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STAFF LOAN COMMITTEE 1961



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SLC/M/61-40

Rough Notes of Staff Loan Committee Meeting held on
Monday, September 11, 1961 at 2:30 p.m. in the Board Room

PERU

Sir William Iliff - There were three points to be considered: (1) Peru's creditworthiness; (2) the invitation of negotiators for the loan for the highway project; and (3) the continuation of the Bank's work on three other projects.

As regards the first point, he felt all agreed that Peru's creditworthiness justified further lending by the Bank.

Mr. Cope - He was a little worried about the nature of the project. It had not been the Bank's practice to finance recurrent maintenance. He realized that it was difficult to draw the line. What were they doing about recurrent maintenance? Why were they always in arrears?

Mr. van Helden - In these cases we set the goal and usually the Governments did not achieve it. Maintenance was difficult to control and was scattered over a large area. It took time to train local skill, etc.

Our first loan for maintenance had been a start and did not cover the whole country. Before you could put an area on routine maintenance you often had to make improvements.

Our first loan had not been successful in all respects. The actual amount available for use in the field had been less than anticipated. Since then the Government had increased the amount allocated for maintenance and they now had a suitable program.

We would not finance local currency expenditures. This would come out of the budget.

Mr. Schmidt - In most of these countries, when we started with them they had no maintenance project or conception of it. We had educated them for five years in Peru before they had accepted our maintenance concept part way. The present Government, however, appreciated the importance of maintenance and said that it now sees that the Bank was right about this. This project would take them a good part of the rest of the way on the necessary maintenance and what we had done had been an important contribution.

As the Government was now willing and appreciated the need of maintenance, we should follow through on this.

Mr. Cope - Normally we were financing arrears. If Peru was not financing recurrent maintenance we were not making any real progress.

Were they going to carry out this loan effectively? There was the problem of organization and we needed to be satisfied about that. Did we see an end to their being in arrears? Were we satisfied that they were providing enough other recurrent revenues for normal maintenance?

Mr. van Helden - The willingness of the Government to put up so much more was an indication of their willingness. He was satisfied that the Government was now aware of the need. They would obtain more technical assistance than under the first loan and the new loan would cover a wider network.

We could not draw the line between maintenance and improvements but it was clear that they were working in the right direction. However, it was difficult to give the guarantees that Mr. Cope wanted.

Mr. Stevenson - He felt we were doing rehabilitation and not maintenance.

Sir William - What we were doing was to prevent them from slipping back.

Mr. Schmidt - And assisting in improving the condition of the secondary roads.

Mr. de Wilde - One of the tables in the annex gave the impression of savings of \$11 million from longer lives for tires and motor vehicles. Possibly there was room for the state to capitalize on some of these benefits by higher taxes on the road users.

Mr. van Helden - TOD had discussed this point. The economic justification was a very rough one. The possible cost of vehicles, i.e. cars and trucks, as assumed in the table might be too high.

The Government put up the money for the maintenance cost. If fewer cars were imported, there would be a loss of income to the Government. Also, if the roads were improved it might be possible to use cheaper cars. In the final report perhaps we should be more conservative. The transportation survey group was studying the final figures that should be shown here and its report might say that the Government could tax the users more.

Mr. Cope - Was this a problem to which we saw an end? He did not see normal maintenance figures included as a charge in the budget. He felt that a few tables showing recurrent maintenance charges and ton miles of transportation would give a measure of the normal maintenance needed.

Sir William - The equipment was going to exhaust its life in some years. Would they then come back to us for refinancing?

Mr. van Helden - It had been up to us to start this. We might suggest that depreciation charges for equipment should be put in a fund for the provision of new equipment. They would get to a second peak after four years and then to lower peaks but in the long run these would flatten out, i.e. in about 10 years, and then the Bank should move out of the picture.

To build up a fund for the replacement of equipment was very nice in theory but if the Government had a deficit in its budget it would be rather unrealistic to have \$2 or \$3 million in a depreciation fund.

Mr. de Wilde - He did not share Mr. Cope's doubts. We had started out with a deficiency of resources in Peru which had to be made good by some form of external financing and he felt that the Bank's loans should be applied where the Bank felt they would do the most good. He felt that we might influence them more in the right direction by financing road maintenance.

Mr. Kheradjou - He had a question about the financing of the transportation survey and had the feeling that some of the cost should be financed by the country.

Sir William - They were paying for half the cost and this was the common practice.

Mr. Kheradjou - If a project were revenue-producing, we often required that the cash generated by the project should take care of the maintenance. In the case of roads there were benefits to the economy at large.

Mr. Schmidt - He thought it was important that we should continue to exercise our influence with the financing of maintenance and the import of equipment. If we were only going to do this maintenance loan and then get out, we should make a longer-term loan.

Mr. van Helden - The life of the loan was only nine years and it would take about twenty years to depreciate the equipment.

Mr. Demuth - Had the survey group said anything about this yet? Was it likely to make recommendations before the proposed loan was negotiated?

Mr. van Helden - This was possible but not likely. TOD would keep in touch with them about this.

Mr. Kheradjou - The private investment figure of 3% of GNP was high. Is it suggested that private investment should be decreased. He felt that the total investment could not be increased much more. Was the idea then to divert some private investment to the public sector?

Mr. Tobiesen - Public investment had risen in 1956 and 1957 and had then fallen. There was need for public investment and he felt that there should be some addition here.

Mr. Stevenson - Why should public investment fall?

Mr. Schmidt - They had been tightening down and carrying out financial reforms in order to achieve financial stability. Also they had been applying higher standards to what went forward.

Sir William - As regards our future lending policy in Peru, we would have the new economic report.

Mr. de Wilde - What was the proportion of capital equipment to labor for the project? Was the labor component low? Was it the right proportion of labor to the use of equipment?

Mr. van Helden - You had to distinguish two types of operations. In one they could do most by hand and mechanization was not very high and labor was low. It was hard to establish a comparison. We were satisfied that the consultant had made a good analysis relating the number of people to the amount of equipment.

Sir William - Were we satisfied that the soles cost would be forthcoming?

Mr. Schmidt - We would have to get undertakings.

Sir William - We would then go ahead on this basis.

The meeting adjourned at 3:10 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Wednesday, July 19, 1961 at 3:00 p.m. in Board Room

HAITI

Mr. Diamond - Mr. Gonzales, the Fund Resident Representative in Haiti, who had been visiting Washington last week, had been elated about the improvement in the financial administration, including customs and other aspects of tax collection, in Haiti. They had told us well in advance about their new budget. In this biennial good year \$3 million would be added to the Government's income. This would be devoted to debt service and was not to be used to increase the Government's expenditures.

He had talked to Mr. Leddy about the position of the U.S. Government and Mr. Leddy had felt that the U.S. Government would welcome lending by others in Haiti. The Eximbank had no objection but would like to see IDA credits and not Bank lending. DLF was discussing with Haiti the provision of funds for the study of an important road project but would not provide these funds unless the Bank financing for the maintenance organization were forthcoming.

The German Minister in Haiti had written to Mr. Donner and Mr. Bochenski suggesting that all the national and international agencies operating in Haiti should get together about the provision of funds and for the more important purpose of imposing discipline on Haiti's financial policies.

The Germans had told Mr. Gonzales that they would be interested in investing \$5 to \$6 million in Haiti, but that they wanted an international group to take the responsibility of where this money should be used.

The U.S. State Department had talked to Mr. Bochenski somewhat on these same lines.

Sir William Iliff - Re the suppliers' and contractors' debts referred to in clause (a) on p. 3 of the Area Memorandum, was this external debt?

Mr. Diamond - Yes.

Sir William - How much?

Mr. Simmons - \$2.7 million of principal and a dubious figure of \$1.35 million of interest.

Sir William - This was a sizeable amount.

Mr. Bochenski - The figure was based on the maximum and some of this was disputed.

Sir William - Was there likely to be trouble about that?

Mr. Diamond - One of the suppliers had been raising a fuss and Senator Dirksin had spoken about this on the floor of the Senate. No one had made any objection to the Bank. The credit to which Senator Dirksin had referred had been one made by a U.S. firm for \$295,000 for a housing project.

Sir William - Had we had a similar situation before where objections had been raised by suppliers before we had made a loan?

Mr. Clark - No.

Sir William - He would like a note on this.

Mr. Bochenski - The subject was covered partly in the report and he would give Sir William a full summary.

Sir William - What was the political situation?

Mr. Diamond - The President had recently fraudulently re-elected himself and thus Haiti had been able to avoid the stress and strain usual prior to an election.

There was pressure on the Government. It was upset about the Dominican situation and by criticisms about the election and the general situation in Haiti and the Government was a little uncertain of itself. There was no evidence of any substantial effective opposition in Haiti. If the present Government collapsed, there was likely to be a vacuum and no immediate alternative appeared to be available.

Mr. Bochenski - For the last 150 years all the Haitian elections had been either fraudulent or dubious. This had been so in the case of the former President, Gen. Magloire, at the time the Bank had made its loan to Haiti.

The present administration suffered from graft but more from lack of experience. In President Magloire's time they had more experience and more graft.

The present President was a country doctor and while it was doubtful that he was really a good President, he should probably be credited with more good intentions than his predecessor.

In the past the Government's stability had been affected by invasions from outside and army coups d'etats.

The President had a policy of reshuffling the army command and had created a police organization nearly as strong to keep the army in check. In Haiti this increased the chances of stability.

Sir William - To what extent was Haiti making contributions to its own development?

Mr. Diamond - This was referred in para. (b) of the Memorandum.

Mr. de Wilde - It had been said that there was little opposition to the present Government. If this were so, why had 23% of the budget to be spent on defense?

Mr. Bochenski - The Haitians were apprehensive about the Dominican Republic; also during the last years there had been two invasions, one from Cuba and one from Florida.

Mr. Diamond - There was no doubt that the repressive measures did reflect fairly widespread dissatisfaction with the Government, but there was no power on the horizon to replace the present administration.

Mr. Iverson - Haiti generally spent 25% of its budget on defense and it would be a real problem for them if they tried to reduce this.

Mr. Diamond - The Minister of Finance, with the approval of the President, had given Mr. Gonzales authority to discuss with U.S. military representatives in Haiti the possibility of reductions in the defense budget. However, it should not be overlooked that if such reductions were made they might be added to the budget for the secret police or militia.

Sir William - Could they do anything in the way of contributing?

Mr. Diamond - It was difficult to see how they could do much more.

Mr. Bochenski - The current budget was cut to the core and practically no funds were provided for development programs by the Government itself. 18 million gourdes was provided for projects with the Bank and ICA.

Mr. Collier - In the economic report, it was stated that perhaps the wealthy Haitians should be more highly taxed. If this were done, would it make any real difference?

Mr. Bochenski - There were few wealthy Haitians and the para. was not intended to give the idea that this would make any significant difference.

Sir William - If we went ahead in the way suggested, could Haiti make any contribution?

Mr. Diamond - Haiti was contributing 260,000 gourdes a month for the present project and provision had been made for this for the next year. There was no reason why they could not do this and more in addition.

The Area Department was not proposing more than 75% of the cost of the project should be provided by IDA.

Mr. de Wilde - Would the balance come from U.S. aid?

Mr. Diamond - It might come this way every other year when there was not a good coffee year. The situation might be compared with that of Jordan.

Mr. Rucinski - He did not think this parallel was a good argument for the Western Hemisphere or a good argument against his proposals for Jordan.

Mr. Diamond - He expected that Haiti would put up part of the cost.

Sir William - Our agreement to go ahead was conditional on that.

Mr. Diamond - Yes. We felt it was too early to say how much and would make recommendations when and if they came up with a suitable project. This would apply to the maintenance project. He was not so sure about the road project.

Sir William - Would the maintenance project involve recurring expenditures?

Mr. Bochenski - The Bank had financed maintenance equipment which had not been available on the spot and also the service of consultants.

We have financed and would continue to finance shops and training. A certain amount might be for renewal of equipment.

Mr. Aldewereld - It was not the intention that we should finance recurrent expenditures, but the 'know-how' of foreigners to train them and maintenance equipment.

Area Memorandum

Mr. de Wilde - He would like to criticize the facts about Haiti's contribution to its own economic development. He felt that we should look on the whole of the field of development. Haiti showed a sorry spectacle of incompetence and inability. No attempt had been made to attack the agricultural problems of land erosion. No efforts had been made to establish an effective extension service.

Their major project in the Artibonite Valley had been mismanaged. No attempt had been made to set up a professional civil service. They were spending an undue proportion of their budget on defense. We might make excuses for them as a poor country with a poor Government. But in Asian countries we had expected a great deal more.

He agreed that perhaps we should not drop the maintenance project, but felt there was merit in a common approach to insure financial discipline with the others concerned and he felt that there would be more effective action if they cooperated and attacked the Haitians jointly.

Mr. Aldewereld - He did not share the conclusion that an attempt to a common approach would effect much in Haiti. He doubted that the Governments would get together on this and he wondered what would happen if they failed to do so.

He felt that it was a pretty disorganized jungle and questioned whether it was proper for IDA to get involved. He wondered whether the aid should not come in the form of pure charity from another country rather than from IDA.

Mr. Diamond - While he agreed with Mr. de Wilde in a good deal of what he had said, he felt that the situation in Haiti was not hopeless. The Bank had been doing institutional building which had been effecting some economic benefit to the country.

Some Haitians were worried about the present situation and it was possible that they might find their way into the administration and also into the political field.

If through these modest means we could effect increased production by setting up something, he felt that we should do so.

Sir William - Were the Haitians congenitally ignorant?

Mr. Bochenski - Most Haitians were worried about the situation, but did not know what to do. They had not always been given the best advice. Dealers and contractors had been inclined to take a fast buck and undoubtedly some of the faults that had arisen were due to highly objectionable and unscrupulous contractors. He felt that Mr. Aldewereld had made an overstatement about the situation.

It should be noted that there had been improvement in their budget, taxes and reserves after a difficult year and they should not be condemned completely. While he agreed it was a difficult situation, he felt that the negative side should not be overstressed.

Sir William - If Haiti had a conventional development program, would the projects proposed by the Area Department be of top priority?

Mr. Bochenski - Jointly with other projects under way, they would be of top priority.

Mr. Diamond - Last January we had had discussions with the Government authorities. They had all cited the high priority of the highway system. In talks with the Government we had continued to stress the importance of matching the development of the highways with more effective and intensive activity on the agricultural side.

Sir William - Mr. Aldewereld and Mr. de Wilde's ideas were that until more drastic over-all discipline were imposed, we should not go into these projects at all?

Mr. de Wilde - A modest amount could be said in favor of institutional building. The interested governments would like to get together with the Government to see what could be done about agriculture, power, etc.

Mr. Rucinski - Was Mr. de Wilde advising that we would not do the proposed operations?

Mr. de Wilde - He felt that we should go on with the loan maintenance project and supplement this by trying to get a coordinated approach to the Haitian problem. We could not hold up our hands hopelessly.

Sir William - There was some merit to an approach on the basis of putting one or two pieces into a jigsaw puzzle in the hope that eventually you could fill a wider and wider field.

Mr. Diamond - He welcomed Mr. de Wilde's suggestion. It was planned to explore the possibility of a joint approach with the other agencies but were not sure of the outcome and had to remember that we were a small tail to the dog, and that the U.S. was the big dog.

The U.S. was favorable to the idea but we did not know what other projects they might have in mind or other general views they might have on the Caribbean which might affect their actions.

Sir William - Would the Haitians accept a developmental adviser?

Mr. Bochenski - He thought so but they had had too many advisers in the past. They had, amongst others, one from the Inter-American Development Bank which had made a loan of \$3.2 million for the Haitian Development Bank on the condition that IDB should provide its management.

The Fund had an adviser there and practically nothing could be done in the financial field without his concurrence.

The idea of a coordinated approach had been put to practice as a modest in 1958 but had petered out with the changes in the Cabinet; the Germans wanted to revive this.

It might be better if one voice were raised in meetings with the Haitian Ministers instead of a number of a number of smaller ones. He felt that Haiti would accept a permanent representative from the Bank, but he did not feel that we could recommend this as we would not be a major partner in their financing.

Mr. Diamond - He was not sure about the matter.

Sir William - Should they have an adviser like this?

Mr. Diamond - He did not know. The collective approach suggested might be better, e.g. a committee representing the national and international agencies now operating in Haiti as an advisory group to the Government. The U.S. felt that this should meet monthly but the matter had not been discussed in detail with them.

Mr. Iverson - Was this to be a resident committee and how was the Bank to fit in?

Mr. Bochenski - It was thought that they would meet in Haiti.

Sir William - It seemed to him that they needed someone there continuously.

Mr. Rucinski - He did not believe that a committee could assist the Government to run its economic affairs. Was the proposed approach that we should go ahead anyhow?

Mr. Diamond - The Area Department proposal was that they should proceed while exploring the possibility of coordinated pressure on the Government.

Mr. Cavanaugh - He was worried about the calls for the settlement of outstanding suppliers' credits which had been made to him in a number of instances in this case. He felt that we should go ahead if we felt that the reorganization had helped and that the debt matter would not backfire. However, he felt that we might get some very serious backfiring.

Sir William - Was there any policy precedent in connection with this?

Mr. Rucinski - What about Turkey?

Mr. Collier - In their case their debts had been refunded and were out of the way.

Sir William - Were these Government obligations?

Mr. Bochenski - Yes.

Mr. Diamond - See Annex I.

Mr. de Wilde - Were the U.K. and the U.S. pushing their claims?

Mr. Diamond - In January he had spoken about this to the U.S. and U.K. representatives and they had raised no particular objection. The U.S. was not paying much attention to Senator Dirksen on the subject.

Sir William - We would have to think about the debt question and the point of over-all discipline. He felt that we needed to do something and that the committee approach would not effect very much. He felt the need for a permanent representative, to sit side by side with the President, either from the Bank or another institution and that simultaneously the Bank should go ahead with its modest approach and show them how to tackle the matter the right way.

Mr. de Wilde - Should this apply to the credit for the wharf?

Sir William - Would this be a top priority item?

Mr. Diamond - Mr. Carmichael had just come back from there and believed the project to be of great importance.

Mr. Bochenski - Mr. Carmichael felt the need to do something. We should create an autonomous port authority to run the port and this would create another enclave excluded from political influence.

Mr. Diamond - The port was now administered by the Central Bank.

Sir William - Should we say at this time that we would only go ahead with the road maintenance project and keep our bargaining position?

Mr. Diamond - He would like to go ahead with all three. Our bargaining position was small. They depended on U.S. advice and weighed this much more heavily than they did ours. If we did these three we would contribute further to institutional building.

Mr. Rucinski - Should this be presented as a package? We were in a more exposed position than the U.S. about the unsettled debt.

Sir William - Was Mr. Rucinski saying that we should insist on settlement of the outstanding debt before we went in?

Mr. Rucinski - If we financed one of the projects and they were not paying their debts, there would be repercussions from other countries.

Sir William - He felt there was a difference between a default to contractors and a default on a public bond issue.

Mr. Diamond - Discussions on the debt to the U.S. were now going on with the Export-Import Bank. They would work out something, possibly a new schedule. The real question was the outstanding suppliers' credits.

Mr. de Wilde - Our usual policy had not extended beyond public loans. Should we extend it to suppliers' credits? If the U.S., the U.K. and France did not insist, then he suggested we should not defer our lending until these debts were settled.

Sir William - It would seem hard that Haiti should be denied IDA assistance because it had been exploited by unscrupulous contractors.

