had been gained of disbursements under the first loan (567-BR).

3. Discussion: The South America Department, noting that rapid price inflation and frequent exchange rate adjustments which would not necessarily move parallel to changes in construction contract prices were a normal feature of the Brazilian economy, said that the immediate purpose of the Brazilian formula was to avoid frequent changes (reductions) in the percentage of Bank loan funds disbursed against construction contracts. It was a simple and convenient administrative device and avoided the possible strain placed on Bank relations with the borrower which frequent reductions in disbursement

percentages might cause. Apart from these two advantages, which the South America and Transportation Projects Departments considered important however, the objective and net effect of the Brazilian formula were the same as the Bank's existing disbursement procedure: to ensure that, irrespective of varying relationships (i.e. time lags) between changes in domestic prices and adjustments in the official exchange rate, disbursement of loan proceeds would continue until physical completion of the project. The Transportation Projects Department added that, since the new formula was being applied in the first highway loan (567-BR) - albeit not yet in practice because no loan disbursement had been made at this time - it was desirable, and probably less confusing for the borrower, to retain the same disbursement procedure for the proposed second highway loan.

4. The Controller's Department recalled that at a Loan Committee meeting on April 3, 1969 in connection with the second road loan to Argentina (619-AR), at which their objections to the further application of the Brazilian formula had been discussed (cf. LC/M/69-7 dated May 16, 1969), it had been decided to leave this question in abeyance until the ad hoc committee had studied it further on the basis of disbursement experience under the first highway loan to Brazil (567-BR). The Brazilian formula was open to criticism on the grounds indicated in paragraphs 9-12 of Mr. Sella's draft paper of May 13, 1969, in particular that, by delaying its requests for reimbursement of payments already made to contractors, the borrower, in the event of a devaluation during this period, would receive a larger share of the cost of a contract - in terms of local currency - than that which the Bank intended to finance. This criticism was potentially of greater significance in the loan now under consideration, which was much larger ($100 million) than the first one ($26 million) and, if applied, would create a second undesirable precedent. Finally, the Controller's Department said that the Brazilian formula did not eliminate entirely the need to adjust disbursement percentages resulting from other factors (e.g. changes in project costs resulting from increases in construction quantities).

5. The Chairman said that the issue was not the Bank's general disbursement policy, nor was it intended to apply the formula generally for all Brazilian loans. The formula was a specific device for experimental application in the special circumstances of these two Brazilian highway loans. Although, in his view, the arguments for and against its re-use in the proposed second highway loan were finely balanced, he favored a consistent approach.

6. Decision: The Chairman decided that the Brazilian formula should apply also to the proposed second highway loan to Brazil on the clear understanding, requested by the Controller's Department, that it did not establish a precedent for future loans and was without prejudice to subsequent reconsideration of the issue on the basis of experience gained under disbursements of both highway loans to Brazil

David Pearce
Secretary

Cleared by: Messrs. Knapp/Cope
Poore/Gabriel
Sella
Geolot/Whyte
Wiese

cc: Loan Committee
Participants

bhon.

FORM No. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

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WBG ARCHIVES

LC/A/70-2

February 3, 1970

NOTICE OF MEETING

A Meeting of the Loan Committee will be held on Friday, February 6, 1970, at 11:00 a.m. in the Board Room.

AGENDA

India

The Committee will consider the attached memorandum of February 3, 1970, from the South Asia Department entitled "India - Gujarat Agricultural Credit Project" (LC/O/70-10).

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

Mr. J. Burke Knapp, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
Directors, Area Departments
Director, Projects Department
General Counsel
Director, Economics Department
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Directors, other Departments
Special Adviser to the President
Executive Vice President (IFC)
Vice President (IFC)

CONFIDENTIAL

LC/O/70-10

February 3, 1970

LOAN COMMITTEE

MEMORANDUM FROM THE SOUTH ASIA DEPARTMENT

INDIA - GUJARAT AGRICULTURAL CREDIT PROJECT

Background

1. Attached is an Appraisal Report (PA-34) dated January 30, 1969 recommending that the Association make a credit to India of $US36.0 million equivalent for this project. The most recent version of the five-year lending program is attached. The amount of this credit is increased from that previously contemplated. It has been recognized for some time that the amount shown in the lending program was subject to change during appraisal. The amount proposed has been set according to considerations discussed in paragraph 11 below.

2. The Gujarat agricultural credit project would finance an investment program in minor irrigation works and farm mechanization in the State of Gujarat in west-central India. The Governments of India and Gujarat are aware of the need to provide expanded credit facilities to farmers as part of the strategy of increasing foodgrain production through the coordinated provision of modern inputs. It has been estimated that a five-fold increase in medium and long-term agricultural credit will be required during the period of the Fourth Five-Year Plan (ending in 1973/74) in order to keep pace with the projected level of major investments in agriculture.

3. In November and December of 1968, the Bank group sent a reconnaissance mission to India to review the prospects for Bank/IDA participation in agricultural credit projects in several states. This mission recommended that projects in Gujarat and in Punjab could be suitable for Association financing with some further preparation, and that projects in several other states could be developed in the course of time. The Gujarat project is the first to be appraised of this series of credit schemes; the Punjab project has been appraised and will be ready for Loan Committee consideration in a few weeks. Credit projects in four other states are in various stages of preparation.

Bank/IDA Lending Program

4. The proposed credit would be the twelfth lending operation of the Bank group in support of agricultural projects in India, the eleventh being the $US35.0 million credit for the Kadana Irrigation Project. In addition to the Punjab agricultural credit project, appraisal reports are

being prepared for proposed Association credits for a further Industrial Imports project, a Second Power Transmission project, an Agricultural Aviation project, two irrigation projects, and the Mormugao Port project. Many of these will be ready for loan committee consideration and inclusion in the lending program for FY 1970. A number of other projects are at various stages of preparation, including a further loan to ICICI which is the only proposed loan in the lending program for FY 1970.

5. The lending program will be reviewed in the context of a new country program paper in February.

The Economy

6. The last economic report "Economic Situation and Prospects of India", (R69-75, April 28, 1969) pointed out the considerable achievements in India in fiscal year 1967/68. Paragraphs 22 through 27 of the President's Report and Recommendation on the Kadana Irrigation project (P-774, January 21, 1970) reviewed the developments during the ensuing months. The improvements in the economy continued, on the whole, through 1968/69, and growth prospects for 1969/70 appear fairly good. A new economic report is being prepared and should be completed by April 1970.

7. In spite of recent improvements in the general performance of the economy, which include progress on the balance of payments deficit, it is clear that India still requires substantial inflows of net aid, and the debt service position makes it apparent that this aid must be on concessionary terms; thus IDA financing is fully justified.

8. The direct import content of high priority projects in India is quite small, and this is particularly true in the agricultural sector. Bank group financing for agricultural projects in India therefore necessarily will involve financing a substantial proportion of the local currency expenditures on the projects.

The Project

9. The Gujarat agricultural credit project consists of a three-year lending program to finance investments by farmers in minor irrigation and farm mechanization. The borrower would be the Government of India. The proceeds of the Association credit would be on-lent to farmers through the Agricultural Refinance Corporation, (an all-India body which provides medium and long-term resources to agricultural credit institutions) and the Gujarat Cooperative Land Development Bank. Loans to participating farmers would be for the purpose of installation of pump sets on existing wells, the construction of lift irrigation systems and new wells of various types, and investment in tractors and farm implements. In addition, the credit would finance consultant services for a groundwater study to determine the capacity for further development of minor irrigation in the project area.

10. Benefits from the project would arise from increased agricultural production. The cropped area would be expanded by some 93,000 hectares through increased double cropping and better farm practices. Assured water supplies through minor irrigation development also would permit dependable higher yields. It is estimated that foodgrain production would increase by over 60 percent on average on the lands of participating farmers. Project benefits would accrue to small and medium-sized farmers as well as to those with large holdings. Farmers with holdings down to a minimum size of 5 hectares would be able to participate in the project. The economic rate of return is estimated to be between 17 and 29 percent. In addition, the increased agricultural production should make possible savings of foreign exchange.

11. The Appraisal Report estimates the total cost of the project at about $US67.0 million. It is proposed that the Association finance 100 percent of the total estimated foreign exchange cost of $US8.6 million, and $US27.4 million (or about 47 percent) of the total local currency costs. The Association would thus finance about 54 percent of the total expenditures on the project.

12. Several important issues, which we will be discussing for the first time with India in the context of a single lending operation, and which will affect future project lending for agriculture, arise in the consideration of this scheme. The first of these is the method to be followed for the procurement of tractors. We have had preliminary discussions with the Government of India on this point and in August 1969 we sent a memorandum to the Government suggesting one possible method of tractor procurement. The Government indicated that this proposal was acceptable as a basis for further discussion. The method proposed in that memorandum is followed in the recommendations of the Appraisal Report, (See Annex 7). It would enable the farmers' choice of tractor makes to be taken into account and introduce an element of price competition through bulk purchase of tractors at prices indicated in advance by suppliers. Although there is agreement amongst the staff to negotiate on the basis of the system recommended in the Appraisal Report, a procurement system involving straightforward international competitive bidding also might be practicable, and it is quite possible that the proposed method of tractor procurement might be modified during negotiations.

13. The second significant issue involves the changes in lending policies of the Land Development Bank as recommended in the Appraisal Report. These changes include an increase of one percent in the lending rate, reduction of the length of repayment periods, and a more liberal method of determining the sufficiency of collateral of participating farmers. The borrower may find certain of these recommendations difficult to accept (particularly the increase in the interest rate) because they represent changes in policies which would affect lending institutions throughout India as well as in the project area.