Mr. Rucinski - He did not feel we should wait until settlement had been made. Our policy had included payment to owners of enterprises nationalized in Egypt.

Sir William - He felt that they were in a different category.

Mr. Rucinski - He felt that the degree of willingness to settle was important.

Sir William - We had to be satisfied of their ability to pay. He did not believe that they could pay. If arrangements could be made with their creditors, we could go ahead.

Mr. Clark - Also we had the condition in this case that some of the debt was in dispute.

Mr. de Wilde - He questioned whether the unsettled claims caused a dispute between Haiti and other governments.

Sir William - The U.S. Government had never taken any interest in the default on their foreign bonds.

Mr. Kheradjou - He did not feel we should encourage these creditors too far.

Mr. Aldewereld - He was worried about lending to a country without discipline that could be duped by unscrupulous contractors. Was there any move to develop discipline in Haiti? If so, he did not see it.

Mr. Rucinski - Then Mr. Aldewereld felt that we should take this as a package?

Mr. Aldewereld - That was right.

Sir William - He agreed with Mr. Rucinski on this point. Couldn't we invent the machinery to induce willingness on the part of the Government?

Mr. Aldewereld - He felt we should not do this lending without strings attached and should try to achieve something along the lines we wanted.

Sir William - Had we discussed with Haiti their defaulted debts?

Mr. Diamond - We had told them that their existence would raise a very serious obstacle to our lending. We had not put the heat on them to pay because they could not do so. It was the intention of the Government to put its surplus into debt service and some payment to suppliers but not to all of them in view of the disputed debts.

Mr. Diamond - He would be shy of a package deal and this had not been discussed with the others concerned and would take twice. He would hate to see the maintenance and better projects postponed.

Sir William - Should we go ahead with the maintenance project and leave the rest to depend on a package approach?

Mr. Collier - If the U.S. had the real bargaining power, he agreed with Mr. Diamond. The situation depended on the U.S. Government. He felt that we could give better technical assistance to Haiti if we were doing something.

Sir William - The U.S. Government was influenced by the general political situation in the Caribbean and he doubted whether they would undertake what we wanted.

Mr. Collier - Our carrot was not big and he felt that it would be a shame to abandon the little enclaves that we had set up.

Mr. Rucinski - He suggested that the two things should go forward simultaneously. It would be best to push the discussions with the U.S. as far as possible. If the question on maintenance was urgent and we felt we were making progress with the discussions, we should go ahead. We might do the maintenance project and wait till we saw some progress.

Sir William - We should go ahead with the road maintenance program and discuss with the others interested in development investment in Haiti, an approach to the Government. We should try to get the Government to do something about its defaulted debt and we should try to persuade others interested in Haiti's development to use such influence as they had to introduce over-all discipline in their economic and financial policies.

We should tell them that in our view the best way would be to station an expert there as adviser and to defer the two projects till we saw progress on these lines.

Mr. Diamond - He felt that this should be discussed with them before we went into it.

Sir William - He felt that we would not get far unless we had someone there.

Mr. Bochenski - They had had an adviser there all the time. The Fund had control over the issue of checks and their financial monetary policy and progress with U.S. aid required his green light.

They had advisers from ICA in other fields in every Ministry. No one individual had great influence on the Government's everyday economic policy.

Sir William - He felt the need for a special adviser.

Mr. Aldewereld - They needed to make some start on a logical plan of investment, etc.

Mr. Diamond - He was not lukewarm to what was proposed, but he had an uncanny feeling that too much emphasis was being made on over-all advice to the President as opposed to getting the development service agency working in the field.

Mr. Alter - There was no indication at the highest level of the Government that their intention was wrong. They needed stimulation of the right kind more at the bottom. The matter would not be solved by advice to their top political leaders. We should push financial assistance for the extension service. They needed to get a lot of technical assistance on a massive scale at all levels and the U.S. was pushing this.

He felt that we might be overstressing the top development adviser as the means of solving all these problems.

Sir William - But the U.S. wanted a committee for this.

Mr. de Wilde - They needed a good adviser plus simultaneous activity at all levels. The Area Department might discuss with the various governments concerned what could be done and in the line of the discussion what would be the best method for a coordinated approach.

Mr. Diamond - He would like that better.

Sir William - Had any of the advisers talked about the settlement of their debt?

Mr. Diamond - Yes, Mr. Gonzales. He doubted that the U.S. had done so.

Mr. Bochenski - And the Bank had done so repeatedly.

Sir William - He considered that for the moment we should concentrate only on the maintenance project and that the Area Department should talk to the U.S. Government and others concerned and tell them our views that something was needed to pull together the external aid and also to pull together the external and internal activities of the Haitian Government and the various advisers they had there, and whether the best way to achieve this would not be by the appointment of a permanent adviser to the Haitian Government.

We should say that we expected Haiti to make a reasonable effort to settle their external default debt.

The meeting adjourned at 4:45 p.m.

HGA Woolley/mrd

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Rough Notes of Staff Loan Committee Meeting held on
Wednesday, July 5, 1961 at 4:00 p.m. in Board Room

CHINA

Mr. Knapp - At the last Staff Loan meeting on Taiwan we discussed the question of the relending terms, which raised questions on IDA policy. Because I now think we went, in those discussions, beyond a point reached in earlier discussions on IDA policy, I thought we should have another meeting to review this question.

The purpose of the so-called concessional terms of IDA was to provide balance of payments relief for a country, but as a side effect this may provide budgetary relief or would give relief to another beneficiary if the credit were relented by the government on the same terms. The latter was not the intended purpose of IDA credits. At the last meeting, we said that for the dredging project, while the Provincial Government would be using the funds provided on a non-self-liquidation basis, it would be performing an economic service and, therefore, the Provincial Government should service the credit received on conventional terms, 20 years at 12%. However, the 12% rate would apply over the entire 20-year period. If the monetary situation improves, it might be assumed that the customary rate will decrease, outmoding the 12% rate. I suggest therefore that rather than holding them to 12% over the entire period of the loan, we have a letter agreement saying that the 12% rate is proper now in the light of existing conditions but would be subject to reconsideration if monetary conditions in Taiwan should change. This point should furnish valuable propaganda for IDA.

Mr. Ripman - Would this suggestion apply to other credits such as those granted by ICA?

Mr. Knapp - I don't know whether there are any others.

Mr. Ripman - It is possible that existing ICA credits already have such a clause.

Mr. Knapp - Since the custom has been for the Provincial Government to provide money to the National Government, I doubt whether there is any precedent for the course we are now proposing.

Mr. Lejeune - We already have a precedent of Bank loans relented at lower rates than the customary rate in the country concerned.

Mr. Knapp - That may not be true as most of the cases did not involve the foreign exchange risk. Here the 12% rate covers the exchange risk. It could be that if the Government took the exchange risk, we could use a 6% rate for relending.

Mr. Schmidt - And part were for shorter periods of time.

Mr. Knapp - The Groundwater Development project is more involved because the money would be relented again by the Provincial Government to the four irrigation associations, and in that case, we said at the last meeting that the terms of the loan from the National Government to the Provincial Government should be 12% for 20 years and the provision of funds to the other beneficiaries, the irrigation associations, should be on the same basis except that to the extent that a case is made for a public subsidy the rate might be lower. Such a public subsidy

would preferably take the form of grants but might possibly take a form of a reduction in the rate of interest below 12%. The justification for the subsidization is based on the present high tax rate paid by the farmers, which actually offsets the aid received by the farmers.

The Chinese representatives have indicated that they cannot agree to this proposal, that the farmers pay only 6% and the Provincial Government 12%. Overlooking the indirect benefits to the Provincial Government, they maintain that the Provincial Government cannot bear this expense. As an alternative, the Chinese propose that the National Government advance the proceeds of the IDA credit to the Irrigation Development Fund on IDA terms, 50 years at no interest, and 3/4 of 1% to cover expenses, with the exchange risk to be underwritten by the Provincial Government since they do benefit indirectly from the program; the proceeds to be relent by the Irrigation Development Fund to the farmers' irrigation associations at 12% for 20 years, except to the extent that a case can be made for some degree of public subsidy as was discussed at our last meeting.

The problem here is the relationship between the National Government, the Provincial Government and the Irrigation Fund. We have a special situation in that the National Government and Provincial Government cover the same geographical territory. If there were no duplication of government of this nature and the Irrigation Fund were completely at the national level, we would welcome the fact that counterpart funds would be generated for the use of the National Government and Irrigation Fund. However, in the present case, insistence by the Bank that the counterpart funds go to the National Government would have the unfavorable result that the counterpart funds would not be used on the developmental level but for the national budget which is concerned with military and administrative expenditures rather than developmental expenditures.

Mr. Schmidt - How would the Provincial Government recoup any outlays to cover exchange losses?

Mr. Knapp - Not out of the Irrigation Fund.

Mr. Cargill - Under the proposal of the Chinese, the Irrigation Development Fund would receive funds from the farmers over and above what it now gets from various sources, including the Provincial and National Governments.

Mr. Iverson - Why do we arrange for the Provincial Government to take the exchange risk in the case of the counterpart development project and not in the other projects?

Mr. Cargill - Actually, we haven't discussed that problem. It would probably be better if they were the same.

Mr. Lejeune - I have two thoughts on this. First, the same problem of duplication of government appears in Nyasaland so that we must bear in mind that we may be setting a precedent. Secondly, would it be possible for the Irrigation Development Fund to repay the loan from the National Government on customary terms and for the National Government then to reinvest the proceeds in the Irrigation Development Fund? The result would be the same in the end, and the pattern of not passing IDA terms on to the beneficiaries would not be established.

Mr. Cargill - Here we accomplish what we want at the developmental level without getting involved in the relationship between the different governments in Taiwan.

Mr. Lejeune - I am worried about the precedent. We have been preaching that the other beneficiary of IDA credits should service these credits at conventional rates and now we are suggesting that this need not be done in this case.

Mr. Cargill - No, that's not right. The farmers' irrigation associations would be paying at the conventional rate.

Mr. Broches - The suggestion being made here, is not, I believe contrary to the decisions taken at our earlier meetings on IDA. In stating that the National Government should pass the funds to the other beneficiary on conventional terms, we always made the exception for the case where we wanted to make concessions in order to benefit a particular user other than the State. We did not rule out the possibility that capital be placed at a point other than the National Government. The discussions focused on avoiding a situation where a private or public financially viable entity received a windfall because a credit to the government was passed on to it on IDA's terms, but did not exclude passing credits on on IDA's terms if doing so would put the cheap capital where we believed it should go. We spoke particularly of money going by such means to development banks.

Mr. Knapp - That's an interesting comment. I had forgotten this point. Although now that you mention it, I do remember the discussion about funds going to the development banks. Certainly, there is no point in getting caught in our own rules to the extent that we are prevented from putting money where we think it will do the most good.

Mr. Cavanaugh - My initial reaction is that we should maintain the position that enterprises benefiting from IDA credits should pay for themselves. As the funds are in such short supply, they should not be used for projects which are not self-supporting. However, I have not fully made up my mind.

Mr. Knapp - The belief that irrigation projects should charge users sufficient amounts to be self-supporting is certainly not uniform throughout the world, so this suggestion would not be in violation of the Bank's policy.

Mr. Broches - As we agreed at the last meeting of the Staff Loan Committee on China that some degree of public subsidy could be given to the farmers because of the situation in Taiwan, I think we should now focus on the relations between the National and Provincial Governments and the Irrigation Fund, and not on the question of charges to the farmers.

Mr. Cargill - We are not suggesting a departure from the decision taken at the last meeting on the terms to the farmers' irrigation associations, but rather we are concerned with the question as to whether the funds would accumulate at the Central Government level with the Irrigation Development Fund.

Mr. Lejeune - The suggestion means tying up funds for a long period of time in an irrigation program which may not, over the long period of repayment, be the most beneficial to the country economically.

Mr. Kheradjou - That problem is not so serious as the Irrigation Fund is not independent, being dependent upon in-put of funds by the National and Provincial Governments. The ability of the National and Provincial Governments to change the rates of these in-puts gives flexibility which can be used to avoid the difficulty you mentioned. The Irrigation Development Fund is only an accounting agency of the National and Provincial Governments.

Mr. Cargill - Mr. Lejeune is correct theoretically, but we are sure that irrigation is going to be one of the most important sectors for investment during the next 20 years.

Mr. Ripman - This suggestion involves putting strings on the use of counterpart funds, although we agreed we would not do so for IDA credits. Otherwise, I have no objection.

Mr. Knapp - We haven't put strings. They are suggesting, we are not imposing anything.

Mr. Lejeune - I favor the accumulation of investment funds in the hands of the Provincial Government rather than the National Government. On the decision between the Provincial Government and Irrigation Development Fund, I don't have any preference. Why can't IDA lend to the Provincial Government?

Mr. Cargill - That would upset the whole balance of payments benefit purpose of credit.

Mr. Knapp - And we would have to have the guarantee of the Central Government anyway.

Mr. Ripman - Is the proposal of the Chinese linked to a reduced contribution by the Provincial and National Governments to the Irrigation Development Fund?

Mr. Kheradjou - No. But the Central Government has been talking about other moves which might have the effect of reducing their in-put to the Irrigation Development Fund.

Mr. Knapp - I think we have a solution here which will not start undesirable precedents.

The meeting adjourned at 4:55 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Tuesday, June 20, 1961 at 3:00 p.m. in Board Room

CHINA

Mr. Knapp - The question here is one of IDA-worthiness. The Economic Report shows a reasonably good record on mobilization of resources but that we should be less complacent about their fiscal policy. China is clearly not eligible for Bank loans because of the balance of payments situation. SEC has concluded that IDA assistance should be provided. The existence of U.S. aid may make Taiwan more attractive for IDA aid but this is not to mean that they would not be eligible for IDA aid if U.S. aid were stopped.

Mr. Tolley - I wish to emphasize that the past year has been encouraging in the increase in output and the reduction of inflationary tendencies, and having looked at the economy, we now think a continuation of past progress can be expected despite the temporary setback.

Mr. Knapp - I agree, but para. 57 seems a little too strong. I think the Report should have a little less emphasis on praise and more on exhortation.

Mr. Cargill - I agree with that.

Mr. de Wilde - The dangers of renewed inflation are underplayed in the Report, I believe, and I think the Bank should explain the importance of keeping this situation under proper control.

Mr. Cargill - That's right, particularly as their record on control is poor.

Mr. Kheradjou - Actually the situation is in balance now but we must wait and see how they perform against their promises for the future.

Mr. Stevenson - Is IDA now to replace the U.S.?

Mr. Knapp - I said before you came in that the existence of U.S. aid made the proposition attractive but that the disappearance of U.S. aid should not bar Taiwan for consideration for IDA credits.

I think the Economic Report should not have operational conclusions and therefore the last sentence of the Report should be deleted.

Mr. de Wilde - The point of that sentence was that the position of the Staff Economic Committee makes more sense if the reader knows in what context the decisions of the SEC were reached.

Mr. Knapp - I agree. I was only talking of the form in which the Economic Report would go to the Board. Your point could be covered by the minutes of the SEC meeting on the Economic Report sent to the SLC with the Economic Report.

* * * * *

On the question of the outstanding debt of China, the policy of IDA is the same as that of the Bank. Here there are special circumstances and I suggest that the problem be discussed with the U.S., British, Canadian and French Executive Directors before the meeting. I understand that the point has already been cleared with the Canadians and they will not raise the question of default of debt unless somebody else does.

Mr. Cargill - Mr. Rosen has already talked to Mr. Larre and Mr. Pitblado. The United Kingdom said that Peking, not Taiwan, is obligated to them and the French do not intend to raise the issue.

Mr. Kheradjou - The French are not abstaining from this question. They don't want the problem to be raised for fear of raising other problems.

Mr. Cargill - We should discuss the question with Mr. Leddy before the meeting, but I understood that the U.S. position to be: they would not raise any questions.

Mr. Diamond - What is the size of the present outstanding debt of Taiwan, disregarding the debt before the move to the island?

Mr. Tolley - About \$33 million. The debt service amounts to about 4% of export earnings.

Mr. Aldewereld - This is a problem which should have been cleared before we sent a mission.

Mr. Cargill - It was at the time of the Annual Meeting last year.

Mr. Knapp - I have a question as to what we should disclose regarding the default of debt over and above what it said in sub-para. 4 on page 20.

Mr. Cargill - The whole external debt picture has been set forth in Table 19A but because this was not clear, we have added a bit in the covering memo.

Mr. Knapp - The problem should not be covered up. The question is one of giving an explanation which doesn't leave the impression that we are accepting the debt situation because it is an IDA credit and not a Bank loan.

Mr. Kheradjou - Table 19A may be wrong because it is based on memory of the Chinese and not an official list agreed with creditors. We will get a debt representation letter from them acknowledging their debt.

Mr. Knapp - What's the purpose of a debt representation letter for IDA credit? Bank loans are made on the basis of its representation but it is not so important for IDA. But I suppose getting the information is useful. What did we do in Honduras?

Mr. de Wilde - We just got one from Honduras. We realized there was no point as far as IDA credit was concerned, but decided we would ask for it whenever necessary to complete our information, and I hope to continue on this basis.

Mr. Knapp - I agree. We may want to know how big the debt is.

Mr. Broches - Do we get a new statement each time we make a Bank loan even though we have received a recent statement.

Mr. Lejeune and Mr. Diamond - We get a new statement each time.

Mr. Diamond - The memo raises questions about the international political situation but does not conclude anything, and also questions the internal political situation without giving a definite answer.

Mr. Kheradju - The Chinese came to Taiwan in 1945, practically as conquerors and the uprising took place in 1947. The U.S. complained about the treatment of the natives. The Governor was changed but there was really no satisfactory action until the government itself moved to Taiwan. Since then, there have been economic benefits and the Taiwanese are gradually being integrated into the economy, but it is a big question when they will ever get a voice in their political affairs.

Mr. Cargill - There is economic and social stability on which we can count. On the political side, it is more difficult to forecast. If the two Chinese governments become permanent after the departure of Chiang Kai-Chek, the duplication of the government in Taiwan will probably disappear but we will just have to await the resolution of the international problem.

Mr. Kheradju - The Premier of China is the heir-designate of Chiang Kai-Chek, but the Governor of Taiwan may actually win out.

Mr. Knapp - At the Executive Directors' meeting several problems can be raised, particularly as some of the member governments do not recognize Taiwan. First, the question of Red China's entrance into the UN, which does not affect the Bank. Second, the question of what happens if Taiwan becomes a province of Red China. Third, what happens if Red China is admitted to the UN and the Republic of China is out.

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Ports and Harbors

Mr. Knapp - This is also an interesting report but I don't see any serious questions. We do have to settle the question of the terms of relending to the Provincial Government by the National Government, bearing in mind that this may set a precedent for future IDA operations.

Mr. Kheradju - As the Provincial Government covers the same area as the National Government, it is assumed that the Provincial Government would receive funds on the same terms as the National Government.

Mr. Cargill - That would set a very bad precedent. Presumably, we can't do it.

Mr. Alderfeld - The same question arises in India where we have a very similar project. There we said that the relending terms should be related to the economic life of the project.

Mr. Cargill - O.K., but what rate? I suggest the Bank rate of interest on 20 years 6%, inasmuch as the exchange risk would be borne by the National Government.

Mr. Broches - I have trouble understanding what the project is legally, as it has been described as the provision of operational equipment. Why don't we use the dredging program as a project?

Mr. Cargill - I agree to that.