14. A further major issue raised by this project involves the sale price of tractors to farmers. The Appraisal Report concludes that this price should be increased by 25 percent, to help ensure that tractors end up in the hands of farmers best able to use them economically. This would require legislation, possibly involving the price of all tractors, including domestically produced tractors and tractors obtained through the rupee area countries on trade arrangements. It also would have implications for the Government's stated policy of maintaining low prices for all goods necessary to agricultural production. Accordingly, the Appraisal Report recommends that during negotiations the Government and the Association merely initiate discussions on the possibility of an eventual price increase.

15. I do not expect that local preference will be a difficult problem. I expect the Government to agree to limit procurement of tractors to competitive purchase of imported makes. Further, the prevailing rate of customs duty on most of the other items to be imported is expected to be 15 percent or less. The only significant exception is the case of drilling rigs, which have an estimated total cost of about $US1.0 million. There are local suppliers, but the appraisal mission is not satisfied with the quality of their product, and we are recommending international competitive bidding with specifications to be approved by the Association.

Recommendation

16. I recommend that the borrower be invited to negotiate the proposed credit of $US36.0 million on the basis of the recommendations and conditions set forth in paragraphs 8.01 and 8.02 of the Appraisal Report, subject to the reservations expressed in paragraphs 12 and 13 above.

I.P.M. Cargill
Director
South Asia Department

Attachments

Population: 543 m
Per Cap GNP: $76

INDIA - ACTUAL AND PROPOSED LENDING THROUGH FY1975

Attachment 1

($ millions)

		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73	Total 1971-75
								Fiscal Years									
Farm Improvement	IBRD	10.0															
Tarai Seeds	IBRD							13.0									
Irrigation	IBRD	19.5															
Irrigation - Tube Well	IDA	6.0															
Irrigation - Shetrunji	IDA	4.5															
Irrigation - Salandi	IDA	8.0															
Punjab Flood Control	IDA	10.0															
Irrigation - Sone	IDA	15.0															
Irrigation - Purna	IDA	13.0															
Kadana Irrigation	IDA								35.0								
Agricultural Credit - Gujarat	IDA								37.0								
Agricultural Credit - Punjab	IDA									25.0							
Agricultural Credit	IDA									25.0							
Irrigation - Krishna-Godavari	IDA									10.0							
Irrigation - Cauvery Delta	IDA									15.0							
Irrigation - Pochampad	IDA									10.0							
Irrigation - Godavari Barrage	IDA									10.0							
Irrigation - Tawa	IDA									10.0							
Agricultural Aviation	IDA									5.0							
Grain Storage	IDA									10.0							
Fisheries	IDA										7.5						
Agriculture Projects)	IDA										140.0						
Agriculture Projects) (5-8)	IDA											150.0					
Agriculture Projects)	IDA												165.0				
Agriculture Projects)	IDA													165.0			
Telecommunications I	IDA	42.0															
Telecommunications II	IDA			33.0													
Telecommunications III	IBRD							27.5									
"	IDA							27.5									
Telecommunications IV	IDA									40.0							
Telecommunications V	IDA										40.0						
Telecommunications VI	IDA											40.0					
Telecommunications VII	IDA												35.0				
Telecommunications VIII	IDA													35.0			
DFC - ICICI I-V	IBRD	90.0															
DFC - ICICI VI	IBRD			50.0													
DFC - ICICI VII	IBRD						25.0										
DFC - ICICI	IBRD								40.0			40.0		40.0			
New DFC	IBRD									10.0	25.0		25.0				
Education Unidentified I	IDA										20.0						
Education Unidentified II	IDA													20.0			
Indian Iron & Steel I & II	IBRD	51.5															
Indian Iron & Steel III	IBRD					30.0											
Tata Iron & Steel I & II	IBRD	107.5															
Coal Mining I & II	IBRD	54.5															
Public Sector Fertilizer	IDA									25.0							
Fertilizer Plant Unident.	IBRD									25.0							
Industry Unidentified II	IBRD											15.0					
Industrial Imports I	IDA		90.0														
Industrial Imports II	IDA				100.0												
Industrial Imports III & IV	IDA					215.0											
Industrial Imports V	IDA							125.0									
Industrial Imports VI	IDA								75.0								
Power	IBRD	25.0															
Kothagudem Power I	IDA	20.0															
Kothagudem Power II	IBRD			14.0													
Koyna Power I	IBRD	25.0															
Koyna Power II	IDA	17.5															
Trombay Power I & II	IBRD	26.0															
Bokaro-Konar Power	IBRD	18.5															
Durgapur Power Extension	IDA	18.5															
Power Transmission I	IBRD			70.0													
Beas Equipment	IDA				23.0												
Power Transmission	IDA								38.0								
Power Transmission	IDA									60.0				60.0			
Power Unidentified I	IDA											15.0					
Power Unidentified II	IDA												15.0				
Aviation	IBRD	5.6															
Highways I	IDA	60.0															
Highways II	IDA									30.0							
Ports I-III	IBRD	64.0															
Ports IV	IDA	18.0															
Port - Mormugao	IDA									10.0							
Ports - Bombay/Calcutta	IDA									30.0							
Railroads I-VI a/	IBRD	379.0															
Railroads VII	IDA	67.5															
Railroads VIII	IDA			62.0													
Railroads IX	IDA				68.0												
Railways X	IDA								55.0								
Transportation Projects Unident.	IDA										65.0						
Transportation Projects Unident.	IDA											60.0					
Transportation Projects Unident.	IDA												50.0				
Bombay Water Supply	IDA										10.0						
Water Supply Unidentified I	IDA											15.0					
Water Supply Unidentified II	IDA												15.0				
Unallocated	IDA										15.0						
	IBRD	876.1		134.0		30.0	25.0	40.5	40.0	35.0	25.0	55.0	25.0	40.0	189.0	195.5	180.0
	IDA	300.0	90.0	95.0	191.0	215.0		152.5	240.0	315.0	297.5	280.0	280.0	280.0	591.0	1,265.0	1,392.5
	Total	1,176.1	90.0	229.0	191.0	245.0	25.0	193.0	280.0	350.0	322.5	335.0	305.0	320.0	780.0	1,460.0	1,572.5
	+ No.	44	1	5	3	2	1	3	6	17	14	12	12	5	11	52	57
Note: the IDA lending program is to be adjusted to -										231.0	280.0	280.0	280.0	280.0		1,183.5	1,355.0
IBRD Loans Outstanding																	
including undisbursed		698.8	648.7	742.0	693.7	671.6	650.2	651.9	650.5	628.4	601.5	606.9	584.9	579.9			
excluding undisbursed		543.7	528.8	525.6	530.8	515.5	511.0	498.5	514.2	525.5	536.5	539.9	548.9	539.9			
IDA Credits Outstanding																	
including undisbursed		300.0	390.0	485.0	675.5	889.1	887.4	1037.6	1273.6	1508.6	1787.8	2065.9	2343.1	2618.5			
excluding undisbursed		48.5	133.7	287.9	452.1	662.5	849.3	989.6	1052.6	1242.0	1438.4	1707.1	1977.5	2252.9			

a/ Railroads II covered four separate lending operations

Form No. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

February 3, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Yugoslavia - Telecommunications Project

Attached for information is a memorandum from the Director of the Europe, Middle East and North Africa Department to the Chairman of the Committee, dated February 3, 1970, transmitting for approval the draft Report and Recommendation of the President on a proposed loan for a telecommunications project.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

TO: Mr. J. Burke Knapp DATE: February 3, 1970

FROM: M. P. Benjenk

SUBJECT: YUGOSLAVIA - Loan for Telecommunications Project

1. I attach for your approval a copy of the draft Report and Recommendation of the President on a proposed loan of $40 million to the Yugoslav Investment Bank for a Telecommunications Project, together with copies of the draft Loan, Guarantee and Project Agreements. It is planned to distribute these documents to the Executive Directors on February 5 for consideration on February 17.

2. Since an external debt representation letter was signed on January 30 in connection with the Industrial Loan, no further letter is required for the proposed loan. The letter on representations by the Yugoslav Investment Bank is routine and therefore not attached.

3. The memorandum to the Loan Committee (LC/O/69-111, dated December 19, 1969) on the proposed loan stated that the major issue on which agreement had to be reached during negotiations concerned the unit rate for metered telephone traffic. At the time the project was appraised, the Community of Yugoslav Posts, Telegraphs and Telephones had proposed to the Federal Price Control Commission a uniform rate for long-distance service of Din. 0.40 per pulse. This, according to the projections, would have resulted in revenues much higher than those necessary to cover the PTT's requirements. During negotiations, however, we were informed that the Federal Price Control Commission would agree only to a pulse rate which would bring about uniform long-distance rates at a level of Din. 0.30. This is in any case the rate level which the Bank considers as adequate.

4. The Appraisal Report has been revised to take into account the increase in the Loan from $36 million to $40 million, as approved by Mr. Cope. The increase covers an increase in the cost estimates for some categories of equipment and additional equipment to enlarge the capacity of the long-distance systems financed under the project.

5. This memorandum and the papers mentioned herein have been cleared with all departments concerned. The economic section of the draft President's Report has been cleared with Mr. C. H. Thompson.

6. The oral presentation would be made by Mr. Lamers of this department and would deal with the institutional arrangements in the Yugoslav telecommunications sector and their consequences for the channeling of the Bank loan.

7. I would appreciate your giving your comments on these papers to Mr. Lamers (ext. 4806) at your convenience.

cc: Mr. McNamara
Mr. Cope
Loan Committee (without attachments)

Form No. 60
(4-68)

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

February 2, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Morocco - Credit Immobilier et Hotelier (CIH)

1. The Committee is requested to consider, without meeting, the attached memorandum of February 2, 1970 from the Europe, Middle East and North Africa Department, entitled "Morocco - Credit Immobilier et Hotelier (CIH)" (LC/O/70-9).