Mr. Knapp - I agree that this is similar to a highway maintenance project in which we use the maintenance program as the project to be financed.

Mr. Lowdon - The working party has agreed to a similar change in the Philippine proposal. As a program of maintenance is one that is subject to change for various reasons, usually dredging expenses are not capitalized and it is a difficult matter to inspect the program, TOD suggested, as a practical matter, that the purchase of the equipment be considered the project.

Mr. Aldewereld - The question is whether the Bank can make a loan for a project of a maintenance nature.

Mr. Knapp - I think we passed that one.

Mr. de Wilde - Another question is whether the project should be self-liquidating. The Chinese have port revenues which could support the debt service on the dredging program. Why don't we lend to the ports?

Mr. Kheradjou - That's impossible as the ports are not legal entities.

Mr. Stevenson - Would an explanation of the National and Provincial Governments covering the same area be spelled out in the President's Report?

Mr. Cargill - This is already in one of the annexes in the Report but it would be spelled out.

Mr. Kheradjou - As the two governments do not always see eye to eye, I think the Bank will have to be flexible to meet the problems inherent in this very special situation. The money could go to the project itself on conventional terms but the Provincial Government should not necessarily be treated that way.

Mr. Cargill - It is important to avoid the precedent of relending on IDA terms. I think we can adjust between the Central and Provincial Governments by means of the financial payments between them without disturbing the precedent. The Provincial Government usually operates on a surplus and generally lends to the National Government rather than the other way around.

Mr. Aldewereld - In the case of the dredge, it is true we are talking bookkeeping, but for the groundwater research project, we are talking about a revenue project which should be on a sound financial basis.

Mr. Cargill - I agree, but we still have the precedent problem.

Mr. Knapp - I have a question about one credit being relent at 6% and another at 12% although I realize that the 12% is still tentative and subject to further discussion.

Mr. Motheral - The Central Government has lent to the farmers' irrigation associations for agricultural projects through the Provincial Government at 6%. Recently, it has decided to shift to 12% and drop a subsidy that the farmers were getting. We think this is not a firm decision and we also think should be reopened as farmer resentment to the increased rate may jeopardize the success of the project. Therefore, the 12% rate used in the Technical Report was merely to illustrate the thinking of the time.

Mr. Knapp - Getting back to the interest rate for relending, earlier discussions on this subject were rather fuzzy where the relending was to be done without covering the exchange risk, and particularly the discussion didn't cover the situation where the local pattern was for rates of 10% or 12% because of monetary instability. I think we should discuss this question further.

Mr. Aldewereld - Here we are talking about a 20-year loan at 12% and in India we are talking about a 12-year loans at 4-1/8% because the government generally makes funds available at that rate.

Mr. Knapp - The rate in India is certainly arbitrary.

Mr. Cargill - The rate of 12% in Taiwan is artificially low taking into account the element of inflation discount.

Mr. de Wilde - Why do we have a different rate for different projects?

Mr. Cargill - The 12% was assumed for illustration only and it hasn't been settled.

Mr. Knapp - We could require a 6% rate to the farmers' irrigation associations from the Provincial Government and a 12% rate to the Provincial Government from the National Government; but, ICA puts in a great deal more money and has taken a very stiff line that the government should not continue subsidies and charge 12% to the farmers' irrigation associations.

Mr. Knapp - What are we considering on the self-supporting water works?

Mr. Ripjan - We are assuming a 12% basis there.

Mr. Tolley - There is no established market for long-term money. It is hard to determine the rate.

Mr. Knapp - Agreed, but I have heard that 12% is the normal rate in Taiwan and wonder why it should not be adopted unless adequate reasons can be put forward for deviating from this. Do we agree that the Provincial Government should pay 12% to the Central Government for funds for self-liquidating water projects and that the consumer should pay rates to support this debt service?

Mr. de Wilde - On the dredging project, if there were an independent port authority, I would expect that that would receive funds at 12% also. Therefore, I don't understand why we don't charge 12% to the ultimate beneficiary - the port users - merely because there is no authority. The Provincial Government should certainly be able to raise enough to service the debt at 12%.

Mr. Kheradjou - The trouble is that the Provincial Government is subsidizing the National Government already.

Mr. Knapp - I think the 12% should be O.K.

Mr. Broches - I would make a distinction between the rate at which funds are passed from the Central Government to the Provincial Government and between the Provincial Government to the authority.

Mr. Cargill - The dredges are difficult because they will be operated by a part of the Provincial Government and consequently, there is not the need for the maintenance of financial discipline on the part of the ultimate beneficiary.

Mr. Aldewereld - Our difficulty is that the Bank has no established line on the proper financial policies of ports and irrigation projects as we do in the case of power projects. We can't turn to established institutions, for example, as many different practices are followed in different parts of the world.

Mr. Knapp - I still say that we should relend on the 12% basis for the precedent reason.

Mr. de Wilde - I don't think we should depart from this unless a clear case can be made for subsidy.

Mr. Cargill - I would agree to leave it at 12% unless we bump into trouble and can't reach agreement with the Chinese.

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Groundwater Resources Development

Mr. Knapp - I take it that the main point is that of the self-liquidating nature of the project and that may not be an issue if the government sticks to its present position that the funds should be lent to the farmers' irrigation associations at 12% provided, of course, that the farmers will go along with this.

Mr. de Wilde - Here there is also a question that the project may be economically valuable despite the subsidies, which cannot be removed because of the farmers' violent feelings toward that matter, and, therefore, must be accepted - and can be accepted because the project is economical nevertheless. The farmers would never agree that they would be able to make a profit without the subsidy.

Mr. Motheral - The farmers have been taxed very heavily and are, understandably, very restive.

Mr. Reid - It's possible the farmers might accept the payment by them of 12% if part of this was held in the reserves of their associations and the ICA might accept an arrangement where the farmers' associations paid only 10% rather than the 12% to the Provincial Government.

Mr. Cavanaugh - I have trouble agreeing that we should change our rule about the relending charges because the farmers do not agree.

Mr. Motheral - I agree, but this is a very worthwhile project and a needed project. The support of the farmers is required for its execution.

Mr. Broches - My question is whether the charge is reasonable in the light of the other charges now borne by the farmers in the form of the high taxes.

Mr. de Wilde - The farmers already are subsidizing the government by being overcharged on other things so the insistence on the rate to the farmers doesn't seem right.

Mr. Aldewereld - For \$6 million, how can we expect to change the whole agricultural pattern of China? We haven't raised the question in other countries and I don't see why we should here, particularly as we can be satisfied with the general economic benefits of the project.

Mr. Knapp - O.K., but the Provincial Government should pass the 12% on to the Central Government as the Provincial Government gets increased revenues resulting from the increased production.

To sum up, the Central Government should relend to the Provincial Government for 20 years at 12%. The Provincial Government should relend to the farmers' irrigation associations for 20 years either at:

- (i) 12% with no subsidy; or
- (ii) 12% with a capital subsidy to offset the high taxes;
- (iii) a lower rate of interest as a form of subsidy.

This would mean some latitude for the farmers but we should hold the line on the Provincial Government because as they stand to gain.

Mr. Cargill - We can try.

Mr. Kheradjou - This is going to stop all development financing if the money goes to the Central Government. The Provincial Government is concerned with developmental expenditures, not the Central Government.

Mr. de Wilde - That's a question of what the Central Government does with the money received.

Mr. Knapp - I suggest we try 12% across the board with a possible concession, as we discussed, to the farmers, if that's needed.

Mr. Cargill - If the Provincial Government is upset by this, it is always possible for it to cut down on its subsidy to the Central Government, so that there might not be a net increase in the amount that the Provincial Government passes to the Central Government.

Mr. Lejeune - I had a question whether the terms of the IDA credits to Taiwan shouldn't be stiffer than IDA has used heretofore, given their central earnings and their reasonable favorable prospects.

Mr. Knapp - I think that the suggestor of deviation from the established IDA lending pattern should bear the burden of proving the necessity of the deviation suggested.

Mr. Lejeune - The point is that Taiwan offers a special situation and is, therefore, a good case for exceptions to the normal pattern.

Mr. de Wilde - I think that the special military political situation there upsets the argument for stiffer terms for IDA.

Mr. Knapp - I would think that we would stiffen the terms for IDA in those countries where we are considering a blend of Bank and IDA operations because the creditworthiness of the country is such to warrant consideration of Bank as well as IDA operations.

Several people - It could be done either way.

Mr. Lejaune - The point is that if a country is eligible for Bank operations but cannot be considered for the Bank loan for some special reason, it might be considered by IDA but not under the normal IDA lending pattern.

Mr. Knapp - I suggest we continue on the present pattern.

I do have one question. Would the UN Special Fund team on water resources development continue?

Mr. Motheral - Yes, we would expect to handle the finance of this through the Contingency Fund allowed in the proposed list of goods and to include a requirement in the Loan Agreement that they continue to receive expert advice.

The meeting adjourned at 4:45 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Friday, June 16, 1961 at 3:00 p.m. in Board Room

INDIA - Project for Private Coal Industry

Appraisal Report

Mr. Knapp - This is a most interesting project and pattern but I do have only a couple of questions to discuss today. Since this project has already been discussed at a Department Head Meeting earlier, I don't think it's necessary to go back over the project or the terms unless others want to.

First I suggest that the words "balance of payments loan" be deleted in the report, not because it's not true that this is a balance of payments loan, but because the word has come to have a derogatory sense. Actually this is a balance of payments loan with the proceeds earmarked for a particularly productive sector, unlike the Australian loans which were balance of payments loans directed toward the whole economy of the country with the trading community determining which sectors of the economy would benefit. Here the particular sector chosen is very important, giving weight to the point that the loan is not for the economy in general but for the coal sector in particular.

Also, I wanted to note that this was a very well written report by Mr. Van Dine who is leaving us today.

Thirdly, I do not think the report should blink the past treatment of the coal industry by the Government, but some of the statements in the report are rather severe and I suggest that before going to the Board these statements be toned down without changing the basic facts.

Does anybody have any questions on the Technical Report?

Mr. de Wilde - At the risk of disclosing the fact that I haven't read the report, who is going to pay the interest on the loan?

Mr. Knapp - The Indian Government.

Mr. Diamond - Para. 122 suggests that assurances be obtained that prices will be maintained at a level sufficient to assure the private coal industry a reasonable return on its investment. My question is what is intended here, over and above what we have already received or would receive in negotiations to satisfy ourselves, and, secondly, who is going to determine what is reasonable?

Mr. Van Dine - You are quite right that it's not possible to apply a formula, but the working party thought that some general language might be possible which would permit the Bank to raise the question in the future if prices go down. Up until now the return has been too low, but it is expected to increase now as a result of subsidies. In two or three years' time the Bank should review the situation and might wish to raise the question with the Government on the basis of the general assurances received.

Mr. Mason - Actually the biggest factor in the company's return is labor cost for which an automatic adjustment in price is provided.

Mr. de Wilde - I take it that it's not intended to justify price increases to cover unproductive work.

Mr. Van Dine - That's correct.

Mr. Hoffman - I am in sympathy with the conclusion, but I wondered why the report did not recommend that they do away with the price controls completely. However, I think that the recommendation is on sound ground as long as the Bank continues to keep the problem in mind.

Mr. Van Dine - As you can guess, we thought it useless to recommend abolition.

Mr. Hoffman - That is probably right.

Mr. Knapp - On p. 29 the report refers to procedures followed by the DLF and the Export-Import Bank. What were these?

Mr. Van Dine - This technical procedure was employed with several credits for industry. Some of those loans actually had allocations for the public sector of the coal industry but were not used and were shifted to the private sector.

Area Paper

Mr. Rucinski - The amount of the loan I suggest leaving to the negotiators, as I understand the Indians do not want the full \$60 million.

Mr. Knapp - I take it that para. 1 of your memorandum means that a particular mine must be financed entirely in the first tranche or the second tranche of the loan and not that all of the equipment for the new mines should be financed in the first or the second tranche.

Mr. Rucinski - That's correct.

Mr. Mason - It's questionable whether we can work on this basis because they may not have the information available for any of the new mines.

Mr. Aldewereld - As was pointed out at the Department Head meeting at which this project was considered earlier, the point to this is merely that we don't want any individual mine started unless its complete financing is assured.

Mr. Knapp - We all agree that no new mines should be considered for Bank financing unless the finance for all of the mines is assured. The only question is whether plans for some mines are far enough advanced at this point to make that determination. I suggest that this be left to the negotiators.

Mr. Rucinski - What if the Indians ask for reimbursement in the second loan of later cost of mines?

Mr. Cavanaugh - I would object on the grounds that this is merely a device to avoid commitment charge.

Mr. Knapp - If you are talking about another mine entirely, we certainly could include it in the second loan, but we cannot at the time we make the first loan make any commitment for a second loan. Consequently, we should play down when we talk about reimbursement.

There is another question of reimbursement in the second tranche of additional expenditures on mines financed under the first tranche. This is something for negotiators to keep an eye out for.

Mr. Mason - If all of the new mines are included and the first two years for the other categories the arithmetic shows that there isn't much involved, i.e., \$50 million versus \$60 million.

Mr. Rucinski - I was talking of \$10 million, for instance, for 10 new mines and after the first loan the cost goes up requiring the Indian Government to put up additional funds for these 10 mines for which they might request reimbursement in the second tranche.

Mr. Knapp - That would all depend upon whether we can get their agreement on a definition of a project. The case you oppose might be considered but I doubt if we will be able to get any such agreement which would enable us to determine increased costs.

Mr. Lejeune - How much has been committed for this second tranche?

Mr. Knapp - There is no commitment. We are talking about \$60 million and they may wish to cut that down to \$50 million or so for the first tranche.

Mr. de Wilde - Why are the expenses stretched out over five years? Is this due to technical problems or to the administration of screening projects by the committee?

Mr. Van Dine - For the new mines the expenditures for the first year will be almost entirely local currency. The foreign exchange expenditures come later after the shafts have been made. Therefore foreign exchange expenditures will be small for the first year. However, it should be remembered that these figures are only estimates but it's assumed that the committee will approve all mines as they come up for consideration and will not space requests for foreign exchange over the five years.

Mr. Knapp - I think we should leave this to the negotiators, but I wondered whether we shouldn't have the same requirement for Item 2 of the list, that is, the equipment to achieve additional production for existing loans.

Mr. Van Dine - To a certain extent but it depends on each individual project. It's not true of category 3, which would be purchase of individual pieces of equipment rather than a program of a work for a mine.

Mr. Armstrong - The completion of the purchase of the equipment for the second category is not as important as it is with the first category since the principal expansion of production in the existing mines will result from proper working of the mines rather than from the new equipment.

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Mr. Knapp - What are the thoughts about the term of the loan?

Mr. Rucinski - Power loans to India have been for 20 to 25 years; railway loans for 20 years. Since this loan would be merely for the benefit of the Government rather than the coal industry, it could be argued that the Bank should go to 25 years in this case.

In answer to the question why we would not make the PICIC loan for 25 years, which also provides foreign exchange, is that in PICIC we had the exchange risk problem and also the question of who would pay the interest for that long period of time.

We made a statement at the Indian Consortium Meeting that the Bank loans to India would follow the Bank's normal pattern of 10 to 25 years, therefore I think we can make this one 25 years since it is not closely attached to the project.

Mr. de Wilde - Since this loan is not directly related to the coal industry, the latter will not have to repay the loan. The loan is related to the Indian economic situation. I think the term of 25 years can be justified on the basis of the general economic situation.

Mr. Knapp - I think your argument should be stated somewhat as follows: if the loan were related to the coal mine, and assuming a life of 8 to 10 years for the equipment, the loan should be for 8 or 10 years regardless of the Indian foreign exchange picture. But if, as I think the case is here, the operation is not related to the coal industry and does not require financial discipline on the ultimate user of the goods acquired with the loan, I think we can make a distinction and agree to a longer term.

Mr. Rucinski - That's right and that's why this loan is not the same as that for the Chasnalah project. There, where the loan is related to the project, we intend to have a shorter term.

Mr. de Wilde - I am inclined to think that, even if the coal industry did need the money and the operation did require financial discipline on the ultimate user, we should agree to a long-term maturity in view of the very serious problem of the foreign exchange.

Mr. Aldewereld - The suggestion that we agree on 20 to 25 years worries me because we seem to be giving an IDA character to Bank operations. Even though the ultimate recipients of the loan don't need the money, the life of the equipment is only 10 years and there is going to be another burden on the foreign exchange resources of the country when they have to replace the equipment. Basically I am urging that we should make a distinction between IDA-type operations and Bank operations and not try to merge the two.

Mr. Rucinski - We have a big problem of providing foreign exchange for India. I don't see why we can't do this loan providing funds for an important sector of the economy on a 25-year basis. In 10 years from now the whole situation may have changed, but I don't think the argument about the cost of replacing the equipment is any good. Moreover, I think it's unwise for the Bank, against its own advice, to impose terms upon India which are likely to cause a further crisis in their balance of payments problem.

Mr. Knapp - In answer to Mr. Aldewereld, I would agree if we were talking about a loan for a normal project. But here we are not talking about the users of the equipment. Actually, we are talking about a loan to assist the Indian economy and using the coal industry program as a vehicle for this assistance. I agree with Mr. Rucinski that in 10 years from now many changes are likely in the balance of payments picture and in any event the additional burden of replacing equipment is likely to be a very small factor.

Mr. Aldewereld - I have no objection to the objective of relieving a pressure on the balance of payments of India, but if this is our purpose, why don't we do it by means of IDA and keep the Bank in its present business of conventional development lending?

Mr. Rucinski - The Bank's commitment to assist in the present balance of payments problem amounts to \$200 million which is about equal to repayments on existing loans. Consequently, it doesn't really make much difference to the Bank. On the other hand, shifting to IDA would make a lot of difference to India because IDA is intended to do more local currency financing leaving the foreign exchange to the Bank. If we shift this foreign exchange loan to IDA, it would mean less foreign exchange would be made available to India to meet their requirements over the next two-year period.

Mr. Knapp - On the other hand, India is being helped because in the proposed project we would be putting together a number of small projects which otherwise would not qualify for lending from external sources.

Assuming \$200 million IDA credits for India in the next two years, could we fit this in?

Mr. Rucinski - Yes, we could. We now have about \$125 million in IDA projects for India, including BEAS.

Mr. Knapp - Why BEAS in IDA?

Mr. Rucinski - Looking at BEAS we now think that is quite appropriate for IDA. First, it has a large percentage of local currency financing and second, because the initial return on the investment is going to be rather low.

Within a list of acceptable projects, we can shift any way we want between IDA and Bank. It doesn't make any difference to us, but it does make a lot of difference to the Indians. So I ask why go to IDA with this project, thereby hurting India?

Mr. Knapp - There seem to be three alternatives and I would like to hear the Committee's feelings about these three: (1) a 15-year Bank loan for the coal industry project; (2) a 25-year Bank loan for "the balance of payments;" (3) an IDA loan on IDA's normal terms.

Mr. Lejeune - Logical reasons can be put forward for doing this as an IDA loan and also as a Bank operation. From a practical standpoint, I think it should be kept in the Bank because it would be unwise to make a large IDA credit for balance of payments considerations at this stage in IDA's development. To avoid the precedent of a long-term Bank loan to finance goods or equipment with a shorter life, I would suggest a 15-year Bank loan which I understand is the average life of the equipment.