2. Comments, if any, should be sent to reach Mr. Bart (ext. 4807) by 1:00 p.m. on Thursday, February 5.

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

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

CONFIDENTIAL

LC/O/70-9

February 2, 1970

LOAN COMMITTEE

Memorandum from Europe, Middle East and North Africa Department

Morocco - Crédit Immobilier et Hôtelier (CIH)

1. The attached appraisal report (No. DB-61) recommends a Bank loan of $10 million to CIH to finance the estimated foreign exchange costs in the construction and equipment of hotels for approximately one year.

Background

2. Bank loans to Morocco totalling $128.3 million plus IDA credits of $18.3 million had been made by the end of December 1969, and after the recently approved fourth loan to the Banque Nationale pour le Développement Economique (BNDE) has been signed, Bank lending will rise to $143.3 million. The volume of loans and credits to Morocco is expected to average about $57 million annually over the next few years, with Bank loans accounting for about 72 percent of the total. The proposed Five Year Lending Program (copy attached) total for FYs 1971-1975 is $204 million in Bank loans and $81 million in IDA credits. IFC holds participations of approximately $1 million in the BNDE and $1.4 million in Compania Industrial del Lukus (CIL), a company mainly concerned with processing and canning of vegetables.

3. Hotel financing in Morocco is not a new field for the Bank. Ever since 1966 Bank funds have been channelled through the BNDE, which has relent them to the CIH, which in turn has lent directly for hotel projects. Although difficult to operate, this indirect method was adopted in order to utilize BNDE's greater expertise in project appraisal since CIH had until 1966 been primarily engaged in housing finance.

4. The Government has for some years intended CIH to be the source of lending for hotels and has wished the Bank to lend

directly to CIH. The Finance Minister raised this matter again with Mr. Knapp in discussions in May 1968. Mr. Knapp replied that the Bank did not object to lending directly to CIH and agreed that the Bank would explore more specifically the possibility for direct lending after the third loan to BNDE, made in 1968, had been exhausted. Since then, members of the Bank staff have worked closely with CIH and also with BNDE in order to improve CIH's hotel lending procedures and strengthen its financial position. Improvements have occurred in processing hotel projects, and CIH's Director General and personnel have demonstrated both the will and capacity for further improvement. With certain additional measures to be taken by CIH as conditions of the proposed Bank loan, CIH is now considered ready to borrow directly from the Bank for its hotel financing activities. The third loan to BNDE has practically been utilized and the fourth loan to BNDE, which was approved on January 13, will mainly support industry. CIH thus needs new funds, including foreign exchange resources, to continue its hotel financing activities.

5. Construction of additional hotel capacity is essential in order to provide accommodation for the considerable increase in tourist traffic Morocco expects in the coming years. The Government has pushed the expansion of tourist facilities, with the encouragement of the Bank, since increased foreign exchange earnings from tourism will provide essential resources for the development program, and many new tourism-related jobs will be created as well. These can be of particular social as well as economic significance, since most will be in the major cities and in the economically depressed Rif region along the Mediterranean coast. In both these areas, unemployment is a serious and growing problem. According to the Bank tourism identification mission of September 1968, about 16,000 new jobs will be created in this sector by 1972; indirect job creation has not been estimated. As one of the three priority sectors in Morocco's Five-Year Plan (1968-1972), tourism development is an area of major emphasis in the new lending program proposed for Morocco with $45 million earmarked for CIH in the period 1971-1975.

Subsidies for Hotel Construction and Return on Hotel Investment

6. During the time that the Bank staff has been in direct relation with CIH, several major points have been the focus of

Bank concern. Among these is the evaluation of the economic and financial returns on CIH's hotel investments, which were often low. Calculations of the return were complicated by several factors. Some of the data necessary to assess the tourist market and evaluate economic returns in the tourism sector has not been available. The Bank has already discussed with CIH the need for such information and its collection by CIH in 1970.

7. Arriving at an accurate rate of return is also made difficult by the extent of the Government's subsidies for hotel investment. Intended as incentives to attract private investment into hotel construction, the most important of these are an equipment grant of 10-20 percent of the fixed investment in a hotel project and a Government-paid rebate reducing to 4.5 percent the interest rate of 8.75 percent on CIH's long-term hotel loans. Until the effects of the existing subsidies have been examined in depth, the CIH has tentatively agreed not to lend to hotel projects with a financial rate of return on the hotel investment of less than 10 percent, and this will be confirmed during negotiations.

8. As presently agreed with the CIH, the rate of return to be used in evaluating hotel projects is defined as the rate at which the discounted financing of the project is equated to the discounted net receipts throughout the estimated life of the project. The corresponding calculations are made according to the standard discounted cash flow method. Net annual revenue is defined as the difference betweeen the actual annual total of receipts of the hotel being financed and the actual annual total of all operating expenses related to it but excluding usual expenditures devoted to conservation of the assets, their upkeep and repair, their depreciation and the financial charges. The financing of the project is defined as the sum of the borrower's input, the equipment grant from the Government, and the loan from CIH. Refinements in the definition of the rate of return and the basis for its calculation will be discussed during loan negotiations. In particular, the utility of including the land in the investment cost should be explored and the treatment of maintenance costs be made more explicit. Agreement will be sought from CIH to apply to all hotel projects on a continuing basis the rate of return worked out with the Bank.

9. As part of the next Bank economic mission to Morocco (scheduled for April 1970), the interest rate of both BNDE and CIH, and their economic effects, will be examined together with the effects of other governmental incentives for industry and tourism investments. The nominal rate of 8.75 percent chargeable to hotel investors on long-term loans from CIH is possibly reasonably close to the true rate for the economy. It is the interest rebate of 4.25 percent on the nominal rate, plus the other subsidies to hotel investors that may actually be distorting influences on the allocation of resources. The Government has expressed its willingness to review and consider the findings of the mission on this issue. This study, with the additional data on tourism earnings to be collected, should permit a more accurate determination of appropriate financial returns on hotel investment and of economic returns.

Debt/Equity Ratio

10. The ratio of CIH's long-term debt to net worth is expected to increase from 8.4:1 in 1968 to 14.6:1 in 1973. Even though housing loans, for which the risks borne by CIH are practically negligible, will continue to constitute a large part of its portfolio, thus allowing for a higher debt/equity ratio than is usual in a first Bank operation with a development finance company, it is not deemed desirable in terms of good financial practice to envisage at this stage a ratio higher than 6:1. There are several ways, as outlined in paragraphs 85-86 of the appraisal report, open to CIH to keep its operations within the limit. We intend to outline these to CIH and the Government, and press for early action to improve CIH's debt/equity position.

Future Lending to CIH

11. In keeping with the conclusion reached by the Loan Committee at its meeting of November 5, 1969, (LM/M/69-51) the proposed $10 million loan is intended to provide resources for the CIH for one year to allow time for the Bank to work out with CIH the needed improvements in the institution's performance and with the Government the questions on interest rates and investment return discussed above. Meanwhile, it

is expected that the notional rate of return of 10 percent to be used by CIH in evaluating hotel projects will prevent its resources from being misallocated. Assuming that satisfactory solutions will be reached to these problems, the Bank lending program anticipates recurrent loans to the CIH over the next five years to assist Morocco in meeting its needs to expand hotel capacity.

Recommendation

12. I recommend that the Bank invite CIH and the Government of Morocco to send representatives to negotiate a loan of $10 million equivalent to CIH, to be guaranteed by the Government, substantially in accordance with the recommendations set forth in paragraphs 91-96 of the attached appraisal report.

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

Population: 15 m.
Per Cap GNP: $ 205

Attachment 1

MOROCCO - ACTUAL AND PROPOSED LENDING THROUGH FY 1975

($ millions)

		through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	total 1954-1968	total 1969-1973	total 1971-1975
Agriculture (Sidi Slimane Irrigation).	IBRD			17.5													
Agriculture (Sebou Irrigation)	IBRD								45.0								
Agricultural Credit I	IBRD				10.0												
Agricultural Credit II)	IBRD									7.0							
" ")	IDA									3.0							
Agricultural Credit III)	IBRD											5.0					
" ")	IDA											5.0					
Agricultural Credit IV)	IBRD													8.0			
" ")	IDA													7.0			
Agricultural Unidentified I)	IBRD											7.0					
" ")	IDA											8.0					
Agricultural Unidentified II)	IBRD												15.0				
" ")	IDA												10.0				
Agricultural Unidentified III	IDA													13.0			
BNDE I	IBRD	15.0															
BNDE II	IBRD				17.5												
BNDE III	IBRD							15.0									
BNDE IV	IBRD								15.0								
BNDE V	IBRD									18.0							
BNDE VI	IBRD											20.0					
BNDE VII	IBRD													22.0			
CIH Hotel Financing I	IBRD								10.0								
CIH Hotel Financing II	IBRD									15.0							
CIH Hotel Financing III	IBRD											15.0					
CIH Hotel Financing IV	IBRD													15.0			
Education I	IDA				11.0												
Education II	IDA									10.0							
Education III	IDA												10.0				
Sidi Cheho hydroelectric	IBRD										12.0						
Roches Noires Power	IBRD												15.0				
Roads I)	IBRD								7.3								
")	IDA								7.3								
Roads II)	IBRD											5.0					
")	IDA											5.0					
Safi Port	IBRD										5.0						
Water Supply I)	IBRD										10.0						
" ")	IDA										10.0						
Water Supply II	IBRD												10.0				
	IBRD	15.0	-	17.5	27.5	-	-	15.0	78.3	40.0	27.0	52.0	40.0	45.0	45.0	212.3	204.0
	IDA	-	-	-	11.0	-	-	-	7.3	13.0	10.0	18.0	20.0	20.0	11.0	48.3	81.0
	Total	15.0	-	17.5	38.5	-	-	15.0	85.6	53.0	37.0	70.0	60.0	65.0	56.0	260.6	285.0
	No.	1	-	1	3	-	-	1	4	4	3	5	4	4	4	17	20
IBRD loans outstanding																	
- including undisbursed		15.0	15.0	32.1	58.9	57.5	55.7	66.9	141.0	176.0	198.0	243.0	275.0	309.0			
- excluding undisbursed		0.0	2.6	7.0	16.7	25.0	30.0	41.9	53.0	67.0	102.0	135.0	159.0	200.0			
IDA credits outstanding																	
- including undisbursed		-	-	-	11.0	11.0	11.0	11.0	18.0	31.0	41.0	59.0	79.0	99.0			
- excluding undisbursed		-	-	-	0.0	0.0	0.5	1.1	6.0	22.0	25.0	34.0	47.0	61.0			

EMENA
1/19/73

Form No. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

Oliver

CONFIDENTIAL

LOAN COMMITTEE

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January 30, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Chile - Second Highway Construction Project

1. The Committee is requested to consider, without meeting, the attached memorandum of January 30, 1970 from the South America Department, entitled "Chile - Proposed Bank Loan to the Republic of Chile for a Second Highway Construction Project" (LC/O/70-8).

2. Comments, if any, should be sent to reach Mr. Shibusawa (ext. 4767) by 5:00 p.m. on Wednesday, February 4.

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 when agreement has been reached on a suitable railroad action program as indicated in paragraph 2 of the attached memorandum.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

CONFIDENTIAL
LC/O/70-8

January 30, 1970

DECLASSIFIED
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LOAN COMMITTEE

Memorandum from South America Department

CHILE - Proposed Bank Loan to the Republic of Chile for a Second Highway Construction Project

1. Attached is appraisal report No. PTR-38 recommending a Bank loan of US$10.8 million to the Republic of Chile to assist in the financing of a highway construction project. The proposed loan will be the fifth operation in the highway sector and second for highway construction. The first two investments were made simultaneously by the Bank and IDA in 1961: they were a US$6.0 million loan (287-CH) for road maintenance equipment and an IDA US$19.0 million credit (4-CH) for highway reconstruction and improvement. The third loan (US$11.6 million) was made in 1968 in support of a four-year highway maintenance program. The initial studies for the roads included in the proposed loan were financed by a technical assistance grant of US$210 thousand which was made by the Bank in 1966.

2. We stated in our memorandum to the Loan Committee (LC/O/69-110) of December 17, 1969 that the proposed loan will be related to a program for improving the efficiency and the financial performance of the State Railroads. We have now prepared a draft letter on improvement of railroad organization and operation (attached). The five principal points covered in the draft letter are: (i) measures for the improvement of operational efficiency; (ii) studies and actions to be taken on uneconomic branch lines; (iii) a moderate tariff increase (in real terms) during 1970 accompanied by a comprehensive review of the tariff structure which should form a basis for tariff policy after 1970; (iv) a reduction in the number of surplus employees; and (v) the investment program for 1970. It is our intention to enter into negotiations for the proposed loan only after reaching substantial agreement with the Government on the draft letter on railroad policy. The Transportation Projects Department is in agreement with this proposed approach but would not insist on items (iii), (iv) and (v) above as preconditions for lending for highways. The South America Department, on the other hand, would like to reserve its judgement concerning these points until the discussions with the Chilean authorities on the draft letter have taken place. In any case, disagreement is probably more likely on early action to discontinue service on certain uneconomic branch lines than with respect to tariff increases, reduction in the number of surplus employees and the 1970 investment program. Both the South America and Transportation Projects Departments feel it is important to obtain commitments on such action. Provided agreement is reached with the Chilean authorities on the draft letter, the loan would be presented to the Board before the end of FY 1970. The five-year lending program (FY70-FY74) is attached.

Economic Performance

3. The proposed highway project, the second vocational training project (LC/O/69-110) and the secondary education project are the only three loan operations now envisaged for Chile in Fiscal 1970. They would total $19.7 million. The recent economic mission has confirmed that Chile in 1969 broadly met the performance conditions established in August 1968 (EC/O/68-81/1) which called for (a) maintenance of a flexible exchange rate policy; (b) continued limitation on short and medium term external debt; (c) actions in the area of fiscal, incomes and monetary policies to limit the rate of inflation to no more than 30 to 40 percent a year; and (d) financing of 60 to 70 percent of public investment from public savings. During 1970 the balance of payments situation is likely to be far more favorable than previously anticipated because of higher than expected copper prices, increases in copper production and exports resulting from accelerated implementation of the copper expansion program and the effect of the new agreements with the copper companies which provide the Government with a greatly increased share of earnings. However, the fact that the Government, under military pressure recently agreed to a very sizeable increase in military pay will result in a sharp rise in current expenditures. Performance in the areas of incomes and fiscal policy is thus expected to deteriorate during 1970 and even assuming a degree of import liberalization, price inflation is likely to exceed the 1969 level of about 30 percent. We shall be discussing with the Government those policy choices affecting 1970 on which decisions have not yet been made, especially import liberalization. Given the substantial improvement in the medium term outlook for the balance of payments, the appropriateness of the performance criteria approved in 1968 as well as the rationale for future Bank lending to Chile will be reassessed in the country program now being prepared.

The Project

4. The proposed project consists of: (i) the construction and improvement of 4 sections of primary and secondary roads in Chile, totaling 154 kilometers, (ii) construction supervision for the above; and (iii) studies for future highway projects. The proposed Bank loan of US$10.8 million would finance the presently estimated foreign exchange cost (i.e. imported equipment and materials as well as consulting services). The Government would finance the local cost estimated at US$13.0 million equivalent. To insure the availability of local funds for the project, an agreement would be sought from the Government during the negotiations for the creation of a project revolving fund into which periodic deposits would be made based on scheduled progress of construction. The amount in the fund should be sufficient to cover three months of project costs in accordance with the work schedule.

Recommendation

5. I recommend, and the departments concerned concur, that the Bank inform the Chilean Government that it is prepared to enter into formal negotiations for a loan of US$10.8 million as soon as agreement is reached on a suitable railroad action program as indicated in paragraph 2 above.

Gerald Alter
Director

Attachments

Attachment

CHILE

BANK LENDING PROGRAM
($ Million)

Sector	FY 1965 and Prior	FY 1966	FY 1967	FY 1968	FY 1969	Total to FY 1969	FY 1970	FY 1971	FY 1972	FY 1973	FY 1974	Total FY 1970-1974
AGRICULTURE	4/27.8 1/	-	-	-	-	4/27.8	-	2/45	1/10	1/15	1/15	5/85
Agricultural Credit (Agrarian Reform and Livestock Development)	-	-	-	-	-	-	-	30	-	15	15	-
Irrigation	-	-	-	-	-	-	-	15	-	-	-	-
Fruit Development	-	-	-	-	-	-	-	-	10	-	-	-
COAL MINING	2/21.8	-	-	-	-	2/21.8	-	-	-	-	-	-
EDUCATION	-	1/2.75	-	-	-	1/2.75	2/8.9	-	-	-	1/3	3/11.9
Secondary Education	-	-	-	-	-	-	7.4	-	-	-	-	-
Vocational Training	-	-	-	-	-	-	1.5	-	-	-	3	-
ELECTRIC POWER	4/65.4	-	1/60	-	-	5/125.4	-	-	1/15	-	-	1/15
ENDESA Expansion	-	-	-	-	-	-	-	-	15	-	-	-
INDUSTRY	1/20	-	-	-	-	1/20	-	-	1/15	-	-	1/15
Industrial Development Bank	-	-	-	-	-	-	-	-	15	-	-	-
TRANSPORTATION	1/19.0	-	-	-	1/11.6	2/30.6	1/10.8	2/25	-	2/25	-	5/60.8
Road Construction	-	-	-	-	-	-	10.8	-	-	15	-	-
Highway Maintenance	-	-	-	-	-	-	-	-	-	-	-	-
Ports	-	-	-	-	-	-	-	10*	-	10	-	-
Railroad Rehabilitation	-	-	-	-	-	-	-	15	-	-	-	-
TOTAL	12/154.0	1/2.75	1/60	-	1/11.6	15/228.35	3/19.7	4/70	3/40	3/40	2/18	15/187.7
Bank	11/135.0	1/2.75	1/60	-	1/11.6	14/209.35	3/19.7	4/70	3/40	3/40	2/18	15/187.7
IDA	1/19	-	-	-	-	1/19	-	-	-	-	-	

1/ Includes $445,500 cancelled from Loan No. 49-CH.

* Sector condition for this under discussion in the Bank and with Chilean authorities.

January 20., 1970
South America Department

Draft Letter on Railroad Organization and Management

I. Introduction

Chilean State Railways (CSR) is one of the largest enterprises in Chile, and there is a vital public interest in how its services are performed. The Government recognizes that the public interest can best be served if CSR is organized, managed and operated in accordance with sound economic and financial principles. The objectives of public policy are therefore twofold: first, to ensure that CSR is a modern, efficient railway capable of performing its proper economic role within Chile's overall transport system and second, to enable CSR to become financially self-sufficient. These two objectives are in practice closely related, since the prospect of continued subsidies inevitably undermines the incentive towards greater operating efficiency. The purpose of the present letter of intent is to describe specific targets for improvement in the field of railway organization operations that have been set to achieve those objectives.