Mr. Aldewereld - I am not as worried about IDA's reputation as the Bank's, if we should make a 25-year loan to finance a 15-year project. If we have to give long-term funds, IDA was supposed to provide long-term funds. I am afraid the precedent would destroy any possibility of continuing to relate the term of Bank loans to the life of equipment in the future. IISCO, for instance, does not have foreign exchange and exactly the same argument can be used to make a long-term loan for the Chasnalah project.

Mr. Cargill - I agree with Mr. Aldewereld. All of the arguments that have been given for deviating from Bank policy are all arguments for IDA. I don't think the distinction based on the requirement for financial discipline on the ultimate beneficiary is going to help in the future. The Government will offer to discipline the user through the terms of its loan to the ultimate beneficiary while asking for 25-year loan from the Bank. If I had to vote for a Bank loan I would vote for 15 years.

Mr. Iverson - It appears to me that we would not make a long-term Bank loan if IDA did not exist.

Mr. Rucinski - No, that's not true. We have made loans to Australia on a long-term basis for balance of payments purposes, but I think that the fact that we are using the coal industry as a vehicle for this loan should not blind us to the fact that the Government sorely needs foreign exchange on a long-term basis and that is the important problem here.

Mr. Cargill - I thought that the commitment of \$200 million for the Bank and \$200 million from IDA over the next two years was made particularly so the Bank would not have to deviate from its usual practices in providing money for India. I don't understand why abandonment of those practices is now being urged on one of the first Bank projects considered to fulfill the \$200 million commitment.

Mr. Diamond - I am in sympathy with Mr. Cargill's position, but since we are providing funds for the Government I would prefer to see an IDA credit rather than a Bank loan.

Mr. Lejeune - I wouldn't disagree with that, but I recommended a short-term Bank loan from the practical standpoint of IDA's reputation.

Mr. de Wilde - I agree with Mr. Rucinski. The financing of local currency expenditures on a large scale will be necessary and, therefore, we should reserve the IDA funds for the local currency projects.

I agree with what has been said that a long-term loan granted for balance of payments purposes will lead to requests for the same thing from others with the Government taking over the role of disciplining the borrower. However, I think that this is something that we have to accept in order that the terms of the loan are realistic in terms of the country's ability to repay considering the balance of payments position.

Mr. Cavanaugh - I would favor a Bank loan for 15 years. The First of Boston representatives visiting the Bank have been asking whether the IDA philosophy would spread to the Bank in view of the shortage of IDA funds. I think that this recommendation for a longer-term loan illustrates exactly the fear that they expressed and will be seriously damaging to the Bank in the long run.

Mr. Clark - I agree that it should be an IDA loan.

Mr. Hoffman - I sympathize with Mr. Rucinski. If IDA had a lot of funds for India, I would agree that IDA finance this project. In the absence of funds, I think IDA should be reserved for projects which are not fully foreign exchange projects. Mr. Aldewereld's argument is a good one, but where the loan is divorced from the goods financed, as it is in this case, I think the argument loses force, particularly when so much can take place between now and repayment. It certainly is not as important a consideration at the present time as the over-all Indian economy and the balance of payments difficulties. Thirdly, I think that the question of India's success in solving its difficulties is so important that the precedent argument doesn't make much difference. If India does not succeed, the catastrophic results will be immeasurably greater than the difficulties created by the precedent of a long-term Bank loan for short-lived equipment.

Mr. Iverson - If it were possible to shift the Indian projects between Bank and IDA, I would suggest that this go to IDA, and if it has to stay in the Bank, I would prefer 15 years.

Mr. Cargill - As I understand it, the Bank has argued that the other members of the Consortium should lengthen the terms of their loans to India, thus reducing the burden on India, because the Bank could not lengthen its term. I don't understand why we are now arguing that the Bank should lengthen the terms of its loans.

Mr. Rucinski - In the Consortium Meeting we were arguing for softness of the loans of the other members urged longer terms because India could not repay at the suggested rate but no consideration has been given to changing the Bank terms.

Mr. Cargill - That's exactly what I just said.

Mr. Clark - Do we not have enough 25-year projects to fill the Bank's \$200 million commitment?

Mr. Rucinski - Yes.

Mr. Knapp - To summarize the discussion, I would like to say three things:

(1) We certainly made it clear in the Indian Consortium Meeting that the Bank would not distort its normal lending pattern for India, but we would do all possible within the framework of our existing policies.

(2) I think Mr. Rucinski is right that this is not a normal Bank project. Because there is no financial discipline on the ultimate borrower we would be justified in setting a term unrelated to the life of the equipment. However, as the discussion here today has indicated that the members of the Staff Loan Committee are not convinced that this is not a normal Bank operation, I am convinced that we should stick to our conventional pattern, which in this case would mean a 15-year loan.

(3) I don't think that we have to decide now whether to finance this project with an IDA credit. We can reserve that question until we have had a review of the whole program of investment by the Bank and IDA in India. Initially my reaction is that \$60 million for the highways and \$60 million for this coal project is a little too fast for IDA.

Mr. Rucinski - I think that this should be a Bank project because of the local currency problem.

Mr. Hoffman - I agree. The question of free foreign exchange is a very crucial one.

Mr. Knapp - Certainly we should do what we can but we do not have to settle India's free foreign exchange problems regardless of the consequences for the Bank. I think that is a problem that the Consortium members have to settle, not the Bank and IDA. Also we should remember that financing this project is a contribution for India as we would be picking up in this program numerous small expenditures which would otherwise be lost.

Mr. Rucinski - I wasn't arguing that the Bank has to settle India's foreign exchange problem. I was merely arguing that India's need for foreign exchange is so important that in considering our lending it outweighs other considerations.

Mr. Knapp - It is possible that the Indians may wish the Bank funds reserved for other long-term projects thus getting long-term repayment rather than a short-term loan now, and would welcome IDA financing for this project.

Mr. Rucinski - The immediate foreign exchange problem is more important than the problem of repayment in future years.

Mr. Knapp - I suggest that the minutes should note that the Committee agreed a Bank loan of 15 years is appropriate to finance the coal industry program but if it later appeared desirable because of other general considerations to shift the financing to IDA this would be satisfactory.

TRINIDAD and TOBAGO

Economic Report -

Mr. Knapp - I take it the only creditworthiness question is why the Bank is lending to British Guiana?

Mr. Cavanaugh - We sold participations amounting to \$1 million out of \$1.25 million British Guiana loan and were turned down for the balance of the loan only because the maturities were too long and the rate was too low. None of the purchasers raised any questions about the creditworthiness of British Guiana.

Mr. Knapp - That's my point. If we sold \$1 million of the \$1.25 million loan at a yield of 5-1/2%, one may ask why the Bank makes a loan at 5-3/4%.

Mr. Lejeune - Trinidad could not borrow without the Bank's participation in the operation.

Mr. Knapp - The question could be asked, "Why not change rules so that these borrowers could borrow in the market with a U.K. guarantee without going through the Bank's operation?"

Mr. Cavanaugh - I think that they would have to pay much more if the Bank were not in the picture. The purchasers of the British Guiana participation had special reasons for their purchases, and bought the participations because the U.K. guarantee was attached to them and the Bank was in the picture.

Mr. Lejeune - The U.K. is not likely to guarantee loans from the U.S.

Mr. Knapp - I am not objecting but merely pointing out that it does seem a little strange.

Mr. Fajans - The U.K. authorized Trinidad last fall to borrow in the New York market for a package deal involving a sanitation project. However, the operation never came off. A Trinidad mortgage agency is about to borrow in the U.K., at a rate of 6-1/2%, to finance housing projects, but the transaction has not been finalized as yet.

Mr. Cavanaugh - While we probably would be able to sell some participations in the proposed loan to Trinidad, we could not sell the entire \$23.5 million.

Mr. Knapp - I agree that we may be able to sell some.

I take it that the economic paper has been reviewed by the SEC.

Mr. de Wilde - Yes.

Project Report

Mr. Knapp - The project report is also rather straightforward.

Mr. White - That is true except for the problem of the gas pipeline. A telegram has just been received stating that agreement has been reached on the supply of natural gas. No details are given. However, last week we were informed that the agreement would provide for the purchase of gas at a price 20% below the figure used in the Technical Report.

Mr. Diamond - Why is the price for gas as high in Trinidad as in the U.S.A.?

Mr. White - In the U.S.A. the average price is 15¢ per thousand cubic feet. Assuming the information received last week is correct, the rate in Trinidad would be about that of Venezuela.

Mr. Knapp - I suggest that in para. 35 of the Technical Report it should be clarified that the price per thousand cubic feet is the well-head price.

It would appear then that the telegram fills the last remaining gap in the picture.

I have a question as to why in para. 76 use of an operating ratio covenant was suggested.

Mr. Aldewereld - The circumstances here call for the operating revenue covenant because there will be unutilized capacity which would make a covenant on the rate of return on investment unreasonable. In order to reach a satisfactory rate or return, the rates charged for power would have to be unnecessarily high. The alternative of using the operating revenue covenant is one suggested in the paper prepared by the special working party established to consider the Bank's revenue covenants.

Mr. Knapp - The paper of the working party is stuck with me. I have not had a chance to read it, but will do so as soon as possible, and it will then go to the SLC for consideration. This seems an interesting way of working out the problem.

Mr. Diamond - In view of the uncertainties inherent in a constitutional change, has any thought been given to requiring consultation for a change in the management of the Commission?

Mr. Cargill - There would be a normal covenant requiring the Commission to operate in accordance with sound utility practice.

Mr. Fajans - The working party has discussed this matter and thought that a side letter providing for consultation on proposed changes in the top personnel would be appropriate. In reaching this conclusion the working party was partly guided by the thought that the Bank's contribution would represent a large percentage of the total cost of the project.

Mr. Knapp - Normally such a letter is not used unless the situation confronts us at the time of negotiations. There isn't any reason why we couldn't insist on assurances if there is any possibility that the situation might arise later.

Mr. Lejeune - It is quite probable that the standards of the past may look good in the future. Over the uncertain years ahead the quality of the management of the Commission will probably decrease. Therefore a letter would appear advisable.

Mr. Cargill - If that's the case, a general covenant would be a better vehicle of protection than a side letter.

Mr. Clark - It's the Legal Department view that reliance on the general covenant is to be preferred because the specific letters dilute the power of the general covenant.

Mr. Knapp - In the Volta River project agreement wouldn't there be a covenant that the management must be satisfactory to the Bank?

Mr. Clark - That's so much bigger that it's not comparable. It may not be any bigger in percentage than this, but in absolute amounts it's so much bigger that it changes the value and cannot be compared.

Mr. Knapp - I question whether we should have a covenant on management in the Loan Agreement.

Mr. Fajans - We could try during negotiations. This point hasn't been discussed at all.

Mr. Lejeune - I am satisfied with the present management but I am afraid that this might be a weak spot in the future after the present management has gone. Since we would have a big stake in the enterprise, I think we should have a side letter although I realize that one can question how effective this would be.

Mr. Knapp - I think that you should cover this management problem, but I don't care how it's done.

Mr. Clark - We could cover the management problem in the standard covenant, but I do object to a covenant that the management must be satisfactory to the Bank.

Mr. Knapp - No. That's not what I meant. We only want something on which to hinge later consultation on management.

The meeting adjourned at 5:10 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Wednesday, June 14, 1961 at 11:00 a.m. in Board Room

ECUADOR

Mr. Knapp - As I understand it, we are discussing creditworthiness and IDA-worthiness for Ecuador and not approving the projects at this time?

Mr. Schmidt - Right. If the projects materialize we would come back to SLC for permission to proceed.

Political Situation

Mr. Knapp - Judging from the newspapers, Ecuador would appear to be the next country on the list to go "Fidelistic" and the papers have pointed to Mr. Araujo as the possible leader of the revolt. As the mission report gives a much calmer picture, I would be interested to hear comments on this.

Mr. Davies - It is true that Mr. Araujo is a very powerful and dangerous man and it is reported that the Soviet Ambassador to Mexico, bearing large sums of money, has been in contact with Mr. Araujo. The big question appears to be what President Velasco will do. So far he has neutralized Mr. Araujo by removing him from the Cabinet. However, there is always the possibility that, under pressure from the right, the President may turn to the left for support.

Mr. Broches - I was not particularly relieved by the statement in the Report that bankers and businessmen were the main influence on the present administration since they may not be sufficiently objective and sufficiently foresighted to avoid difficulties and may not express the desires of the bulk of the people.

Mr. Schmidt - Ecuador has always been difficult, with a long history of political instability. The present President is in his fourth term but the first two terms were never finished. However, there has been some improvement in recent years. First, the last three Presidents have managed to complete their elected terms. Second, the radical talk of President Velasco may serve as a safety valve. Third, Ecuador does have a record of economic development and there are opportunities for future development which might serve to relieve social pressures. The situation is certainly not perfect and requires watching but is not such that we should cease operations.

Mr. Knapp - What is the political risk of the submerged Indians, representing half or two-thirds of the population, who are still completely out of the political and economic picture?

Mr. Davies - The leftist movement has originated in the towns and cities and not in the rural areas. The Indian element is still inactive although the increased vote in the last election indicated that some political feeling is penetrating into the country. However, the total vote was only 300,000 or 400,000 out of 4.4 million.

Mr. Demuth - Is the leftist movement of local origin or part of the international Communist movement?

Mr. Davies - The leader is Mr. Araujo but he has certainly been in touch with Cuba and has been reported to have been in touch with the Soviet Ambassador in Mexico, as I previously stated.

Mr. Knapp - On the basis of the economic factors, it would appear that Ecuador has some margin of creditworthiness, but looking at the political risk, it appears to me that we are moving into pretty shaky ground.

Mr. de Wilde - Ecuador has a good record of economic and financial performance considering their size and situation and actually has had some economic growth but they are now facing a lower rate of growth which creates a very difficult situation politically for the Government. I wonder whether this isn't a strategic time for agencies interested in development, such as the Bank, to step into the picture in order to maintain the rate of growth and thus try to prevent deterioration in the political situation.

Mr. Knapp - That would be a better argument for the U.S. to go into Ecuador. That is the sort of salvage job that the U.S. must perform.

Mr. de Wilde - I don't consider this a salvage job. Ecuador has a good record, although it does need new capital now to avoid a decrease in the rate of growth. On economic grounds a case can be made for the Bank going in and I think that the Bank should take the political risk.

Mr. Broches - Where does Ecuador stand on the index of social injustices Mr. Kennedy has been referring to?

Mr. Schmidt - While there is great disparity in the distribution of wealth in Ecuador, this is less so than in other countries in Latin America. Also, Ecuador has resources of new land along the coast which can be tapped. It is not like Peru which has only a few valleys coming down to the sea. The Indians up on the mountains are still quiet although the Government has not really been doing very much on their behalf.

Mr. Demuth - In looking at the Latin American feudal countries, and I believe we have to consider Ecuador a member of this list, to be realistic we must assume that revolutions are going to occur and only hope that the revolutions will result in a new politically stable society which will honor the obligations of former Governments and with which we can live.

Mr. Knapp - The recent Cuban experience would not indicate that hopes should be very great.

Mr. Demuth - I don't think the revolution in Cuba is over yet. It is too early to judge. We can only hope that finally the revolution will result not in Castro but in the necessary reforms which Castro was demanding when he was challenging the Batista regime.

Mr. Schmidt - I have two comments to make on that. First, I think all the Latin American countries are in a process of revolution and possibly the most the Bank can do to assure that the eventual outcome will be a society the Bank can live with is to finance projects, as it has done so far, which will help the general welfare of the countries concerned, thus leading to a gradual evolution rather than violent social eruptions. The projects we have in mind for Ecuador are a continuation of just such projects as we have financed in the past.

Second, it is not intended to rush into these projects. We would move slowly and would watch the situation very closely.

Mr. Knapp - Castro has not shown any appreciation for foreign investment. However, you are probably right in saying that the good projects would survive the revolution.

Mr. de Wilde - And in addition, the revolution may be peaceful as a result of the wider distribution of benefits resulting from the project.

Mr. Aldewereld - Colonialism is certainly bad in Ecuador. I suppose I can even say it is worse than that in the Far East. Something violent is going to happen. The question is, "What can we do about it?" I think that our projects do serve to relieve internal pressures but the country is still faced with external pressures. These I think the Bank has to accept.

Mr. Knapp - There are several things we could do about it. One, stop consideration of any Bank loan. Two, shift over to IDA operations completely. Three, pull out what we have invested. Four, avoid default by setting up a grace period extending beyond the period of possible revolution.

Mr. Aldewereld - I agree that we might consider more IDA money because of these political risks.

Mr. Rucinski - I am inclined to sympathize with Mr. de Wilde and believe that, if we had done more in Ecuador from 1958, the political situation would be less serious today, and suggest that we don't make the same mistake now. But I agree that we might do more IDA business than Bank because of the political risks. In sum, I suggest that we go ahead on a larger scale than has been suggested by the mission, welcoming the U.S. as a partner in this venture.

Mr. Knapp - In connection with a larger program, the minutes of the SEC meeting spoke of the necessity for help in development programming and the formulation of projects. How much progress has been made in these fields? Would they be able to handle larger amounts?

Mr. Schmidt - They have made progress. (1) The highway program that they have submitted now is a big improvement over that submitted seven years ago. At that time they violated every concept of the Bank and would not listen to any arguments. Now they are proposing a sensible program of five roads, three of which the U.S. is financing. (2) They have started a planning office which is headed by an able man. (3) They have commenced a study of a national power program. In general the performance has been satisfactory recently and they are moving in the right direction.

However, it would be hard to make a large number of loans to Ecuador rapidly, particularly with the U.S. picking up all the good projects. However, I believe that we can wield considerable influence even though we do not contribute a great deal of money.

Mr. Kheradjou - The problem of "revolutions" is new to the Western Hemisphere and therefore may be over-emphasized. Communist pressure has existed on countries in other parts of the world for some time and has not prevented us from doing business.

Mr. Knapp - That is correct, but we are at the moment not doing any business in Viet-Nam.

Mr. Demuth - But we did considerable business in Iran, which has been under pressure.

Mr. Collier - I agree with Mr. Kheradjou and I think it is not a question of revolution but the nature of the society that comes out of the revolution. In Iraq, as far as I know, the investors are able to get along with the new Government. Moreover, Governments which take a neutralistic stand do not necessarily create risks for the investor.

I am also concerned about what arguments can be used to refuse a loan because of the external pressures and the internal political situation.

Mr. de Wilde - If the political situation were bad and the economic situation were bad, there would be justification for refusing to consider lending operations. In Ecuador the economic situation is satisfactory and I think that the Bank was set up to take the political risk. Therefore we should go ahead.

Mr. Knapp - That is true, but political situations do lead to defaults. The recent semi-annual report of the Eximbank surprisingly enough listed their loans in default, practically all of which were in Latin America, with Cuba heading the list.

Economic Report

The Economic Report is very interesting and well-done but the economic situation is not the issue here. Do we have any questions or comments?

Mr. Weiner - I should report that a \$10 million stand-by credit had been received from the Fund and the country has undertaken a currency stabilization program. The underlying balance of payments situation is fairly good.

Mr. Knapp - I suggest that para. 85 might be clarified. If there is a definite possibility of American and Foreign Power lending for hydroelectric power facilities, I think the report should say so, and if not, the reference to the possibility should be deleted.

Area Memorandum

The conclusion of the Area paper that there should be an IDA-Bank blend with two projects for the Bank and one for IDA is somewhat inconsistent with the other conclusions that the Bank consider lending \$10 to \$20 million for high priority projects in the next year or so, inasmuch as the Quito power project would require a loan of about \$6.5 million and the Comité de Vialidad highway project a loan of about \$3 million for a total of less than \$10 million.