Chile has undertaken a series of studies in the transport sector with the assistance of the UNDP and the IBRD. These studies were carried out over a period of one and a half years and included investigations of the problems of transport coordination, railway management and organization, accountancy, budgeting, tariff policy, track maintenance and renewal and rolling stock maintenance. The consultants who have carried out these studies, SOFRERAIL (France), have made useful proposals, with which CSR and the Government substantially agree. The measures proposed by the consultants are major and their implementation will substantially improve CSR's capacity and quality of service.

II. Program of Action

CSR and the Government will take measures, including organizational changes, staff reductions, operational improvements, adjustment of rates and fares, and the closure or rationalization of uneconomic lines and services, so that, by 1972, CSR's operating revenues shall be sufficient to cover its operating expenditures (not including depreciation and debt service), and will continue to improve its operations and effect economies so that by 1975 its operating revenues shall cover total expenditures, including depreciation and debt service.

The most important measures which will be taken by the Government and CSR to improve the performance of CSR are as follows:

(a) Organization and Management

To ensure better coordination between operating Departments at regional level and to keep closer contacts with rail customers, CSR will establish and delegate authority to three Regional Superintendents in charge of the Northern, Central and Southern regions. Appointment, by CSR, of the three Regional Superintendents will be effective by March 1, 1970.

To improve CSR's statistics, a comprehensive and coordinated plan of statistical data has been set up by the consultants and approved by CSR. This plan will become effective by March 1, 1970.

(b) Staff Reductions and Studies

The number of permanent CSR employees (total Northern and Southern networks) was 22,275 at the end of 1968, a decrease of 3,218 or 13 percent since 1961. There is, however, surplus labor in various departments and CSR has decided to make a thorough study of its staff in order to determine actual needs and to draw up a program to correct existing distortions. To that purpose, and based on the organization already set up in the Transportation Department for determination of staff at each station, manpower study units will be created and introduced in each Department not later than March 1, 1970. The objective of these units is to establish concrete targets for personnel reduction. The overall target for 1970 is to reduce the number of personnel by at least 600, with increased reductions in coming years as necessary to allow CSR to meet its financial targets. The Government will give adequate authority to CSR's management to dismiss or retire workers, and will adopt a suitable program for removing or retraining the excess labor force.

(c) Operational Improvements

Among the most important measures the CSR will take to improve train operations and give a better quality of service to rail customers are the setting up of a transportation plan for freight and passenger, a modification in the less-than-carload (LCL) organization, a review of the car allocation system, and a reorganization of switching services, all along the lines recommended by the consultants. Implementation of these new operating measures on the Southern network, as a first focus, will become effective not later than March 1, 1970; extension to the whole network will be made as soon as possible.

With the objective of improving utilization of motive power and rolling stock, CSR has decided:

- by March 1, 1970, to apply periodic maintenance cycles for motive power and rolling stock, together with a coordinated spare-parts supply program;
- by December 31, 1970, to extend the new system of stores procurement, already applied to five depots, to all depots;
- by December 31, 1971, to concentrate and specialize workshops, together with a detailed organization of repair work in order to perform each maintenance operation in the most efficient manner.

CSR will also extend periodic track maintenance work to the entire Southern network, as a first focus, by March 1, 1970.

(d) Rate Policy

CSR has decided to intensify the cost studies now under way with the objective to determine the relevant economic costs of handling key traffic commodities by December 1970. This will be the basis of the pricing policy which will aim at the commercial principle that rates and fares should be sufficient to cover at least the short-run marginal costs of transporting each commodity and each type of passenger traffic, and the full costs of carrying the traffic, as a whole. If, in exceptional circumstances, the Government should deem it necessary that certain services be provided at less than cost, the resultant subsidy shall not be a burden to the CSR, but will be paid for by the appropriate ministry or agency of the Government.

During 1970, and pending the findings of the cost studies, CSR will at a minimum increase its freight rates and passenger fares so as to achieve an average increase in real terms of 3.5 percent and 3.8 percent respectively. In subsequent years, and following the results of the cost studies, rate adjustments, together with other measures such as personnel reduction and improvement in operating efficiency, will be made as necessary to meet the financial targets of CSR.

(e) Closure or Rationalization of Uneconomic Lines

A substantial part of the present network is uneconomic and will remain so in the foreseeable future. The Government intends to close all uneconomic lines where studies indicate that the traffic can be carried at lower cost by another transport mode. The Government has decided to adopt the following procedures for study and action to be taken: Studies will be initiated by CSR to determine, with the most recent data available, the annual net financial savings to be obtained by the closure or rationalization of a line (the net financial savings are equal to the costs that could be avoided by partial or total discontinuance of services minus the revenues which are lost due to such actions). Where there are net savings, CSR will apply for Government permission to close or rationalize the service. CSR's application will be studied by the Government. In Phase I of the study, the annual avoidable expenses of CSR will be compared with the annual incremental cost of highway transport to haul the traffic now being carried by the railroad. If the highway incremental cost is not more than 50 percent of the avoidable railway expenses, the study will conclude at that point with the recommendation that railway service should be discontinued. If incremental highway cost is above 50 percent of the avoidable railway expenses, the study will continue to Phase II, which will be based on a traffic projection for a 15 year period and estimates of investments required by rail and road transport during such period for an efficient operation.

Annex 1 gives a list of 23 branch lines divided into three groups:

- Group 1, comprising 5 lines already studied by CSR and which are considered to be the most obvious cases for total discontinuance of railway services. Closure of these lines, or discontinuance of service, is to be carried out before December 31, 1970;

- Group 2, comprising 5 lines: CSR's study will be completed by November 1, 1970;
- Group 3, comprising 13 lines: CSR's study will be completed by November 1, 1971.

According to the findings of each study for Group 2 and 3 lines, and subsequent review which takes account of alternative modes of transport, the Government intends to take appropriate action within six months of the completion of the study by CSR, including measures to provide alternative road service where required.

(f) Investment Plan

The 1970 investment plan will be revised by CSR to concentrate capital investments mainly on modernization of workshops and on track rehabilitation; no additional commitment will be made for motive power and rolling stock; electrification of Laja-Temuco will be postponed.

By mid-1970, CSR will prepare a revised five-year investment plan taking into account the effect of the measures taken to improve operational efficiency. This revised investment plan will give first priority to rehabilitation of track and workshops; estimation of needs of equipment of all types will take into consideration the commitments already made as well as the material on hand; further electrification will be restudied and based on full economic justification.

(g) Valuation and Depreciation of Assets

Accounting procedures will include the charging of depreciation as an item of expense, and the basis of revaluation of fixed assets will be examined in order to establish that depreciation is calculated only on depreciable assets that should be replaced at the end of their useful lives.

Obsolete stocks will be written down in value and will be sold where possible; an aggressive policy will be adopted for the sale of scrap material.

FORM No. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LC/M/70-1

January 30, 1970

Minutes of Loan Committee Meeting held at 3:00 p.m. on Monday, January 19, 1970 in Room C1006

A. Present:

Mr. S.R. Cope, in the Chair	Mr. E. Gutierrez
Mr. A. Broches	Mr. K.D. Hartwich
Mr. B. Chadenet	Mr. C.G. Melmoth
Mr. B.M. Cheek	Mr. F.R. Poore
Mr. R.H. Demuth	Mr. A. Stevenson
Mr. L.J.C. Evans	Mr. G.K. Wiese
Mr. R.J. Goodman	Mr. J.H. Williams
Mr. R. Gulhati	Mr. D. Pearce, Secretary

In Attendance:

Mr. W.C. Baum	Mr. R.E. Rowe
Mr. D.J. Fontein	Mr. B.G. Sandberg
Mr. D.M. Gold	Mr. D.M. Sassoon
Mr. J. Foster	Mr. G.M. Street
Mr. M.L. Hoffman	Mr. W.A. Wapenhans

B. Malaysia - Second Jengka Triangle Project

1. The Committee considered a memorandum dated January 16, 1970 from the East Asia Department entitled "Malaysia - Second Jengka Triangle Project" (LC/O/70-3) and the accompanying appraisal report (PA-31 dated January 9, 1970) which recommended two loans totalling $21 million, comprising: (a) $13 million to help finance the second stage of land settlement in the Jengka Triangle, and (b) $8 million to cover the foreign exchange costs of a forest industry complex. The estimated total cost of the land settlement project, comprising the clearing of about 32,000

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

acres of forest and the planting of 16,800 acres of oil palms, 13,650 acres of rubber and 700 acres of other crops, was \$28.5 million of which approximately \$7.2 million, including interest on the proposed Bank loan during the estimated seven year disbursement period, represented the foreign exchange component; the proposed \$13 million loan would thus include about \$5.8 million of local expenditure financing. The estimated total cost of the forestry project, comprising equipment, a sawmill and buildings for the extraction, processing and marketing of lumber, was \$11.8 million, of which \$8 million represented the foreign exchange component and the amount of the proposed loan.

2. During its review of the proposed land settlement project, the Committee noted that:

(a) Apropos the market prospects for rubber and oil palm, the Economics Department regarded the projections contained in Annexes 13 and 14 of the appraisal report, which forecast a drop in current prices by the mid-1970's, as still valid. Estimates of project earnings and settlers' incomes were based on these assumptions of longer-term lower prices which would nevertheless yield economic rates of return of 18% and 11% for oil palm and rubber respectively.

(b) The basis for determining the management levy to be paid by the settlers, which would be on a sliding scale geared to possible fluctuations in commodity prices and thus to settlers' incomes, would be agreed with the Government and the Federal Land Development Authority (FLDA) during negotiations of the proposed loan.

(c) Procurement would be undertaken on the basis of international competitive bidding and local manufacturers would be allowed a 15% margin of preference or the customs duty whichever was lower. In evaluating bids, duties on imported components of locally manufactured goods in excess of 15%, provided they were in fact payable, could be waived if the Government so requested - this facility was in line with the more flexible policy on preferences for domestic suppliers recently approved by the Executive Directors.