Mr. Schmidt - That is right. The \$10 million figure was for the two present projects and the additional \$10 million we had in mind using for other projects which might come along.

Mr. Knapp - I think we should hold the decision on whether the other projects should be Bank or IDA. At the present time we agree to consider \$10 million for Bank loans.

Is there any other question on para. 17? I am prepared to accept these three projects on the basis on which we have been talking.

Mr. Broches - There is a question whether we should try for a broader scope, particularly whether we should move into agriculture. The two projects suggested are continuations of present projects.

Mr. Schmidt - I agree. As we said in the Report we intend to continue to explore the agricultural possibilities.

Mr. Knapp - My question is how. We have been trying for five years. Let us see if we can get something done now.

Mr. Schmidt - We have been trying to find a vehicle for agricultural credit. Klein and Saks, now working on this problem, are trying to sell an idea to the Government, we understand, of starting a new organization. We have not seen the report.

Mr. Knapp - I think the Bank should be helping to put over their suggestion if it is a good one. We certainly ought to study their proposal and make a decision.

Mr. de Wilde - The problem of agricultural credit cannot be solved merely by organization of a new institution. What we need is a properly supervised agricultural credit system.

Mr. Knapp - I agree with that but let's get some action.

Mr. Demuth - Since an agricultural project is likely to involve a large percentage of local expenditure financing which is more appropriate for IDA than the Bank and since the political problems originate in the agricultural areas helped by an agricultural loan, wouldn't it be better for the Bank to finance all the road and power projects and hold IDA financing for the agricultural projects, using the promised credit as a bait for setting up a proper organization to carry out the project?

Mr. Knapp - The radicalism does not originate in the rural areas. It comes from the urban areas. I certainly favor the agricultural credit but I think that if we are ever able to do that we could use additional IDA money above the amount we are now talking about for the national highway program.

Speaking of difficulties of ever doing this project, it is quite likely that the Inter-American Development Bank will preempt this field and probably make a mess of it, thus preventing achievement of worthwhile program.

Mr. Schmidt - That is possible. It's true that the injection of PL 480 money whenever the existing agriculture credit organization got in trouble has effectively prevented the necessary reform of the organization in the past.

Mr. Broches - Is our existing loan to the Comite in default? The memorandum mentions that the proposed loan would be to assist in completing five unfinished roads financed by Loan 94 EC.

Mr. Schmidt - While it is true they haven't completed the roads, even after several adjustments had been made in the agreement, one cannot say that they are in default on their performance under the agreement. To be frank, the appraisal made by the Bank at the time was not good. The cost estimate was too low so that it was impossible for the borrower to complete the project at the estimated cost in the time allowed. Even after the adjustments made, certain sections remain unfinished but they are usable and we have considered the performance acceptable in the circumstances.

Mr. Kheradjou - I have a question as to why one of the non-revenue producing projects was suggested for the Bank rather than IDA.

Mr. Knapp - In general it is probably a good idea to consider non-revenue producing projects for IDA and I started that way but here the Comite has had a long struggle, supported by the Bank, to maintain its independence which might be jeopardized if an IDA credit were made to the Government.

Mr. Kheradjou - From a tactical standpoint it might be wise to put the revenue producing project in IDA to prove what we have been saying, that IDA would look at projects with the same critical eye as the Bank.

Mr. Knapp - That may be so but it is offset by the disadvantage, I think, that they would expect easier treatment in IDA.

Mr. Rucinski - I have the same question as Mr. Kheradjou as to why not put both highways in IDA.

Mr. Knapp - As I said, the problem of maintaining the independence of the Comite convinced me, particularly as the small amount of \$3 million is not enough to justify a shift to IDA for creditworthiness reasons.

Mr. Rucinski - If it were in IDA, it would permit the financing of a higher percentage of local currency.

Mr. Knapp - Not much because we have been financing 45% of the total cost under the present loan. As the standard procedure for IDA is to finance 50% of the total cost, not much would be gained on this point by shifting to IDA.

I accept the recommendations of the Memorandum.

The meeting adjourned at 12:10 p.m.

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SLC/M/61-23

Rough Notes of Staff Loan Committee Meeting held on
Wednesday, June 7, 1961 at 11:00 a.m. in Room 927

Proposed New Program of Development
Advisory Services and Training

Introduction

Mr. Knapp - This is a very interesting and important paper. The question raised in the paper was considered at the Last Weekend and, as I recall, we agreed that because of the Bank's strategic position, it should play a prominent role in development programming, although its contribution might be only a small percentage of the total effort, and the necessary staff to carry out this function should be added. The recommendations we are considering today are a step along the road toward realization of that decision.

I suggest that we consider the paper in two stages: first, the appraisal of the problem; second, the organization of the proposal.

Mr. Demuth - On appraising the problem there were differences of opinion in the committee as to the relative importance of development programming and the evaluation and preparation of projects. I think all agreed that both are needed and in varying degrees in different countries.

The committee was in agreement that the Bank should expand its activities in this field but discussion centered on the difficulties of such expansion. Recruitment will be very difficult and the effect upon the existing staff will be disturbing. The process of expansion will not be easy or smooth no matter how it is done. The recommendation as to organization was suggested by the committee in the hopes of minimizing these difficulties but we do not deny that they will be great. Despite the difficulties of expansion, the committee agreed that the Bank must proceed and therefore must face up to the difficulties.

Appraisal of the Program

Mr. Knapp - On p. 6 the report speaks of providing advice on important economic and financial problems. This seems to me to be work of a short-term nature which the Bank should not attempt to do.

Mr. Demuth - The report was written to cover the case of the mission to Peru as it actually turned out. Although it was intended that the mission would work on long-range problems, it actually handled the important current economic problems because Peru had not worked out a long-range program.

Mr. Schmidt - That illustrates one of the problems in this field. A country sincerely wants programming but in actual practice the leaders of the country are too occupied with their day-to-day problems to consider long-range program planning and turn to the advisors for assistance on their day-to-day problems.

Mr. de Wilde - The Bank has in the past appointed advisors to help on current problems. In Pakistan, for instance, the Harvard University group was concerned with long-range planning. The Bank man advised on economic policies. The paper tried to emphasize the importance of gearing economic and financial policies to the long-range development plans. The right policies must be taken and implemented in order to make the program move forward. This does not necessarily mean taking over the role of IMF.

Mr. Diamond - The point raised by Mr. Knapp is related to a broader question as to which fields the Bank should direct its advisory work. Even limiting the Bank's role to developmental work, there still is a wide range of possibilities. Did the committee reach a decision as to the fields in which the Bank is best qualified to give advice or in which the Bank's advice would be most effective? I raise the question because the paper leaves the impression that the decision of the committee is based on the needs of the developing countries rather than on evaluation of what the Bank is most qualified to provide.

Mr. Demuth - The UN and, to a lesser extent, the Ford Foundation are not, as a general rule, able to employ high-level people, principally because the appointments are temporary and there is no possibility of a long-term attractive career in this portion of the UN's work. Therefore the UN often has to accept second-rate older people or younger people who have not acquired sufficient experience or judgment. The UN admits that it cannot attract the people required to provide a high-level advisory service in this field.

I think that the Bank should not attempt to do the whole job, but should concentrate on this high-level field which cannot be done by the other agencies and leave the other less difficult fields to the other agencies, while at the same time maintaining as much flexibility as possible in order to shift the Bank's function to meet the need required on a particular case.

Mr. Schmidt - In order to do a proper job, a development programming mission must be able to call on a large reservoir of technical skills. The high-level advisor cannot do his job without the technical advice. Do we intend to maintain a reservoir of people qualified to handle the technical aspects of the problem in programming as well as the top economic advisors discussed in the paper?

Mr. Hoffman - The final para. on p. 5 was designed to answer that particular point.

Mr. Knapp - While the para. referred to relates to the point, it does not specifically cover the question of providing technicians.

Mr. Cargill - That certainly is a fair criticism. The discussions of the committee were on the functions of high-level economists and the problem of finding such high-level economists.

Mr. Demuth - The paper was not intended to down-grade technical talent. However, unlike senior-level general development economists, we have been able to find capable technical talent on a short-term basis. Therefore, the paper is directed toward the problem we have not solved.

Mr. Aldewereld - I believe that Mr. Schmidt has a valid question and I have some questions about Mr. Demuth's analysis of the problem. As a general rule, most countries have pretty good men at the top but the officer corps below the top man is lacking in qualification. Consequently, countries need help at the officer corps level in their planning organizations.

I am not arguing that we shouldn't supply top-level men but that this is only a first step.

Mr. Knapp - Certainly a country needs more than just a new top man in charge of development planning and the Bank should try to find the lower level people for the country. The question is whether we maintain a corps of technical people in addition to the top man.

Mr. Cargill - I think there is a demand for the technical people and it would appear to me that this demand can properly be met by TOD.

Mr. Cavanaugh - I have the same question Mr. Diamond raised. With 20 people supplied by the Bank working with many other people from other agencies and from the countries themselves, there is a big question as to how effective we can be if the other people working under the top-level men provided by the Bank are not willing to follow the Bank's advice. This will certainly lead us to a policy of broad recruitment to supply complete teams.

Mr. Broches - The paper does not argue that the Bank play an exclusive role in this field. It merely says that the Bank should provide the 20 high-level economists which the other agencies cannot provide. It was thought that the other agencies would be able to provide the people qualified to make a technical sector analysis and that our 20 men would use the sector people from the other agencies.

Mr. Knapp - If the question is whether the top-level man can do his job properly in isolation without staff, the answer is no. The question of coordinating proper staff obtained by other agencies with the top-level man provided by the Bank is a fair one, but not one that can be answered here today. The answer would depend upon the quality and ability of the man we provide.

Mr. de Wilde - Top economic people doing a program job, would need sector help but perhaps not as much as has been suggested here this morning. It might be possible for the general economist to get the proper answers from the local people by asking the proper questions, and also the general man might be able to make a technical judgment in some cases. The emphasis in the paper is on the general high-level economic job because that is what is needed, and it is a service which we could provide on a continuing basis.

Mr. Hoffman - I would like to make two comments in answer to the point raised by Mr. Diamond and Mr. Cavanaugh. First, the Ford Foundation is unhappy about its work in this development planning field because of its association with the U.S. The Foundation favors an international agency as the provider of the service.

Also the U.S. Government thinks that the Bank is peculiarly qualified to provide this service. Therefore, there isn't a difference of opinion on this matter. Secondly, while I don't want to force a decision right now on the question of creating a pool of technical advisors or the organization of such a pool, it was my thought that such people would be recruited from the Technical Operators Department.

Mr. Aldewereld - I do agree that the Bank is the proper agency to provide this service and I don't disagree with the objectives for the proposal to organize a body of 20 high-level general economic advisors. My only point is that this is not the only thing that has to be done.

Mr. Knapp - At the moment we are talking about a corps of top-level general advisors made up of economists with development programming experience and perhaps economic people who are oriented toward various technical aspects of the project. But we are not considering now the formation of a corps of 500 technicians to perform all of the supporting tasks. To the extent we must supply such technical support we will have to rely on our own staff and future recruiting. I think we will need additional technical talent concentrating on development program. I feel that we are particularly qualified on the basis of our experience in the evaluation of projects to provide this service.

Mr. Demuth - There is no doubt that the proposed program would create increased pressure on TOD and the general economist will be asking for help from the technical people.

Mr. Hoffman - A big part of the job of the high-level man will be to find out what technical people are required.

Mr. Cavanaugh - Has there ever been a general economist performing the job contemplated in the paper?

Mr. de Wilde - The job is really one of liaison in order to make the people of the country aware of the implications of the actions being taken.

Mr. Cargill - I think that too much emphasis has been placed on development advisors, while the main problem is that of providing experts for a shorter period of time to solve the current problems.

Mr. de Wilde - In the past, I believe that the advisors have been concerned with the problems of the country for too short a time and that after their departure there has not been, and there was not possible, adequate follow-up on the advice they had given.

Mr. Schmidt - A follow-up from Washington is possible and in many cases it may be more effective.

Mr. Knapp - Here I understand we are talking about both long-term and short-term advisory service.

Mr. Cope - In that connection many missions are too long. Often long association in a country leads to loss of power, whereas a short visit from Washington may accomplish much more.

Mr. Young - Are there any private companies who could do this job, or have they been excluded from consideration because we feel that they are not doing a proper job?

Mr. Demuth - The private companies have a staffing problem similar to that I have described for the UN and the Ford Foundation, and also they have another serious problem in that they are not necessarily objective. Many of the private companies doing this sort of work are contractors or engineering advisory firms who are basically interested in developing markets for their product. I think there is agreement that there is a demand in the less-developed countries for a small advisory service and that the Bank should provide this service.

Mr. Knapp - I think the para. at the bottom of page 10 properly describes the type of work that should be done by this group of high-level economists advisors, except that I have a question as to whether they should serve as administrators of development programs. Do we all agree to accept the organization of a corps of development advisors as set out in that para.?

Mr. Cope - No, I do not agree because I object to the word "corps". I feel that describing it thus denotes agreement on the proposal for the organization of a new special group in the Bank.

Mr. Knapp - Would you agree with the para. changing the word "corps" to "a number of people in the Bank?"

Mr. Cope - Yes.

Mr. Diamond - Are we agreed that this is the most important task that the Bank can perform in this field?

Mr. Knapp - Actually we are doing this now. The question is whether we should increase our activities. The issue has not been raised as to whether we should change to something else, and I think that at this time we should stick to the question that has been raised.

Mr. Diamond - My suggestion for an alternative task of the Bank is that we provide people to propose projects and to prepare them properly for presentation to the Bank.

Mr. Knapp - That I think is a proper function and purpose of the Area Department and one that they should be performing now.

Mr. de Wilde - Also one of the functions of the 20 high-level people proposed here would be to identify projects and to stimulate the preparation of their presentation to lending agencies.

Organization

Mr. Knapp - As I understand it, while there was agreement in the committee on the need for such a service and that the Bank was qualified to provide this service, the committee disagreed as to the method of organizing such a service.

Mr. Demuth - A big problem here is that of recruitment. Because of this problem some members of the committee have proposed the formation of a new corps outside of the regular pyramidal organization of the Bank. These members of the committee felt that a horizontal organization of the advisors who would all be high-level and equal, standing outside of the Bank's administrative hierarchy needed for operations, would help in recruiting the high-level people required.

It is believed that the required high-level people might be willing to join a group organized as is the faculty of a university or the partners of a law firm which they might not be willing to come into the existing organization of the Bank.

Mr. Cope - I have considerable difficulty with the proposal because of the organizational set-up envisaged. The committee's paper and the discussions of the committee placed emphasis on the problem of recruitment and the publicity attendant upon the new extension of the Bank's function in this field. I think these considerations are secondary. The first and most important point is to determine how to use these high-level advisors most effectively. I feel that advice to its members is a proper part of the Bank's work, a most important part, and related to lending operations of the Bank. How effective the Area Departments have been in performing the role of this advisory function is very difficult to measure. But I feel certain that advice from an independent corps outside the Bank's primary operations, it is likely to be less effective than advisory service coordinated with the regular operations.

The authors of the report object to the pyramidal organization of the Areas on the grounds that it prevents employment of high-level persons for this advisory service. The history of the Bank shows that this is not true. I think it's possible to have the advisory service centered in the Area Departments provided the people concerned could be shifted around in different Departments and I see no reason to cut the technical people off from TOD. The argument that the advice would be secondary to the operating function of the Bank depends entirely on how many people are involved in the service. I also think that there is a good argument for maintaining high-level economists on the Economic Staff who would be members of a group without assignment of definite rank ready for service outside the normal work of the loan operations, and who could be shifted to one Area Department or another in connection with their assignment to advisory work around the world. By having such a group in the Economic Staff, integration and coordination of the advisory service with the Bank's other operations could be achieved. I think that the suggestion made by the paper for a separate independent corps of high-level economic specialist advisors would lead to conflict between the Bank's operating groups. For the moment I do not think that the paper adequately faces up to this problem.

Mr. Knapp - I did not think that the suggestion in the paper to set up an international advisory center meant that the primary responsibility of the Area Departments for the member countries and development in the member countries would be lowered. Perhaps the paper does not cover this point adequately, but I did not think there was any question about this.

Mr. Demuth - The committee was unanimous on this point, and this point was covered in p. 13 of the report. Perhaps the wording could be expanded.

Mr. Cope - The report does refer to the responsibility of the Area Departments. Nevertheless once a separate organization has been established there will be separate loyalties and separate outlooks toward the member countries' progress. The conflict I mentioned would be inevitable regardless of what is said in the paper.

Mr. Aldewereld - I agree there would be disagreements.

Mr. Cargill - This is particularly so as the recruitment of the special corps of development advisors would be made on the basis of their very independent status.

Mr. Aldewereld - Mr. Cope, in speaking against the proposed organizational set-up, has referred to the possible operational problems. I think there is another problem which is also important. We have in the Bank a very good group of developmental economists, perhaps the best in the world, which has been recruited over a very long period of time.

I think that the proposal for an elite corps, independent of the Bank staff, would have a fatal effect upon the morale of this very qualified existing staff.

Mr. Howell - What would be the effect on morale if a special corps were set up in the Economic Staff?

Mr. Aldewereld - It would probably be less difficult if the corps were attached to the Area Departments.

Mr. Cope - There are advantages of having the corps attached to the Areas or to the Economic Staff, but I think the advantage of having these special economists attached to the Economic Staff and participating in the economic thinking of the Bank can be gained and at the same time the conflict with Areas can be avoided if the special corps people can be assigned to the Area. To work properly, there will have to be a very great degree of mobility between the Areas and the Economic Staff.

Mr. Broches - Mr. Aldewereld and Mr. Cope have raised the problem of the comparison of salary between the special corps and the regular staff. If the salaries of the members of the special corps were to be high, I agree we will have a morale problem which we must face up to. However, I think the safest solution to this morale problem would be to put the special corps in a separate segregated compartment labeled with separate, particularly difficult assignments which justify the salary differential.

Mr. Aldewereld - That arrangement assumes that the members of this elite corps are going to be better than the present staff. I have seen a number of so-called experts that definitely were not as good as our staff members. It depends upon the person. If the special corps member is definitely of high caliber, I don't think any of the other staff members in TOD or Area Departments are going to object to the fact that he gets a very high salary.

Mr. Broches - Mr. Aldewereld is really raising a question as to whether it is possible to hire 20 highly qualified people for this elite corps.

Mr. Knapp - I am a little surprised at this because I thought that our own senior economists would be the first candidates for this new corps.

Mr. de Wilde - That's right. It's not a point of finding more superior people to the economists we now have, but finding more. It is quite possible that recruitments from the academic world might lead to failure because of the candidates' inexperience with actual operations. We will have to work out an arrangement for definite cooperation with the Bank's Economic Staff and this will require a period of screening the candidates for the elite corps during a period of work on the Economic Staff of the Bank.

Also I want to say that the Economic Staff agrees that the Areas should have the responsibility for determining what advice should be given to the member countries and when and where. But also we should remember that the type of men we have in mind for these high-level jobs should not be looking back to the Bank for constant guidance. Having picked a highly-qualified person, we would expect to rely on his judgment.

Mr. Cargill - That's perfectly all right for the resident representative dealing with current problems, but I am concerned with the other aspects of this. That is the long-term development program. It would certainly be necessary for the advisor to keep in very close contact with the Area Departments.

Mr. Knapp - I take it that you have in mind that the Far East Department has had teams in the field which have been vetting development programs and actually formulating programs for member countries.

Mr. Schmidt - The chief argument for this separate organization appears to be based on a thought that it would appeal to top-level people being recruited. I am not sure that this is true and think that it would create certain dangers. The people in the Bank coming along, ready to take on this type of work would be disturbed by the new group, particularly during the training period. Therefore, I think additional personnel recruited should be closely tied in with the regular operations. I think that a group tied in with operations could do a more effective job when they return to the Bank after assignment as advisors in a member country.

Mr. Diamond - P. 9 says that the management decided to authorize a few senior economists in each Area Department, but this has not been done.

Mr. Knapp - Both statements are correct.

Mr. Schmidt - In the last budget meeting, I was told that we couldn't hire additional senior economic staff.

Mr. Howell - It was agreed around Christmas time that the Areas could each get two more senior economists, but actually not a single one has been hired since.

Mr. Aldewereld - Perhaps they haven't, but that does not mean that they could not be. In TOD we have taken on two people recently to do this type of planning work.

Mr. Cope - The paper is based on the erroneous assumption that no hiring is possible with the present arrangement but with the new set-up, would be possible.

Mr. Demuth - That is not fair. The majority opinion expressed in the paper was that it might be easier to hire senior economists for a separate organization, but they did not say it would be easier. Disregard the problem of public relations, the recruitment is definitely going to be the problem and without being able to get the people we won't have any problem as to where to put them.

Mr. Knapp - This has been an interesting discussion. It wasn't the intention to reach a decision on this point now. The decision must be made by the management and the Administration Department, having in mind the needs for the service and fact that the Area Departments are primarily responsible for the relations with our member countries.

The meeting adjourned at 12:40 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Monday, June 5, 1961 at 4:30 p.m. in Room 927

HIGH COMMISSION TERRITORIES

Mr. Knapp - This is an interesting paper. I take it the main question is whether or not IDA should make credits to these Territories, given the unusual financial and economic situation. Also it is a mare's nest politically now that South Africa has become a republic.

Mr. Cope - The situation of the Territories is unusual and their ability to service credits will depend upon the tolerance of South Africa.

Mr. Collier - I discussed the constitutional problem with the Commonwealth Relations Office. Their answer was that the situation was anomalous anyway and South Africa's departure from the Commonwealth would merely make it somewhat more so.

Mr. de Wilde - The revenues of the Territories are received from South Africa as a share of customs; for one of the Territories this amounts to 51% of the total revenues, so it is quite important. Would it be possible to get special assurances on this for the future?

Mr. Collier - The receipt of the customs by the Territories stems from the 1910 Act when the Union of South Africa was formed. While I agree with Mr. Broches that reliance on the Act is not very secure, I don't think that South Africa is likely to turn nasty at the present time. If they did, the U.K. would make up the loss of revenues, as they are contributing to the budgets now.

Mr. Broches - I agree with Mr. Collier. South Africa would be in serious trouble with the U.K. if they caused difficulties over a share of South Africa's customs and excise revenues. I don't think they will take action to destroy the small enclaves such as Basutoland and Swaziland because the South Africans are contemplating the creation of additional enclaves as a possible solution to their social and political problems.

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Mr. Knapp - I notice that Swaziland has become economically oriented toward Mozambique rather than South Africa with the development of the transportation and mining enterprises in cooperation with Mozambique.

Mr. Collier - That is correct, but they are still under the High Commissioner in South Africa or, as he will probably be called, the Ambassador. Undoubtedly changes in the political structure will occur but it is not possible to say now just what arrangements will be made.

Mr. Knapp - It certainly is a curious pattern both politically and economically and will be difficult to explain to the Executive Directors.

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Mr. de Wilde - The U.K. assists the Territories by means of grants-in-aid to the Territories to balance their budgets, and under the Colonial Development and Welfare Act (CD&W) of 1959 finances from CD&W loan funds expenditures which by their nature are not recurrent. I take it that, on the latter, the Territories have assurance that they will receive funds into or through 1964 or later. However, they do not have any assurance on the grants-in-aid for the years ahead but merely expect the U.K. to come up each year with the additional amount necessary to meet the gap between revenues and what the Territories have to pay, so the U.K. in effect provides the revenue to service debts to itself.

Mr. Collier - That is right. But you should add that the U.K. screens the budget before agreeing to fill the gap. In addition, Exchequer loans are a recent innovation. I do not believe that any repayments have actually taken place as yet but, when made, the repayments will probably be made out of the current budget, so in effect money is taken out of one U.K. pocket and put in another.

Mr. Cargill - If IDA did not provide money for these projects, wouldn't the U.K. lend money for them, assuming of course that the projects are needed?

Mr. Collier - That isn't easy to answer. The Territories have set out to find other sources of finance and until it is known whether they will be successful this problem has not been considered. If they should fail, possibly the U.K. will grant additional loans, but one cannot tell.

Mr. Knapp - As I understand it, they had an agreed program and the road projects we are considering, recommended by the Morse Commission, are additions to the agreed program. Therefore, they are searching for additional funds to finance them.

The Morse Mission did not draw up the entire program but, I take it, did endorse the existing program while adding this additional bit.

Mr. de Wilde - Do the Territories have the capacity to carry out the planned investment program, including the road projects which have been added to the original plan?

Mr. Collier - The plan financed by the CD&W grants involves increasing work on existing programs and, therefore, I believe the Territories could carry out this incremental work. However, the \$2 million road programs for Basutoland and Bechuanaland would raise doubts as to their ability to absorb the funds and would require a build-up of the Public Works Department and the planning organization.

Mr. Young - I certainly agree with that. There is only one man in the Highway Department of these two Territories, therefore the Departments have to be strengthened considerably although that in Swaziland is quite different.

Mr. Knapp - To sum up so far, we are agreed that the unusual political and financial relationships of the Territories should not prohibit IDA operations although this is not to be taken as ruling out the considerations later of a Bank loan to the Territories; for instance, for the hydroelectric project that is being studied for Swaziland. The projects proposed appear to be O.K. although

really there is only the project in Swaziland. The \$2 million figures for the other two territories are targets rather than amounts for proposed projects.

Is there any dissent on the proposal that IDA consider providing about \$2 million in Bechuanaland and Basutoland?

Mr. Cavanaugh - Would South Africa get the foreign exchange on the credits and provide the foreign exchange for repayment?

Mr. Collier - South Africa would get the foreign exchange and would presumably provide the foreign exchange for repayment.

Mr. Cope - Or the U.K. would, through the system of grants-in-aid, if the present system continues in operation.

Mr. Knapp - This raises the question of guarantees and whether IDA should have some sort of commitment from South Africa on the provision of foreign exchange to meet the repayments.

Mr. Collier - I raised this question of a commitment from South Africa with them. They said that "they saw the problem and would do some thinking." All I can say is that they are aware of the issue.

Mr. de Wilde - In view of the uncertainties on the future relationship of the Territories with South Africa, should IDA get a stand-by agreement from the U.K. to supply foreign exchange in the event the Territories do not receive foreign exchange from the South Africans?

Mr. Knapp - I thought that in organizing IDA, it had been agreed that the Colonial powers would not guarantee credits granted to dependencies.

Mr. de Wilde - That is true. But we have a special case where the recipient of IDA funds has neither foreign exchange nor its own currency. Because of this situation I think that consideration might be given to getting a stand-by agreement.

Mr. Schmidt - Can the U.K. make such an agreement?

Mr. Collier - I believe so. It is the same as any other U.K. territory.

Mr. Knapp - It would be an anomalous situation to ask for a guarantee from South Africa.

Mr. Cavanaugh - It seems to me that we need some sort of assurance that the Territories will get the foreign exchange required to service the credits.

Mr. Demuth - I think it would be best to get assurances from South Africa on this point but if the U.K. objects to the anomaly, then they could provide, not a full guarantee, but simply a guarantee on the exchangeability of the South African rand for the currency that the Territories would have.

Mr. Cope - If the South African rand should become inconvertible, certainly it would be necessary to make arrangements immediately covering the normal trade of the Territories. I would assume that these special arrangements would apply equally well to the service of debt. In the final analysis, the ability of these Territories to service their debt depends on their balance of payments and not on this unusual currency situation.

Mr. Knapp - The problem is not one of inconvertibility of the South African rand but the possibility that South Africa might arbitrarily cut the Territories out of the distribution of rands from the customs and excise receipts.

Mr. Cope - Under such a circumstance, the Territories would presumably shift their trade to another currency, perhaps pounds, and act independently.

Mr. Knapp - That raises the question whether they should not have assurances from the U.K. if the Territories should shift their transactions to pounds.

Mr. Cope - At the present time the Territories are in fact turning any foreign exchange received over to South Africa and will continue to do so as long as the rand is convertible. If it was not convertible, the Territories would no longer sell for South African rands and would not turn over the foreign exchange to South Africa.

Mr. Collier - This turnover of foreign exchange is an informal arrangement and could be changed without violating any agreement.

Mr. Knapp - Since the U.K. is now putting in sterling in the form of grants-in-aid for budgetary support, wouldn't it be possible to get assurances from them that pounds do not go to South Africa if the High Commission Territories are not allowed enough foreign exchange to service the credits?

Mr. de Wilde - I agree with Mr. Cope that trade would be shifted and this cut-off by South Africa would not be a problem.

Mr. Cargill - I would advocate an all-out guarantee by the U.K.

Mr. Knapp - That is not consistent with the original concept of IDA financing that an international agency and not the mother country would provide the cheap money for the dependent territories.

Mr. Cavanaugh - Does South Africa have control over the borrowing power of the Territories?

Mr. Collier - The Territories aren't part of South Africa.

Mr. Cavanaugh - South Africa must have some control. They are not going to let the Territories continue to run up obligations for South Africa to provide the foreign exchange.

Mr. Broches - In the discussions on the formation of IDA it was contemplated that the mother country might guarantee a credit to dependent territories in those cases where the mother country was on the borderline of creditworthiness but it was not contemplated in a case such as this.

Mr. Demuth - The general understanding was that the mother country would not guarantee credits to dependent territories but the question was not fully resolved and was left open. Consequently the Articles do provide for such guarantees.

Mr. Broches - The main point raised in the discussions during the drafting of the IDA Charter was whether the mother country had done enough already. If they had exhausted their resources there would be no point in asking for a guarantee of the mother country. Presumably they had put into the territory all that they could be expected to put in.

Mr. Cavanaugh - Getting back to the earlier question, it appears to me that as South Africa gets the balance of payments help and has to provide the foreign exchange for repayment, we should be looking to them for the assurance.

Mr. Cope - That isn't correct. Because the U.K. puts in funds through the grants-in-aid program, the South Africans are receiving sterling. At the same time they pay out for the service on the debt. The result is a wash for South Africa and the U.K. is, in effect, providing the foreign exchange for the credit service.

Mr. Knapp - Getting assurances from South Africa on the provision of foreign exchange seems impractical. I wonder whether we could go to the U.K. and ask that they make it available, within the limit of their usual budgetary subsidies, whenever the foreign exchange is not available to the Territorial Governments from the convertibility of the rand.

Mr. Cope - I think we could. The U.K. should agree since it amounts to the same thing they are doing now.

Mr. Knapp - Yes, as long as the Territories are not viable and the U.K. has to provide funds for budget support.

Mr. Schmidt - Do we need to know that the Territories will become viable in order to make credits?

Mr. Collier - What you are doing is raising a question as to whether a country can be so non-creditworthy that it is not eligible even for IDA financing.

Mr. Knapp - The answer to that one is "Yes."

Mr. Demuth - I don't know as I agree. I thought we said that we would never hold back IDA funds; that we could always find some arrangement by which IDA could assist even the most sorely pressed country?

Mr. Knapp - Well, I agree but certainly there could be countries which are not creditworthy for IDA assistance on the terms we have used for IDA so far and we would have to make other arrangements.

Mr. Cope - I think the risk of what happens when the territories become viable is the sort that IDA should take.

Mr. Knapp - I thought we had agreed a moment ago that to the extent that the countries are getting subsidies we should get assurances from the U.K. that they would provide the foreign exchange to service the credit.

Mr. Cope - I did agree and I don't go back on that. But I merely say that IDA should take the risk after the Territories become viable and the U.K. would not provide subsidies.

Mr. Schmidt - What if we do not think that they will ever become viable?

Mr. Knapp - They are not viable but they do have the subsidies. We are nearly back to asking for an assurance on the continuation of the subsidies (as you stated), but it is not quite that as we would be asking for assurances on the provision of foreign exchange to the extent of the budgetary subsidy if these Territories could not get the foreign exchange for South Africa.

Mr. Larsen - Wouldn't it be possible to avoid this difficulty by getting a commitment on this point from the Borrower?

Mr. Demuth - I question whether we should ask the U.K. for this as this would mean asking them not to discriminate against IDA.

Mr. Cope - I suggest that we explore the question with the U.K. and see what might be possible.

Mr. Broches - Assurances as to carrying out the project would be of more value than those on the availability of foreign exchange to service the credit, I think, but I agree that it might be worthwhile to explore this matter with the U.K. authorities.

Mr. Knapp - It is agreed then that we would not require that the credit be guaranteed by the U.K. but that we would try to obtain assurances that the U.K. would provide foreign exchange within the limits of their present subsidy arrangements for the Territorial budgets.

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On the project, I question whether we should not add the other road project being carried out in Swaziland, to which the memorandum refers, in order to lower the percentage of the contribution of IDA.

Mr. van Helden - The other project has been under way for a year.

Mr. Collier - While the project has been under way, I understand that about \$700,000 of orders are yet to be placed on the easternmost part of the Pulp Mill Road and it might be possible to combine it with the project we are considering for IDA.

Mr. de Wilde - I think that we should face up to a 100% contribution because the Territories do not have funds to cover their own operating expenses, let alone contribute toward capital costs.

Mr. Knapp - I realize that situation but local contribution to IDA projects is very important and I would like to see an arrangement worked out which would maintain the precedent of local contribution.

Mr. de Wilde - Many new countries are not going to be able to meet their current requirements and share the costs of capital requirements. As long as they are doing all that they possibly can in the best possible way, I question why we should insist that they contribute toward projects financed by IDA.

Mr. Cargill - Actually the local contribution would be coming from the U.K. and not from the Territories.

Mr. Collier - The possibility of adding other roads to the project and thus decreasing the percentage of the total financed by IDA is unique to Swaziland. We would not necessarily find this solution in the other two Territories.

It will be painful for the Territories to contribute toward the IDA projects as they want to use the money they have for other things. They think, and possibly quite rightly, that they would not be making the best use of the funds available to them if the many small projects they have under consideration are left undone.

Mr. Knapp - Why are we considering financing roads if this project does not represent the most important use of the money?

Mr. Collier - They have many small projects which would be starved if they have to contribute substantial sums to the road project and they will probably ask to be relieved of financing their part of the road program if IDA comes in to finance roads.

Mr. Cope - I agree with Mr. de Wilde that we should not necessarily insist upon a contribution by small countries which are not in a position to switch funds from one project to another.

Mr. Knapp - I think you will agree that the worst cases of mismanagement in the U.A. aid program have occurred where the U.S. has contributed 100% of the cost of the project, simply because this contribution to the complete project cut off all local interest and objective evaluation of the project.

Mr. Collier - With our excellent supervisors I hardly think the example is comparable.

Mr. Aldewereld - I agree with Mr. Collier about our ability to supervise but nevertheless I am worried about the precedent that would be set if we contributed 100% of the project.

Mr. Knapp - We have the problem that a loan for a full amount of the cost may be considered as a present which cannot be questioned. The result is that the recipient country is inclined to permit uneconomic, unnecessary projects to go forward merely because they are free.

Mr. Demuth - This is admittedly a real dilemma. We have been talking in terms of a 70% IDA contribution following the discussions on the Jordan water projects. I think that if we used 100% here it would be used as a standard for the future. Therefore, we need a clear reason for deviating from the matching arrangement and the reason should be put forward clearly in the presentation.

Mr. Cope - It is a very difficult problem, particularly here as they have no funds and no possibilities for substitution.

Mr. Knapp - We have a solution for Swaziland. The problem is what to do with the other Territories. This means they would have to put up a small amount to provide 25% toward the cost of a \$2 million program in each Territory.

Mr. de Wilde - Since the money comes from U.K. grants and not from the Territories, what difference does it make?

Mr. Knapp - We want part of the grants to go to the IDA road program to indicate participation of the Territories in the program. The trouble with it is that in doing so, it means cutting out other projects.

Mr. Cargill - Why is an IDA credit necessary for these small amounts? I should think the U.K. wouldn't need the assistance.

Mr. Knapp - If the U.K. picks up \$2 million here and there for many territories sooner or later it adds up to quite a substantial contribution on the part of IDA.

Mr. Cargill - Why did the U.K. lend to Singapore which is creditworthy for loans and approach IDA for these?

Mr. Knapp - That is an interesting question but what can we do about it?

In Swaziland is it correct that we can do a project as part of a larger program, as we are contemplating for the Indian Highways?

Mr. van Helden - It is possible.

Mr. Cope - I agree that would be all right in Swaziland.

Mr. Knapp - Do we then insist on the matching arrangements for \$2 million programs in the other Territories?

Mr. de Wilde - If we do, we must watch to see that we do not push the size of the projects beyond their economical point in order to make room for the contribution of the Territories.

Mr. Knapp - If the projects only amount to \$2 million, IDA's contribution would be reduced to allow for participation of the Territories. By participation here I really mean only a token participation. While I think the standard for IDA operations should be a 50/50 arrangement, due to the special circumstances here, the IDA contribution might be more than 70%. We started IDA on the concept of matching evenly and we need special justification to go higher than that. What about 20% for the Territories' contribution in this case?

Mr. Aldewereld - 20% is too small.

Mr. Broches - I think it would be O.K. if a proper explanation, giving full details of the reasons for the deviation from the standard policy, is included in the President's Report. A short statement not fully disclosing the position, I believe, would be more dangerous.

Mr. van Helden - It is possible that the foreign exchange cost of the project would be more than 75%.

Mr. Knapp - Then it would be appropriate for IDA to finance 75% of the total cost or the foreign exchange costs, whichever is greater. If you can prove that the foreign exchange costs are equal to the IDA contribution, we do not need any further reason. In this connection I am talking about the principle and not about the \$2 million figures suggested on page 8 of the Mission Report.

Mr. Cope - The foreign exchange cost is not really related to the problem of participation.

Mr. Knapp - I agree. While it is not logical it at least gives an answer to avoid setting up a precedent for deviation from the matching concept.

The meeting adjourned at 5:55 p.m.

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Rough Notes of Staff Loan Committee Meeting held on Friday, May 26, 1961 at 4:00 p.m. in the Board Room

CHILE

Economic Report

Mr. Knapp - The minutes of the SEC meeting appeared to be fully explanatory. I wonder whether the Committee has anything to add.

Mr. de Wilde - No. I think the minutes fully explain the position of the Committee.

Mr. Broches - I did not fully understand the reference in the SEC minutes to "a modest amount of conventional lending". Does this refer to \$6 million for the highways or \$26 million for highways and agriculture.

Mr. de Wilde - The figure is modest in relation to the total possible amount of capital inflow which will be required.

Mr. Schmidt - I agree that it's modest, and we must remember that \$214 million will be paid off in the next few years.

Mr. Knapp - Is everyone satisfied with the economic report, (a) that it adequately states the case for a need for IDA assistance and (b) that Chile is creditworthy for a \$6 million Bank loan?