(d) The proposed local expenditure financing of $5.8 million was justified on the country economic grounds indicated in the Area Department's memorandum. In addition, a Bank loan representing a reasonable proportion of project costs (in this case 45%) was necessary to ensure adequate Bank leverage on the project. However, it was noted that these project considerations were a subordinate argument for local expenditure financing and it was suggested that the appraisal report be amended accordingly.

3. In considering the proposed forestry project, the Committee noted that:

(a) The establishment of an efficient and profitable forestry complex, together with the development of markets for Malaysian forest products, was an issue on which the Bank had previously made representations to Malaysia. The project's 'demonstration' effect would lead to better future utilization of Malaysia's other forest resources. This was an important benefit not included in the project's estimated economic rate of return of about 33%.

(b) The rate of return calculation did not include a factor for 'capital consumption' (i.e. for the costs of replanting trees) since logging would be on a selective "sustained yield" basis.

4. The Committee approved the Area Department's recommendation that representatives of the Government, the Federal Land Development Authority and the Majlis Amanah Ra'ajat be invited in due course to Washington for negotiations of the two loans in accordance with terms and conditions specified in the appraisal report.

C. <u>Adjournment</u>

5. The meeting adjourned at 3:50 p.m.

Secretary's Department
January 30, 1970

FORM NO. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 27, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Pakistan - Industrial Development Bank of Pakistan Project

Attached for information is a memorandum from the Director of the South Asia Department to the Deputy Chairman of the Committee, dated January 26, 1970, transmitting for approval the draft Report and Recommendation of the President on a proposed credit for the Industrial Development Bank of Pakistan project.

David Pearce
Secretary
Loan Committee

\- DISTRIBUTION -

Committee:

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

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Mr. M. Shoaib, Vice President
Directors, other Departments
Special Adviser to the President
Executive Vice President (IFC)
Vice President (IFC)

INTERNATIONAL DEVELOPMENT ASSOCIATION

OFFICE MEMORANDUM

TO: Mr. S.R. Cope January 26, 1970

FROM: I.P.M. Cargill

SUBJECT: PAKISTAN - Industrial Development Bank of Pakistan Project

1. Attached for your approval are copies of (i) the draft Report and Recommendation of the President on a proposed credit to the Islamic Republic of Pakistan for the Industrial Development Bank of Pakistan Project; (ii) the draft Credit Agreement; (iii) the draft Project Agreement; (iv) the draft Supplemental Letters, and (v) the draft Subsidiary Loan Agreement.

2. We are planning to distribute the Report and Recommendation of the President and the Appraisal Report to the Executive Directors on January 29 so that the project can be considered on February 10.

3. The Appraisal Report (No. DB-58) was distributed to the Loan Committee on December 8, 1969, together with a memorandum from the Area Department (No. LC/O/69-107) proposing that the Association consider making a credit of US $20 million to be relent by the Islamic Republic of Pakistan to the Industrial Development Bank of Pakistan (IDBP) on the terms normally applied to the Bank's lending to development finance companies. The Appraisal Report contained a number of recommendations as to IDBP's operations and certain Government policies. The following paragraphs set out the results of the negotiations.

4. The four matters to be included in the statement of policy were agreed to, with minor alterations, and were included in the Supplemental Letter from the Government and IDBP.

5. The recommendation that there should be prior consultation on changes in the managing directorship met with considerable resistance. It was agreed that the requirement of prior consultation should be dropped from the Credit Agreement. Instead, it was agreed that I would write to the Secretary of Finance putting on record our understanding that the Association would be consulted when any new appointment was under consideration. Accordingly I wrote to him on January 21, 1970.

6. A free limit of US $200,000 had been recommended, with an aggregate free limit of US $5 million equivalent. IDBP requested a higher aggregate free limit and it was agreed to increase it to US $6 million equivalent.

7. A list specifying the "administered loans" was agreed and the Government has given assurances by Supplemental Letter that it assumes responsibility for the payment to IDBP of all amounts due to IDBP in respect of, or on account of, such loans. Existing arrears will be cleared in accordance with a phased program of repayment to be completed not later than June 30, 1975. Future arrears in respect of any loans which continue in default for more than six months will be cleared promptly.

8. IDBP confirmed that the refinancing of Sui Northern Gas Pipeline debentures had been effected by extending the arrangements with the State Bank. The Appraisal Report had also recommended that arrangements should be worked out for IDBP to obtain an increased fee for administering the loan. We did not insist on the point; for although the fee is low, the investment itself involves little risk to IDBP.

9. The Government recognized the need to streamline the machinery for financing small industries and agreed to formulate appropriate measures to this end, thereby enabling IDBP to terminate its operations with the East and West Pakistan Small Industries Corporations as soon as practicable. The Appraisal Report had recommended that a period for accomplishing this should be agreed during negotiations. In view of the uncertainties surrounding the constitutional changes to take place in Pakistan, it was decided not to insist on a fixed period.

10. Agreement was reached on the other matters recommended in the Appraisal Report, which remains substantially unchanged except for the modifications mentioned above. (A copy is attached).

11. The draft Report and Recommendation of the President, the draft Agreements and this Memorandum have been cleared with the Development Finance Companies Department, the Controller's Department and the Legal Department.

12. It is proposed that Mr. McCulloch of this Department present the Credit to the Executive Directors. His theme will be the Bank Group's role in industrial financing in Pakistan.

13. I would appreciate your giving any comments you may have to Mr. McCulloch (Ext. 2113).

Attachments

cc: Mr. McNamara
Loan Committee (no attachments)

Iran

FORM NO. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 27, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Iran - Agricultural Development Fund of Iran (ADFI)

Attached for information is a memorandum from the Director of the South Asia Department to the Deputy Chairman of the Committee, dated January 27, 1970, transmitting for approval the draft Report and Recommendation of the President on a proposed loan to the Agricultural Development Fund of Iran (ADFI).

David Pearce
Secretary
Loan Committee

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Committee:

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

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

OFFICE MEMORANDUM

TO: Mr. S.R. Cope DATE: January 27, 1970

FROM: I.P.M. Cargill

SUBJECT: Iran - Proposed Loan to the Agricultural Development Fund of Iran under the Guarantee of the Government of Iran

1. I attach for your approval a copy of the draft Report and Recommendation of the President on a proposed loan of US$6.5 million equivalent to the Agricultural Development Fund of Iran (ADFI). The Government of Iran will be guarantor. Draft Loan Agreement and Guarantee Agreement are also attached.

2. May I invite your attention to Section 5.01(a) of the Loan Agreement. This clause required that ADFI make adequate provision to protect itself against losses resulting from changes in the exchange rate between rials and the currency or currencies in which loan service is to be met. ADFI has informed the Bank that it intends to pass on this risk to its sub-borrowers in a manner similar to that employed by the Industrial and Mining Development Bank of Iran. The Agriculture Projects Department and this Department consider the proposal adequate.

3. During negotiations the Bank agreed to consider financing of the foreign exchange component of ADFI loans made after December 1, 1969 provided the loan would be signed within a reasonable time period. With the submission of this loan to the Executive Directors in February, in my opinion, this condition has been met.

4. Also during negotiations it was agreed that ADFI appoint an Executive Vice President and an internationally recruited adviser prior to signing. The Executive Vice President will be appointed prior to signing. Because of difficulties in finding a suitable individual, the adviser has not yet been officially designated. Dr. Ameri, the President of ADFI, is negotiating with a candidate satisfactory to the Bank, who will be able to take up the duties of this position only on September 1, 1970. In the light of this development, we and the Agriculture Projects Department have agreed that keeping the appointment of an adviser as a condition of signing would be inappropriate. We will receive an undertaking in the form of a letter from ADFI to enter into a contract with a candidate satisfactory to the borrower and the Bank within six months of signing.

5. In my memorandum to you of September 25, 1969, I expressed certain reservations about the measures the Agriculture Projects Department proposed to control ADFI's lending operations. Satisfactory compromise provisions are

included in the grey cover Appraisal Report (PA-23a) which also includes an analysis of the distribution of income that is expected to accrue to beneficiaries of sub-loans made under the project. No other major substantive changes have been made in the green cover Appraisal Report (PA-23 of August 28, 1969) which was circulated to the Loan Committee on October 3 under cover of an Area Memorandum LC/O/69-84.

6. The Economic Report, "Economic Situation and Prospects of Iran", (SA-8a), was distributed to the Executive Directors on January 7, 1970.

7. Mr. Eschenberg will present this Loan to the Executive Directors; the theme of his presentation will be recent agricultural policy in Iran.

8. The President's report has been cleared by the Departments concerned. I will be grateful if you will give your comments to Mr. Clevenger (ext. 2648).

Attachments

cc: Mr. McNamara
Loan Committee (without attachments)

Form No. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

LM/M/70-3

January 27, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Mexico - Third Power Sector Program" held on January 13, 1970, in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

LM/M/70-3

January 27, 1970

Minutes of Special Loan Meeting to discuss "Mexico - Third Power Sector Program" held at 12:30 p.m. on January 13, 1970, in Conference Room B.

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1. Present: Messrs. Knapp (Chairman), Aldewereld, Cope, Chadenet, Gutierrez, Weiner, E.P. Wright, Sella, Cancio, Nelson, Sheehan, Ribi and Pearce (Secretary).

2. Issue: The meeting had been called to resume discussion of the Bank's position concerning the measures to be taken by the Mexicans to implement the first phase of a frequency unification program as part of a project comprising the 1970-71 investment program of the Mexican power sector. Following a Special Loan Meeting on January 9, (LM/M/70-2 of January 27), the Chairman had met with the Mexican delegation on January 12. However, the Mexicans had felt unable to modify the position reached during the preceding week's negotiations of the proposed \$125 million loan for the project. The issue for discussion therefore was whether the Bank should pursue the problem further with the Mexican Government at a higher level, in an attempt to resolve the basic policy questions affecting the implementation of the frequency unification program; or whether the Bank should accept the Mexicans' plans for the program even though the method proposed was not entirely satisfactory.

3. Discussion: The Public Utilities Projects Department reported that, immediately preceding this meeting, the Mexicans had offered an additional assurance of their determination to proceed with frequency unification by indicating that the regulations to be promulgated by the Minister of Industry and Commerce concerning the frequency changeover would include a provision that all new industrial consumers and large housing developments within economic distance of the new 60 cycle outer-ring would be connected at that frequency.

4. The Central America and Caribbean Department took the view that the choice between the alternatives of a show-down with the Mexicans on frequency unification and acceptance of the Mexicans' proposals as they stood was finely balanced. It was most unlikely that the Comision Federal de Electricidad (CFE) could obtain the external financing needed for its program without the Bank's support and, if the Bank stood firm, the Mexican Government would probably be forced to bring Centro's management and the trade unions into line and to push ahead faster with the initial conversion of frequencies along the lines proposed in the Master Plan. However, there was always the risk that a confrontation between

the Bank and the Mexican authorities on this issue might have consequences prejudicial to the objectives the Bank had in mind. If the Bank decided to go along with CFE's proposals, which appeared to have the backing of the Minister of Finance, the Area Department questioned the desirability of including any covenant on frequency unification in the Guarantee Agreement on the grounds that, as with the two previous loans to the Mexican power sector, such a covenant would in practice be unenforceable and thus ineffective.

5. The Public Utilities Projects Department reiterated its view that, if additional meaningful undertakings were to be required of the Mexicans, they should imply a return to an area rather than a customer approach to frequency unification, which the Mexicans had already said they could no longer accept.

6. The Director-Projects, reviewing the history of the Bank's association with the Mexican power sector, said that the importance of the frequency unification program was clear. Following the meeting with the Mexican delegation on January 12, however, he now doubted the utility of the proposed high level meeting with the Government; moreover, in view of the change of administration which would take place in December, 1970, it was unlikely that the Mexicans could reach meaningful decisions on these sensitive issues much before the end of 1971 which was too long to wait for both the Bank and the Mexicans. On balance, the Director-Projects said that he favored proceeding with the proposed loan. The Chairman expressed agreement with his views.

7. Decision: It was decided that the Bank should accept the Mexicans' proposals for the implementation of the frequency unification program and, following the promulgation by the Mexican Minister of Industry and Commerce of the regulations concerning the changeover, that the proposed loan should be presented to the Executive Directors for approval. The Guarantee Agreement should contain a provision with respect to performance of the 1970-71 investment program, which would be supplemented by a letter from the Bank, to be sent to the Mexicans now or after loan approval, indicating the importance which the Bank attached to adherence to the frequency unification program.

David Pearce
Secretary

Cleared by: Messrs. Knapp
Chadenet
Weiner/Sheehan
Wright/Nelson
Cancio

cc: Loan Committee
Participants

FORM NO. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

Ah/on

CONFIDENTIAL

LOAN COMMITTEE

LM/M/70-2

January 27, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Attached for information are the Minutes of a Special Loan Meeting to discuss "Mexico - Third Power Sector Program" held on January 9, 1970, in Conference Room B.

David Pearce
Secretary
Loan Committee

- DISTRIBUTION -

Committee:

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

Copies for Information:

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

LM/M/70-2

January 27, 1970

Minutes of Special Loan Meeting to discuss "Mexico - Third Power Sector Program" held at 3:00 p.m. on January 9, 1970, in Conference Room B.

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1. Present: Messrs. Knapp (Chairman), Aldewereld, Cope, Chadenet, Weiner, E.P. Wright, Sella, Cancio, Nelson, Sheehan, Ribi and Pearce (Secretary).

2. Issue: The meeting had been called to review the status of negotiations for a proposed $125 million loan to the Comision Federal de Electricidad (CFE) and Nacional Financiera (NAFIN), which would make available part of the loan to Compania de Luz y Fuerza del Centro (Centro), for a project comprising the 1970-71 investment program of the Mexican power sector. The main issue for discussion concerned the proposed conversion of the Central (Mexico City area) 50 cycle frequency system to 60 cycles (cf. paragraph 4(c) of Western Hemisphere Department memorandum LC/O/60-105 dated December 3, 1969 and paragraphs 3.02-3.06 of draft appraisal report No. PU-27 dated November 24, 1969), in particular the Bank's position with respect to the measures to be taken by the Mexicans to implement the first phase of the frequency changeover as a condition of the proposed loan.

3. Discussion: The meeting was told that the Guarantee Agreement for the previous Mexican power loan (544-ME) had included a covenant to ensure timely initiation and completion of the first phase of the frequency unification program, but performance in this respect during the past year had been disappointing. While the Bank and the Mexicans were apparently agreed on the objectives and benefits of the program, the Mexicans had once again changed the schedule for its implementation and were now also proposing a different approach for the initial conversion. The Mexicans' revised proposals during the negotiations now in progress were unsatisfactory because they did not adequately guarantee better performance in the future; in particular, they did not represent concrete actions to proceed with frequency unification on an area by area basis.

4. The meeting noted that the Mexicans' problems with respect to the frequency unification program were essentially domestic political ones, involving both management and labor unions. While Centro's unions had, in January 1969, pledged to support integration of the power sector in general (i.e. a merger between CFE and Centro) and the conversion of Centro's frequency system in particular, the Mexican authorities had so far failed to confront this sensitive issue. Moreover, the possibility of decisive action in both areas in the near

future appeared slight in view of the forthcoming change in the Mexican administration scheduled for December, 1970. On the other hand, the Bank's previous experience with this problem in Mexico and the importance of timely frequency unification to the proposed project rendered it difficult and undesirable for the Bank to soften its position at this stage.

5. The meeting reviewed at some length the facts of the frequency unification program. The Public Utilities Department, noting that the 1970-71 investment program of $491 million was based on assumptions concerning frequency unification, said that its benefits which, if anything, were understated in the appraisal report, would be substantial. Savings of the order of $200-300 million (at current prices) over 25 years were projected, representing a return on investment of 15-20%. The Mexicans' alternative proposals for implementing the program, while producing the same ultimate benefits, would be slower and less efficient and, unlike the previous plan accepted by the Bank, would not provide a strong assurance that the frequency unification program would in fact be completed. Consequently, the Bank's acceptance of the Mexicans' plans would incur the risk of continued delay in the program's implementation.

6. Decision: The Chairman decided that, in order to allow time for both the Bank and the Mexicans to consider the problem further, the negotiations now in progress should be suspended. He would meet with the Head of the Mexican delegation on January 12 and, depending on the outcome, would consider writing a letter stating the Bank's position, to be followed by a high-level Bank mission to Mexico to press the Mexican authorities on this issue.

David Pearce
Secretary

Cleared by: Messrs. Knapp
Chadenet
Weiner/Sheehan
Wright/Nelson

cc: Loan Committee
Participants

Form No. 60
(4-68)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

CONFIDENTIAL

LOAN COMMITTEE

January 27, 1970

MEMORANDUM TO THE LOAN COMMITTEE

Panama - Second Power Expansion Project

1. The Committee is requested to consider, without meeting, the attached memorandum of January 27, 1970 from the Central America and Caribbean Department, entitled "Panama - Proposed Loan to the Instituto de Recursos Hidraulicos y Electrificacion for the Second Power Expansion Project" (LC/O/70-7).

2. Comments, if any, should be sent to reach Mr. Mirza (ext. 3877) by 1:00 p.m. on Friday, January 30.

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, Chairman
Mr. S.R. Cope, Deputy Chairman
Mr. S. Aldewereld, Vice President
Directors, Area Departments
Director, Projects Department
General Counsel
Director, Economics Department
Director, Development Services Department
Treasurer

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

CONFIDENTIAL

LC/O/70-7
January 27, 1970

LOAN COMMITTEE

Memorandum from Central America and Caribbean Department

PANAMA - Proposed Loan to the Instituto de Recursos Hidraulicos y Electrificacion for the Second Power Expansion Project

Introduction

1. An appraisal report on the Bayano power project in Panama (PU-28, dated January 16, 1970) is attached hereto for the consideration of the Loan Committee. If approved, this would be the Bank's second loan to the Instituto de Recursos Hidraulicos y Electrificacion (IRHE) and its sixth loan to Panama. All the previous loans, totalling \$18 million net of cancellations, have been fully disbursed, and the amount outstanding at the end of 1969 was \$8 million.

Background

2. This would be the first Bank operation in Panama since 1962 when a loan of \$4 million was made to IRHE for the La Yeguada power project. In the intervening period, discussions have proceeded with the Panamanian Government on various projects in power and transport, including Bayano, but until after the military coup in October 1968 we were unable to get the Government to undertake the institutional reforms needed to provide a satisfactory basis for Bank financing. The agencies concerned, including IRHE, were subject to constant political interference, and management was weak. The new Government, which is effectively controlled by the National Guard and its commander, General Torrijos, has given high priority to raising the level of public investment and to strengthening the public agencies responsible for economic development. As noted in paragraph 5.01 of the attached appraisal report, a new decree was passed in July 1969 reforming the organization and management of IRHE, and this has opened the way to our proceeding with further lending for power.