(No dissent.)

I have some comments on presentation, but I think the report has successfully negotiated the narrow channel required to justify both IDA and Bank operations.

Mr. Broches - I am still not clear as to what the modest amount of conventional lending in the minutes of the SEC refers to. Is \$6 million or \$26 million a modest amount?

Mr. Knapp - Really we are talking about \$31 million and not \$26 million because \$5 million must be added for the development bank, and in this connection I have a question about \$20 million for livestock. I wonder whether they will be able to use that amount of money.

Mr. Schmidt - We have always said that agriculture is important and here we are merely putting up a range of \$10-\$20 million which we might look at as we don't have any definite figure at the present time. In fact, we haven't even seen the project report as yet. This is merely a range of possibility.

Mr. Aldewereld - The report is being translated now.

Mr. Chaufourrier - Actually the agricultural project would include industrial processing of agricultural products and consequently may absorb these amounts.

Mr. Knapp - I doubt whether we can go that fast or whether we could find use for the funds that fast.

Mr. de Wilde - The amount for the whole program of five years is modest. We think we can go ahead without any fear.

Mr. Knapp - We are not trying to work out a whole loan program. I am sure we will have to reconsider our lending limits after we have had a chance to look at the report of the mission and have had a chance to study the policies of the Government designed to follow up the program suggested by the mission. However, we must give the Chileans credit for having moved slowly on suppliers' credits recently.

Mr. Ross - The Chileans have refused to use 300 million Deutsche Marks of suppliers' credits granted to them because the Chileans did not think the terms were sufficiently long.

Mr. Knapp - It seemed to me that the price of copper, 26 1/2¢ per pound, assumed in the report is rather conservative.

Mr. Ross - Perhaps, this price is f.o.b. Chile, which is not out of line with current figures.

Mr. Knapp - I am sorry, I thought it was the New York price. To prevent others from making the same mistake, I suggest that a footnote be added giving the New York price as well.

The chart showing Bank loans and commitments should be modified to delete the proposed IDA credit.

Mr. Schmidt - I agree.

Project Report

Mr. Knapp - After driving through that part of Chile, Mr. Duran-Ballen, Mr. Diamond and myself can confirm the need for and importance of the transversal roads and for improvement of existing roads.

I did not see much in the technical report about the earthquake damage. While I realize that the proposed Bank loan and IDA credit would not be for the purposes of repairing earthquake damage, I think for purposes of presentation to the Executive Directors, it should be placed in the proper perspective.

Mr. Broches - Will the proposed operations finance the import cost of new machinery or depreciation on old machinery or a combination of both.

Mr. Geolot - For the construction project to be financed by IDA the credit would finance the calculated foreign exchange cost of the project and thus would include depreciation in the calculation on both new and old equipment. For the maintenance project financed by the Bank, the loan would cover actual disbursements for purchase of new equipment.

Mr. Broches - This is not made entirely clear in the report and I suggest that it might be cleared up, particularly as there is a difference between the loan and the credit. It is a question that is likely to come up at the Board meeting.

Mr. Hoffman - Why are we making a distinction between the two operations, since both are for foreign exchange costs, which leads us to a breakdown of \$19 and \$6 million?

Mr. Knapp - Admittedly the breakdown was arrived at somewhat arbitrarily by determining the amount that could be allocated to Chile from IDA. The foreign exchange cost over and above that limiting amount were considered for a Bank loan.

Mr. Hoffman - And then, I take it, we found a \$19 million foreign exchange project which would fit the amount allocated to Chile from IDA.

Mr. Knapp - To a certain extent; but given an open-ended project, such as the highway, we were able to make the size of the credit fit the amount aimed for by changing the size of the project merely by adding or dropping the highway sections.

Mr. Demuth - Why do we have a different system for handling the foreign exchange component for each operation?

Mr. Knapp - They are not the same. The maintenance project continues on in time and the construction project does not. The answer I gave to Mr. Hoffman's question would not, of course, be satisfactory for presentation to the Executive Directors without some modification.

Mr. Schmidt - Actually the situation is not as bald as you have put it. We did look at projects before reaching a decision on allocation of funds for IDA and came up with what we thought was the best project. Surprisingly enough, the amount of foreign exchange required was pretty close to the figure we decided on for IDA, making the adjustment by extension or contraction of the project referred to by Mr. Knapp unnecessary.

Mr. Demuth - In the Roseires project we are splitting expenditures between the Bank and IDA on a single project. Why don't we do the same thing here, why are we making two projects here?

Mr. Knapp - This arrangement is much simpler particularly as we will not be disbursing on the basis of depreciation for the maintenance project. We are satisfied with the 6 : 9 ratio.

I have some question about the recommendation in para. 62 of the technical report, "that a representative of the Association be stationed in Chile for the execution of the project". I don't see why this is necessary and certainly if it is, he shouldn't be called a coordinator because that's not what he would be doing.

Mr. Geolot - This is a very big project physically. The cost estimates are not firm, the design work is not completed; the amount and location of the paving work has not been decided. We felt that all these problems could not be supervised properly from a distance and therefore a man should be on the spot to handle these matters in order to speed up execution of the project. Leaving aside the problem of whether a Government will have one team of consultants or several individuals, the matter of engineering services will present an additional large problem which could be handled by a man on the spot.

Mr. Aldewereld - I would like to add that the thought behind this recommendation arises from our experience in Colombia where projects are also spread over a wide geographical area and involve a large number of small decisions. The recommendation is made merely to facilitate the administrative division.

Mr. Knapp - That's certainly a good case for stationing a representative in Chile, but couldn't the same case be made for other projects? Why is this different? Is it because this project is worse than others or because we are in at an earlier stage?

Mr. Aldewereld - Basically the reason is lack of physical concentration of the project. It is spread all up and down the area of the southern zone of Chile.

Mr. Geolot - It's true, as has been suggested, that there are fewer roads in this project than in Iran and the lack of physical concentration may be equally bad, but there, it must be remembered, four different consulting firms are supervising the construction of the project.

Mr. Hoffman - Are you less confident than usual in the cost estimates for this project?

Mr. Geolot - It's certainly true that using fixed cost for kilometers, as we are here, is not the best system for calculating cost, but we have done this before. However, the Chilean organization charged with executing this project has never done anything like this project, either in size or in complexity, requiring a high degree of coordination.

Mr. Cope - It would appear that there is a good case for the use of a consulting firm.

Mr. Aldewereld - I agree. Consulting firms can be used here as they are for the Indus project, acting as agents for us.

Mr. Knapp - I take it that you do not wish to imply that the need for stationing a representative is because IDA is involved with the project.

Mr. Benrubi - Since roads are likely to be subject to political pressures, would it not be likely that our representative would get into political questions and would have to refer back to Washington anyway?

Mr. Knapp - I agree there are difficulties. That is why I suggest that we strike out the last sentence on the function of the representative. That will be taken care of later in the terms of reference anyway.

Mr. Geolot - In answer to Mr. Hoffman's questions, the Chileans probably do not object to a representative being stationed there, but we understand they would object to the employment of a consulting firm to do this work.

One more thing. Does everybody understand that the engineering services included in the construction project to be financed by IDA would also apply to the project financed by the Bank? For administrative purposes, we have lumped both in the IDA operation merely to avoid the problems of separating cost allocations between maintenance and construction.

Mr. Knapp - That will be all right.

Mr. Diamond - The last para. of the report will, I take it, be modified to make clear that the maintenance project is to be financed by the Bank.

Mr. Hoffman - Am I correct that the insistence on mechanization stems from the need to meet specification standards and time schedules?

Mr. Geolot - That is correct.

Mr. Bergan - The mechanization is a matter of degree. While we feel that impacting must be done by mechanized equipment, we are not objecting to the loading and unloading of materials by hand. We are not insisting upon complete mechanization, but we are insisting on a degree of mechanization for the reason you gave.

Mr. Cope - In view of the load on the Print Shop, I think there were a few too many tables in this report. Table 6, for instance, does not mean much to me.

Mr. Knapp - I am not so sure that data on desired standards is not important. However, it certainly would be advisable to go through the report carefully with the view to cutting out tables whenever possible.

The meeting adjourned at 4:50 p.m.

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SLC/M/61-20

Rough Notes of Staff Loan Committee Meeting held on
Tuesday, May 16, 1961 at 3:00 p.m. in Room 927

TURKEY

Over-All Creditworthiness

Mr. Knapp - I must confess that I have had time only to read the covering paper, but it appears to me that the only real issue is whether the economic policies of Turkey are sufficiently sound to pass the test for IDA assistance. The mission's answer is yes, and no one has objected to this answer up to this point. Turkey certainly passes the debt burden test for IDA assistance and probably the per capita income test as well. So the question boils to that of the soundness of their policies. Is there any dissent from the opinion of the mission that Turkey does pass the test?

Mr. Lejeune - One word of caution is in order. We are now dealing with an interim Government. We are not in a position now to judge the soundness of the new Government which will probably be installed the last quarter of this year.

Mr. Schmidt - I was going to question whether it was the intention to sign loans or credits before the installation of a new Government.

Mr. Lejeune - I think it would be unwise to sign a loan just before the election. But making a loan immediately after the election is not an adequate solution to our question as to the soundness of the new Government.

Mr. Wouters - As we wouldn't investigate the project until September, the possibility of a loan before the new Government is not great.

Mr. Groenveld - We do not contemplate an appraisal mission until September because the basic information on the irrigation project will not be available until August. This will have to be studied before the mission looks at the project in the field.

Mr. Knapp - But wouldn't it be possible to proceed earlier with the power project.

In addition to the reasons given by Mr. Lejeune for not making a loan before the new Government is installed, don't we have a constitutional problem as well which would probably prevent making a loan to the present interim Government?

Do we all agree that Turkey is eligible for IDA credits?

Mr. Demuth - Yes, but the amount has some bearing. The minutes of the SEC meeting speak of \$5 to \$10 million. I do not understand whether the figure was meant to indicate what's needed for projects which are ready or as a limit on IDA credits. I would not like to see a limiting figure.

Mr. de Wilde - The figure given in the minutes of the SEC meeting is only intended as background to give the order of magnitude of expected operations.

Mr. Knapp - Let's not concern ourselves about the amount. The question is, do we agree that Turkey will get IDA credits at all. We don't have sufficient information available for a discussion on the amount.

Mr. Collier - Is the question of changing the proposed IDA amortization policies discussable? I raise this question after looking at the schedule of debt service on the existing Turkish debt. After 1972 the service is rather low.

Mr. Knapp - We certainly have not closed the door on flexibility of IDA terms, but the burden would be on the suggester of the change.

Mr. Demuth - We have to assume that the present debt service schedule would be adjusted.

Projects

Mr. Knapp - On the projects, I think we should discuss them on an over-all basis, whether they are suitable, and assume the amounts required for each would not exceed the total amount which we should be willing to finance by IDA.

Since we have always maintained that IDB was our first interest in Turkey, I was surprised to see that the Area has not suggested an IDB operation.

Mr. Adler - IDB still has funds from the existing \$10 million DLF loan. They will not require additional funds until next year and thinking of another DLF loan then. If IDA made a development credit to IDB ^{and} it would probably be in substitution for a DLF loan. Also, IFC is considering investing in the IDB special equities fund.

Mr. Knapp - It appears that they need equity investment anyway. The small table in the Area paper indicates that the debt/equity ratio is too heavy, about 6 to 1 now.

Mr. Demuth - The last Loan Agreement provided that the ratio would not exceed 4 to 1.

Mr. Knapp - From the figure shown here it is higher than that now.

Mr. Wouters - Part of the DLF loan has not been committed so that the ratio on the basis of outstanding debt was not as high as that.

Mr. Knapp - That merely means that they cannot commit any more loans to avoid going over the limit.

Mr. Wouters - TOD recently made an end-use review and found that the ratio was such that IDB still had room to operate for some time.

Mr. Ramm - The figure given in the Area paper for IDB loan is not correct, it should be a lot higher and consequently the debt/equity ratio would be worse if the other figures are correct.

Mr. Aldewereld - It's true these figures are not correct, some of them have been calculated at the old rate.

Mr. Knapp - We should certainly take another look at the debt/equity ratio picture before deciding on anything for IDB.

Otherwise, I take it, they are doing very well and do not need additional funds at this time.

Mr. Adler - That is correct. They are doing very well and will have enough funds with a new DLF loan to cover all their operations through the end of 1961. However, the new DLF loan may be tied to U.S. projects. This they do not know. If it were, IDB would probably come to us for a loan to cover the non-dollar requirements of their customers.

Mr. de Wilde - The development of the private sector is extremely important to the growth of the Turkish economy, therefore, IDB should have all the resources it needs to provide the private sector with adequate capital. Since the other projects are not ready now and IDB is so important, I think it should be considered now.

Mr. Adler - IDB doesn't want any money now and the fact that we are now proposing other projects does not mean that we would oppose a loan to IDB next year.

Mr. Knapp - If they are in need of non-dollar resources, why don't we go ahead now? I am not arguing to drop the other projects, I think we should push all three and I think that if offered IDA funds, they would jump at the opportunity.

Mr. Adler - I think they would prefer to get IFC funds on an equity basis. Mr. Garner has been talking about an investment of \$5 million.

Mr. Demuth - From what you describe, it appears that this is certainly a place for a mix of IFC in the equity fund and IDA credit for loans to IDB's customers.

Mr. Lejeune - The recommendations of the Area paper were designed to get started on the two small projects and not to prevent a credit to IDB.

Mr. Knapp - We understand, but I am not satisfied that IDB does not need more resources now, particularly in view of the non-dollar purchases which will not be financed by the DLF loan.

Mr. Adler - They don't know that yet. The new DLF loan hasn't even been discussed and they won't exhaust the present DLF loan until next year. Therefore they haven't talked to DLF yet. The present DLF loan is not tied to dollar purchases and IDB will assume until told otherwise that a new DLF loan would be on the same terms as the present one.

The existing resources of IDB are being used very slowly. Principally because of the lack of local currency funds to finance the local currency portion of projects financed by IDB.

Mr. Knapp - All right, We should be sure that they do not need or want funds. If they do, we should give IDB a very high priority.

Mr. Lejeune - I agree with that, but I would not like to give the Turks the idea that we were not interested in the other projects.

Mr. Rucinski - I assume that in talking about IDB they are considering a Bank loan since we have never previously considered IDA credits for development banks.

Mr. Knapp - I don't think your assumption is correct. If development banks are the highest economic priority and the creditworthy situation of the country demands IDA financing, why should IDA not finance development banks? In Turkey we consider IDB of the very highest priority.

Mr. Rucinski - Granting IDA credits through development banks will lead to demands from other countries, which demands I would consider unfortunate.

Mr. Knapp - We must remember that Turkey is not a blend situation. In India or Pakistan, which are, the decision to make Bank loans to development bank institutions and IDA development credits for other projects makes sense, but in Turkey we have decided that no Bank money should be made available, leaving only IDA funds which should go to the project with top priority, which happens to be IDB. I don't think anybody agrees with you that development banks must be excluded as borrowers of IDA.

Mr. Hoffman - I agree and I am glad to know that this is the general belief particularly as we should not turn down such an old and good borrower as IDB when it is a project of the highest priority.

Mr. Cargill - We are proposing an IDA credit for a development bank in China.

Mr. Knapp - If India were not creditworthy for Bank loans and a development bank were the project of top priority, would Mr. Rucinski recommend that IDA not lend to the Development Bank?

Mr. Rucinski - I would try to get them help from DLF or somewhere else. If we give IDA funds to development banks, I am afraid that no government will accept less than 50-year payment and the other easy terms of IDA for aid to development banks.

Mr. Knapp - That is true of all IDA operations.

Mr. Rucinski - We should think of other ways of solving the problem. As example of the difficulties we create, the Pakistan Government wants long-term loans for PICIC because of their present balance of payments situation. Our position opposing this request would be seriously jeopardized if IDA were to grant a credit to IDB.

Mr. Knapp - If the Pakistanis are willing to say that they are not creditworthy for Bank loans, then I am sure we would consider giving them IDA credits for PICIC.

Mr. Rucinski - The needs for IDA funds are so high and the amounts available so limited that we should be sure to have the most important projects. I should think we could find something else in Turkey which would be more suitable.

Mr. Knapp - Does anybody else share Mr. Rucinski's doubt about IDA credits to development banks?

Mr. Aldewereld - I have one concern. We are considering IDA credits because of our doubts over the long-term balance of payments problem so I don't understand how a customer of IDB can take the risk of being able to acquire foreign exchange over a long period of time.

Mr. Rucinski - That isn't the problem because the customer repays in a much shorter period and only has the risk during the period of his loan.

Mr. Demuth - Actually ^{it} is not a foreign exchange problem for the customer of IDB but merely the determination of the amount of local currency that IDB borrowers would have to pay.

Mr. Knapp - In view of the balance of payments prospects, perhaps the Government should take the exchange risk but I would assume that normally the customer would take risk as part of his normal business.

Mr. Adler - On Bank loans the Central Bank bears the risk.

On the projects, I don't think we should wait until the Turks come to us. There is much to be gained by our commencing to examine projects as I think this will speed up the presentation by the Turks of many projects which might be worthy of consideration.

Mr. Knapp - I agree there is a clear case for expediting matters particularly in view of the desire to speed up IDA operations and I think we should push ahead as fast as we can, bearing in mind the fact that we may have a constitutionality problem.

In view of this desire to go ahead, why does the mission only recommend a few projects?

Mr. Adler - Our instructions were not to look at the projects, the few mentioned here came up in spite of this.

Mr. Knapp - Are you sure, having not looked at all, that you have the best?

Mr. Adler - I think that irrigation is most important in Turkey and that we should go ahead with it. They are preparing many small irrigation projects which will come along a lot faster if we send someone there to help them with their preparation.

Mr. Lejeune - We must remember that this present exercise was to bring Turkey out of cold storage to commence IDA operations and not for purposes of producing an investment program. We would have to send another mission to work out a program.

Mr. Knapp - I understand, but I think that an irrigation project could be a test model both for us and for the Turks. Its successful conclusion should speed the others.

Mr. de Wilde - I agree on the basis of the information that we have seen that the three projects ~~were~~ discussed today would be of the highest priority if the whole range of projects had been examined.

Mr. Rucinski - I question whether the electric power project is of sufficiently high priority to justify IDA financing since they can get the required funds from other sources.

Mr. Lejeune - The situation in Turkey is such today that we are not willing to put in money on conventional terms nor recommend that anybody else does.

Mr. Hoffman - Is it true that financial help other than ^{on an} IDA basis is out of the question? Isn't there some possibility for suppliers' credits for things like this?

Mr. Adler - The Minister of Finance is trying, and is, reducing the external public debt as much as possible and he is now controlling the state enterprises so that they don't increase the debt behind his back, but I am sure that he will have to refund and roll over some of the existing debt. So we cannot say that there will not be more suppliers' credits. There probably will be more as the suppliers agree to refund their existing debts and it might be possible to get money for this project.

Mr. Knapp - As the electric project is a small fragment which probably could be financed by suppliers' credits, is not particularly attractive and certainly not a model for future operations, while not enthusiastic, I am willing to go ahead because (1) it is a way to get us started in Turkey and (2) it is connected with the Seyhan dam project which has high priority.

Mr. Demuth - Do you mean unattractive or merely unattractive for IDA?

Mr. Knapp - Unattractive generally. The overhead costs, for instance, are too high, it's a waste of manpower. If we could find some other project perhaps we can drop this later.