3. The report of a Bank economic mission, which visited Panama last summer, was considered by the Economic Committee in December and will be distributed to the Executive Directors shortly. A Country Program Paper for Panama was reviewed by the President on January 20, 1970, and a copy of the five-year lending program as approved during this review is attached for information. In addition to the Bayano project, which is scheduled for Board presentation during the current fiscal year, the program includes loans in fiscal year 1971 for a fisheries credit project (\$2.6 million) and the expansion of Tocumen airport (\$9 million). Both projects are at an advanced stage of preparation.

4. The Bank's economic report concludes that, with effective implementation of the fiscal and administrative measures now envisaged by the Government, Panama will be creditworthy for considerable amounts of new external borrowing on conventional terms. The maximum debt service ratio, projected on the basis of existing public debt, is under 4 percent, and Panama should be able to meet its external capital requirements over the next few years, including borrowing for Bayano, without the ratio rising above 7 percent. However, the substantial increase envisaged in public investment over the next few years, in which Bayano is a major element, will call for additional public savings, and we have told the Panamanian Government that we expect new tax measures yielding approximately $9-10 million a year to be taken before the Bayano loan is presented to the Board. We understand that these measures have now been approved by the Cabinet, although we do not yet have full details. In our economic discussions with the Government we have also emphasized the importance of limiting the public investment program to high priority projects which can be effectively implemented, and we propose to discuss this matter further at the time of negotiations. Provided that adequate restraints are maintained on public investment, and provided also that the new tax measures are adopted, roughly two-thirds of the investment program should be financed out of domestic resources through 1972.

5. The present Government of Panama is a <u>de facto</u> government which has now been in power for over a year. It has been recognized by the United States and all other members of the Organization of American States, and although the National Guard has undergone a series of shake-ups, most recently in December when an unsuccessful attempt was made to unseat General Torrijos, the Government appears to be in effective control of the country. When the Government seized power in October 1968, it suspended part of the Constitution, which dates back to the creation of the State in 1903. However, there does not appear to be any constitutional bar to the provisional Government entering into loan agreements with international agencies, and both the United States and Inter-American Development Bank have made loans to it. We have, therefore, concluded that a loan or guarantee agreement with Panama, authorized and ratified by a Cabinet decree of the provisional Government, would represent a valid and binding obligation of Panama which, in accordance with general principles of international law, would have to be honored by any future successor government. In the loan documents, however, we will provide that it will be an event of default if, after the election of a National Assembly, the Borrower and/or the Guarantor shall need any parliamentary authorization or ratification in order to be able to perform any of their obligations under their respective agreements with the Bank, and if then such an authorization or ratification shall not have been obtained.

The Project

6. IRHE's expansion program envisages the construction of the Bayano hydroelectric development with an initial installation of 2 x 50 MW units; a 40 MW steam unit at the existing Bahia Las Minas plant (Las Minas No. 4); 230 kv and 115 kv transmission lines; 6 MW of diesel power; expansion of distribution for the years 1970 through 1972; overseas training for IRHE's staff; and a comprehensive survey of future electric power development in Panama. The total estimated cost of the project proposed for Bank financing, including interest during construction, is US$70.3 million. The proposed Bank loan of US$42.0 million would finance the foreign exchange cost, excluding interest during construction.

7. We have considered the possibility of joint or parallel financing for this project, but after consultation with the Chairman of the Loan Committee, decided to propose only Bank financing because the construction schedule is tight, and asking IRHE to look for joint financing would probably delay the project and prevent it from meeting the power shortages in 1973 and 1974. It would also impose an additional strain on the management of IRHE which has little experience of negotiating external finance.

Issues

8. This is a very large project for a small and as yet largely untried organization such as IRHE to undertake, and particular importance therefore attaches to the proposals outlined in Section 5 of the appraisal report for strengthening management and accounting and training of staff. It would be a condition of presenting the loan to the Board that IRHE should be prepared to enter into a new contract with management consultants, and the Government would be required under a covenant in the Guarantee Agreement to seek the Bank's approval for any changes in Decree No. 235 under which IRHE operates and consult with the Bank prior to making any change in the post of Director General of IRHE.

9. Another set of recommendations in the appraisal report is designed to secure the financial position of IRHE. Almost all its sales up to mid-1971 (from Las Minas No. 2) are covered by a contract already concluded with its two main customers, Compania Panamena de Fuerza y Luz (CPFL), which is a subsidiary of American and Foreign Power, and the Panama Canal Company. Thereafter it is the Government's intention - to be confirmed during negotiations - that IRHE should be subject to regulations which would permit it to earn a rate of return on net fixed assets in operation plus working capital ranging between

8-3/4 percent and 10-1/2 percent. The appraisal report recommends that the enactment of legislation to bring IRHE within the jurisdiction of the Regulatory Commission - and the related step of removing the Director General of IRHE from this Commission - should be made a condition of loan presentation. The Government has agreed to take this action, but may have difficulty in doing so before the loan goes to the Board. Our understanding with the Government is that it will indicate during negotiations a timetable for the measures in question, and provided that proposals are reasonable, I recommend that the Bank be prepared to proceed with the loan on the basis of assurances that the necessary action will be taken before IRHE is ready to sell power from Las Minas No. 3, that is by mid-1971. I do not foresee any major problems arising out of the other recommendations in the appraisal report relating to IRHE's finances, but the implications of some of these have not yet been explored with the Government, and there might be difficulties of which we are not aware.

10. It is essential for the construction of the project that an access road should be built to the site which lies near to the route of the proposed section of the Panamerican Highway linking Panama with Colombia across the Darien Gap. The provision of U.S. financing for this highway is the subject of a Bill now before the United States Congress, but access to the Bayano site will be needed before any decision can be taken on the larger issue, and the Government of Panama will have to finance the access road itself. We shall need to be satisfied during negotiations that this road will be built in time for work on the project to proceed on schedule, as the Government has promised.

11. CPFL, the subsidiary of American and Foreign Power, which is IRHE's main customer, has a franchise for gas and telephones as well as for electricity. The Government has indicated to the Bank that by the middle of 1970 standards will be established for the proper regulation of telephone rates, but that it will probably not want to regulate gas in future because of the competitive nature of this industry (apart from CPFL, which operates the gas mains in Panama, three private Panamanian companies retail bottled gas). I recommend that we accept this position. As the appraisal report points out, CPFL has no complaint about existing telephone rates, and gas is a very minor part of its business, accounting for only about 5 percent of its gross operating revenues in 1970. I do not therefore consider it necessary, and it may not even be desirable, for the Bank to insist on the regulation of gas, while the timing of regulation of telephones should be firmed up during negotiations, without, however, making it a condition of loan presentation as proposed in the appraisal report. I also have

difficulty in accepting the recommendation in the appraisal report that the Bank should insist on the Government amending the regulatory decree issued a year ago (Decree No. 6) insofar as it authorizes the Regulatory Commission to control retroactively the profits made by CPFL on its operations since 1958. This is a new issue brought up in the appraisal report for the first time. The Government is understandably reluctant to make changes in this decree because it would appear to be giving in to pressure from CPFL, which objected to the decree when it was published a year ago. There is anyhow no evident reason to suspect the Government's intentions in this matter, since it has a clear interest in maintaining CPFL as a viable undertaking. It should be sufficient therefore to have the Government's assurance that the Regulatory Law will not be applied retroactively. It is also going too far in my view to require the Bank's prior approval for any changes to any of the laws affecting the regulatory agency, and I do not think we should press this point.

12. IRHE does not intend to place contracts for the construction of Bayano until it is assured of the Bank loan. Any delay in the loan signing would therefore delay the execution of the project, with which the Government is eager to proceed as rapidly as possible. It is principally in order to avoid such delays that I am recommending that the conditions for loan presentation and effectiveness should be confined to the essential minimum already discussed with the Government and IRHE. Some time ago the Government was pressing us to indicate the institutional changes which the Bank considered necessary for the effective implementation of the Bayano project, and a mission from the Bank visited Panama in November especially for this purpose. I do not think that we should introduce new conditions now.

Recommendations

13. I recommend that the Bank proceed to negotiate a loan of $42 million to IRHE, with a guarantee of the Panamanian Government, for the proposed power project, substantially along the lines set forth in the attached appraisal report, but with the changes proposed in paragraphs 9-11 above.

E. Peter Wright
Deputy Director
Central America and Caribbean Department

Attachments

Population 1.4 million
Per capita income: $550

Attachment 1

PANAMA - ACTUAL AND PROPOSED LENDING THROUGH FY1975

($ millions)

		Through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73	Total 1971-75
								Fiscal Years									
Farm improvement	IBRD	1.2															
Grain silos	IBRD	0.3															
Livestock	IBRD											4.0					
Fisheries I	IBRD									2.6							
Fisheries II	IBRD												5.0				
Education I	IBRD										3.0						
Education II	IBRD												6.0				
Power I (La Yeguada)	IBRD	4.0															
Power II (Bayano)	IBRD								42.0								
Power III	IBRD													10.0			
Highways I	IBRD	5.9															
Highways II	IBRD	7.2															
Highways III	IBRD											5.0					
Fishing port	IBRD										6.0						
Airport (Tocumen)	IBRD									9.0							
	IBRD	18.6							42.0	11.6	9.0	9.0	11.0	10.0	-	71.6	50.6
	IDA																
	Total	18.6							42.0	11.6	9.0	9.0	11.0	10.0	-	71.6	50.6
	No.	5							1	2	2	2	2	1		7	9
IBRD loans outstanding																	
- including undisbursed		10.6	10.6	10.4	9.9	9.6	9.1	8.3	49.6	60.4	68.6	76.7	86.8	95.9			
- excluding undisbursed		3.7	6.3	7.1	8.7	9.2	9.0	8.3	7.6	13.9	27.8	45.6	62.6	77.5			

Central America and Caribbean Department
1/13/70