Mr. Walstedt - There are other power projects which will come along when their program is completely prepared but they are not ready for presentation at the moment.

Mr. Knapp - I would recommend that we look for something that would be less costly to handle.

The meeting adjourned at 4:00 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Tuesday, May 2, 1961 at 3:00 p.m. in Room 927

NICARAGUA

Sir William Iliff - I don't intend to discuss this afternoon the question of whether this project should be financed by the Bank or IDA. That is a question that will have to be settled on broader considerations than the position of Nicaragua. Therefore the discussion will be confined to the project.

On the project, I am concerned because the legislation will go into effect if 50% of the farmers in the area participate but the technical report suggests that as a condition of effectiveness for the Bank loan, evidence should be received that "a substantial and, in any case, not less than the legally-required number of farmers in the project area are prepared to participate on a basis satisfactory to the Bank."

Mr. Reid - In order to establish an irrigation district, a decree is required and the decree would not be effective until 50% of the farmers have agreed that their land should become part of an irrigation district. The percentage of farmers needed to form the district is their political problem. We have told them that we are very concerned over the extent of participation of the farmers because enactment of the legislation has taken so many months and the farmers are cynical about whether the district will ever be formed and, if so, whether it will be any good. Therefore we want to be sure the farmers will participate willingly before we go ahead.

Mr. Cancio - Actually there would be two laws: a general law to provide for the establishment of irrigation districts setting forth the principles on which they would be established and a second specific law for the establishment of each district.

Sir William - Assuming that the 50% participation is obtained and that the decree establishing this district goes forward and then we say that the participation is not adequate, I think we would be in a bad way.

Department Heads - Agreed.

Mr. Schmidt - I agree but I think that the proviso in the report was intended to refer more to the basis on which the farmers came in rather than to the number in excess of 50%.

Mr. Reid - The success of this project depends upon the willingness of the farmers to enter into it with the proper enthusiasm. The mere acceptance of half the farmers does not mean success.

Sir William - Then the decree is wrong.

Mr. Reid - Under the law, if 50% of the farmers vote for the establishment of the district, all must come in but the actual success would depend upon their willingness. We are thinking in terms of about two-thirds to determine whether the project will be a success but we don't want to put a figure on this because it depends upon not how many, but who. If the influential farmers in the community located in the center of the project are enthusiastic it will be successful. If the lower-status farmers on the edges of the area refuse to join, the effect upon the ultimate success of the project will be considerably less.

Mr. Aldewereld - The trouble is that the decree does not cover quality of the farmers but only quantity.

Sir William - I should think that we should be willing to accept 50% of the farmers and 50% of the land. We certainly are going to be in trouble with the Nicaraguan Government if we agree to the proposed legislation now and refuse to make a loan effective later.

Mr. Rucinski - Do we intend to tell the Nicaraguans how we proposed to judge whether we consider this participation satisfactory?

Mr. Reid - We have already told them that we are concerned about this and would want to be satisfied that a representative number of farmers (and an adequate percentage of the area), including the influential were prepared to enter into the operation.

Sir William - The danger is that we would end up with an abortive loan.

Mr. Reid - The Government knows that they must pass the legislation and get the participation of the farmers to a decree satisfactory to the Bank before we are prepared to go ahead and make the loan effective. The trouble is they cannot get the farmers' approval to participate until they have a Law and something from the Bank. The farmers are skeptical about the Government ever doing anything. Eventually the farmers will be asked to vote on the formation of a district but without something concrete it is questionable whether an objective vote is possible.

Mr. Aldewereld - This trouble is inherent in every situation where there is no previous experience with irrigation. The success of the whole operation depends on the willingness of farmers to come into it.

Sir William - It seems to me that you have the cart before the horse. These questions should be settled before we made a loan.

Mr. Aldewereld - We had the same worry. This question has already been put to them, but all depends upon the farmers. The Government needs the Bank's signature to get the farmers started moving. There is the risk that the farmers would not participate after the loan is signed.

Mr. Schmidt - This is a risk we have to take. We have to accept the judgement of the experts that this risk isn't very great and they also say that if we refuse to make the loan before the farmers have come in, that will wreck the deal because the farmers will think that we are backing out and that the whole thing would collapse.

Mr. de Wilde - I don't quite understand what the difficulty is about deciding on a number or percentage that would have to join to satisfy the Bank. On the basis of the data given in the report, I would think that it would be correct to say that if two-thirds of the farmers ^{with} or two-thirds ^{of the} of the land had joined, there would be sufficient representation to assure ^{that} enough of the influential farmers with properly located farms would participate in the project.

Mr. Aldewereld - It is true we thought roughly of using that figure but to give us more leeway we did not want to make a definite requirement.

Sir William - I favor 50% of the farmers and 50% of the land.

Mr. Cargill - Why do we have to have a loan before the legislation?

Mr. Cope - The requirements of the Law and of the Bank will have to be the same necessarily. There is no reason why we have to use the 50% ^{not}. On the question of the quality of the farmers, I am just not qualified to answer. On the question of whether we should decide now or wait until the project is set up, I am inclined to think that there should be legislation before we make a loan but again I do not know much about it and think that the views of the Area, which has a closer grasp of this problem, should be weighted heavily in making this decision. If the Area feels that there are sufficient reasons for going ahead before the legislation, I would be inclined to accept their belief.

Mr. Cargill - What are the reasons?

Mr. Reid - We could not make a commitment before there was a district. The whole thing might drop.

Sir William - I would not be sorry if we did break off. I would be happier to see the legislation and the results of a census of the farmers on participation in the project before deciding whether we go ahead.

Mr. Schmidt - I suggest as an alternative we agree to negotiate the documents before the legislation and the census as an earnest of our intent but do not send the loan proposal to the Executive Directors until these things have been done.

Mr. Broches - I am told by the experts that all farmers have to receive bribes and be coaxed to do what is right, therefore the suggestion that the farmers have to have something in hand before proceeding is not shocking to me but I am not in a position to judge whether in this case they need something from the Bank before they start. I do agree with Mr. Cope that it isn't necessary to make the Bank's requirements coincide with the legal requirements.

Sir William - If the participation of 50% of the farmers is not sufficient for our purpose, I question whether the project should go forward at all. Should they be doing it?

Mr. Schmidt - The 50% is just a mechanism to start the project to get everybody in. It does not mean that only 50% are in favor once it gets started. The same system is used in the U.S. for school districts and in the West for irrigation districts.

Sir William - Let us assume that we are prepared to give a moral commitment to make a loan if the census of the farmers shows a satisfactory percentage of willing participants. What would be the reaction of the Nicaraguans?

Mr. Schmidt - I think it would be better and safer to have negotiations in order to set the issues down clearly on paper, but to tell them that we would not put the documents to the Executive Directors until the legislation had been passed.

Mr. Rucinski - Do they really want a loan? You don't have to have negotiations to reach agreements on the various points. If they are really interested in a loan there isn't any reason why they could not get started on it. I wonder whether the priority of this project is so high that other projects could not be substituted for it, which did not have this question, particularly as there are other difficulties.

Sir William - Let us hold the other difficulties for the moment. I would be willing to go ahead on the basis of Mr. Schmidt's suggestion.

* * * * *

Para. 20 of the Technical Report shows that the present net value of production is 378 cordobas per hectare whereas paras. 49 and 50 say the total of amortization and operation charges for the farmers would be 556 cordobas per hectare, meaning that production would have to treble in order to keep earnings for the farmers at their present level. Is the great increase required possible?

Mr. Reid - Because this is the first irrigation district, there is the possibility of high-return intensive farming of bananas, sugar and vegetables, producing sufficiently high returns to enable the farmers to meet the charges. We have already cut down on the estimates of the returns as we were somewhat concerned about this also. We have already informed the Government that the farmer might have trouble in meeting these payments. The Government wants to run the operation in a businesslike way and insisted on the charges to cover all the costs, however, payment by the farmers could be extended over a longer period of time. We did not press this as we did not wish to encourage the Government at this time to back away from their commercial approach.

Mr. Schmidt - The charges actually are lower than the present charges on private irrigation systems in Nicaragua.

Mr. de Wilde - Doesn't this whole question depend on how rapidly and how well the farmers take to irrigation farming? If they understand the operation, the returns might well be sufficient to meet the charges as envisaged but if they have difficulties adjusting to the new form of agriculture there may be difficulties.

Mr. Reid - There is some pump irrigation now but most of the farmers are going to have to learn the new operation, consequently a big training effort will start in the first year of the irrigation district. There is a chance that the payments will have to be delayed.

Sir William - Has the Government said that they would agree to extend payment?

Mr. Reid - We have discussed this matter with them and their attitude was to try on the basis proposed; the payments can always be ~~excluded~~ ^{reduced} later if necessary.

Mr. de Wilde - I also share Sir William's skepticism about the ability of the farmers to meet the payments as scheduled. It may be that payments will have to be revised and the production built up to the ultimate return more slowly than envisaged in the report.

* * * * *

Sir William - Re para. 41, would the local currency costs to be financed by the Government be under a contract?

Mr. Reid - Yes, and the contract would have to be acceptable to us.

Mr. de Wilde - In para. 5 of the covering memorandum, I question whether the statement that the "percentage held in large holdings is not extreme" is entirely accurate. This depends on one's measure of what is extreme. I have calculated that 1% of the people own 40% of the land. Also the statement that the investment in the project is to be fully repaid by the land-owners who benefit from the project is of doubtful value as the report does not say how much of the increased return the Government would get. I presume that the landowners would get the bulk of the increase so the statement made is not meaningful.

Possibly consideration should be given to raising the charges to increase the Government's share of the increased return or to redivide the property.

Mr. Schmidt - We considered this problem and decided against urging redivision of the property because we felt that the distribution of the land was not too inequitable and we were anxious to get the project started. We felt it was better to get this under way because it will help the economy rather than to hold it up waiting revision of the land ownership pattern.

However, because of the problem we thought the Government should explore the possibility of other irrigation projects in order to develop as soon as possible more land for the use of the people.

Mr. de Wilde - I am not urging land reform at this point. It may be that the large holdings are the most economical size. I was merely raising the question whether the percentage of the Government's take in the return should be increased.

Sir William - I suggest that in putting this project forward, you merely say that on balance you have concluded that the Bank should not require any change in land ownership as a condition to financing the project and leave it at that without going into the details that you have presented in the paper since they are subject to question.

Mr. Schmidt - The land distribution in the area of the proposed irrigation is not extreme compared with the situation in the rest of Latin America.

Sir William - It is certainly extreme in comparison with condition in India and Pakistan.

* * * * *

On the problem of the large holding of the Somoza family, I think we have to tell the Executive Directors of this situation.

Mr. Broches - I am told that the Somoza family is in everything and it would be difficult to find anything in Nicaragua which did not raise this problem.

Mr. Bochenski - They are in many things: principally cattle, shipping, ports, textiles, sugar and, to a lesser extent, land. However, this project was not picked because of the interest of the President in this area. The land was picked by a FAO expert after a long study and survey.

Mr. Reid - It is correct it was not picked for that reason and the interest of the President was known from the very beginning. This fact worried Mr. Tipton, leader of the FAO mission. With this in mind he looked for other areas before deciding on this particular one.

Mr. de Wilde - The interest of the President will probably lead to criticism of the Bank but I think the Bank will just have to be prepared to take the criticism and point out that this is the best area and that lots of other farmers unrelated to the President stand to gain by investment in this project.

Mr. Cavanaugh - I am concerned that we would appear to be fostering an arrangement under which people will be urged or required to sell land that the President wants. Therefore the proposal is certainly not a good one.

Mr. Cargill - If the project itself is satisfactory I don't believe that the interest of the president is such a problem that the whole thing should be held up.

Mr. Cope - I agree that the interest of the President should be fully disclosed. I am not very enthusiastic about this operation but I think it would be hard to turn down at this point.

Mr. Rucinski - I agree that it is too late to turn it down but wonder if it is of such high priority that it is impossible to consider substituting something else. It has been said that we can't find anything else that Somoza is not connected with but I believe the fact that this is a land project makes it particularly subject to criticism because the land reform question is so delicate. I would prefer something else if we could find it.

Mr. Aldewereld - Despite the troubles we foresee in getting the project started, it is not a bad project. The problem of the land holding and Somoza ownership is an unfortunate one but it is one that we have been aware of from the very start and I think it is too late to raise this question now.

Mr. Broches - I don't find it an attractive situation not so much because of Somoza but because of the large holdings of a few people, but I don't see how we can get out at this point.

Mr. Reid - On the question of the large holdings I should point out that three of the big holdings are on the outside edge of the area and consequently not of as great importance as they might be. Disregarding these, the large holdings amount to about a sixth of the irrigable property. This isn't anything like the situation in Dez where a few people owned the whole works.

Mr. Aldewereld - I agree it is not as bad as Dez but there we had a lot of mental anguish before reaching a decision to go ahead and we did so in the hope that there would be a change for the better.

Mir William - I will certainly have to put this situation to Mr. Black and warn him that there is a real likelihood of criticism. There is also a question whether we should warn the Executive Directors before the project is presented to them formally. I will first talk to Mr. Black. I would certainly prefer to have President Somoza go ahead and finance this project with other resources and we could take something else.

The meeting adjourned at 4:05 p.m.

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SLC/M/61-17

Rough Notes of Staff Loan Committee Meeting held on
Monday, April 24, 1961 at 4:30 p.m. in Room 1006

IDA Development Credit Regulations - Article III

Sir William Iliff - We have not circulated to the SLC the Articles considered at the previous meeting. Section 3.02 has been discussed with the Executive Directors of the U.K., France, Netherlands, Germany and the U.S. All are ready to go along with the Section as drafted. If Art. III is approved by the Staff Loan Committee, the Credit Regulations, amended to meet the Committee's points, will be presented to the Executive Directors for approval.

Section 3.01

Mr. Rucinski - This is the same as the Bank?

Mr. Broches - No. Loan Regulations provide that the borrower must make efforts to arrange for payment in the currency of the supplier's country. This section is in accordance with the procedure generally followed in the Bank.

* * * * *

Mr. Cope - We agreed in the last meeting on more general language in Article IV to cover disbursements made on the basis of a percentage of total expenditures as well as the List of Goods. I suggest that Article III should be modified similarly for consistency.

Mr. Broches - We have cut down Article IV considerably in accordance with the recommendations of the Staff Loan Committee and 3.01 is not inconsistent with Article IV as it now reads.

* * * * *

Mr. Rosen - How will it be possible to maintain the plan of pro rata distribution of currencies without agreement with the borrower on the currencies to be disbursed?

Mr. Broches - As we can buy one currency with another we will be able to maintain the pro rata feature in the use of currencies even though we might disburse only a few currencies.

Mr. Rosen - Why go through the purchase; the Borrower could do that?

Mr. Cavanaugh - It is easier for the Borrower if we do it.

We agreed earlier that IDA would undertake the conversion task and would accept any profit or loss on the transaction, to ease the burden on the borrowers. This provision merely carries out that decision.

Section 3.02(a)

Mr. Broches - Mr. Cope has suggested that we change this from passive to active. I suggest: "The Borrower shall repay the principal amount of the Credit in any currency or currencies of members of the Association which the Association determines to be freely convertible or freely exchangeable for currencies of other members of the Association for the purposes of its operations."

Section 3.02(b)

Mr. Rosen - In applying this section, if there were a change in the value of one currency, would there be a change in the amount repayable? What is meant by "major currency"? I don't expect answers to these questions. I merely raise them because I think they will come up when we discuss this provision with borrowers and they may be raised by the Executive Directors.

Mr. Broches - They have already come up in our discussions with certain of the Executive Directors. The point is that we do not want a gold clause and thereby put a burden on the borrowers. We are merely providing that if anything happens which may be burdensome, the Association will take a look.

Mr. de Wilde - If a borrower's assets are held in sterling and sterling decreases in value, I take it that this provision will help the borrower.

Sir William - No. If the change in value means a heavier burden on the borrower, we will consider the matter, taking into account all the factors, to decide whether something should be done.

Mr. Rosen - Would a 10% reduction in the value of the dollar, for instance, represent a heavy burden?

Mr. Cavanaugh - Probably not. If Finnish marks became completely valueless, the effect on the borrowers would be less than 1/2 of 1%. There would have to be a weighted calculation taking into account the amount of the currency in the IDA funds to reach a decision as to the burden, if any.

Mr. Rosen - A 10% reduction in the value of the dollar would be a much bigger burden on Brazil than on Ceylon, for instance.

Mr. Cavanaugh - That is right, but Brazil would be hurt for several reasons other than repayment to IDA.

Mr. Rosen - We are trying to provide for relief in the event of a change in the par value of a currency. But, by doing it across the board in a general way, I don't think the language accomplishes the purpose. The consideration by IDA of a reduction in the value of the French franc on a weighted basis does not help Morocco much.. They would be hit full force if all their reserves were in French francs and the value of the franc were reduced.

Mr. Broches - The provision is not intended to deal with that problem. We are only trying to keep away from a gold clause and to keep open the possibility of giving the borrowers some relief if devaluation of one/more currencies justifies. The Bank Regulations certainly would not help Morocco.

Mr. Rosen - Couldn't we make the language more general so that Morocco could be helped?

Sir William - We have left it open for IDA to decide what to do in any particular case, but in any event the burden would not be increased.

Mr. Cope - The question is whether it would be applied discriminatorily. The answer that Mr. Broches has given is that it would be applied across the board without discrimination.

Sir William - The language as drawn is not discriminatory, nor was it intended to be. By "major currencies" we had in mind currencies in international trade which we hold (which would exclude Indian rupees).

However, the provision as it now stands leaves the question entirely open and would even enable the Association to make distinctions between countries on the basis of how hard they are hit by a devaluation.

Mr. Cavanaugh - The key phrase is "which in the opinion of the Association."

Mr. Rosen - Would the Board pass on this?

Sir William - Yes.

Mr. de Wilde - The trouble is going to be in applying and explaining this.

Mr. Rosen - We could only assure the borrowers that they would not be hurt by it. The question is explaining how much they would be helped by it.

Mr. Cope - In practice I believe we will have to give the same treatment to all borrowers.

Mr. Broches - This provision is an attempt to achieve the benefit of an index currency without getting into the complication of the index.

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Mr. Rucinski - How is the Association protected in case of currency value changes?

Mr. Broches - It is not protected.

Mr. Rucinski - Don't any countries care about the erosion of the fund?

Mr. Broches - No country has expressed care; probably because they will never get back any of their money anyway.

Sir William - This is not any work of art, but fault could be found with any proposal on this subject.

Section 3.03

Mr. Rosen - I wonder why we could not make the service charge repayable in any convertible currencies, to avoid bringing dollars back into the picture after trying so hard to get them out.

Mr. Broches - We suggested dollars for the service charge, since it is to cover costs which are principally in dollars. There is an additional cost (2%) in conversion, of course.

Sir William - I would agree to go along with convertible currencies.

Mr. Cavanaugh - That is all right. Any convertible currency, as determined by IDA, would be acceptable.

Mr. Broches - This would in effect then mean that this section would conform with section 3.02(a). I suggest that we change the present 3.02(a) to make it 3.02, covering both principal and service charge, and to make the present 3.02(b), applying only to principal, a new 3.03. The present 3.03 would be deleted.

Mr. Schmidt - Would the $\frac{3}{4}$ of 1% service charge be calculated on the new principal amount in the event there was a recalculation of the amount due in accordance with Article III.

Mr. Broches - Yes.

Section 3.04

Mr. Iverson - I question why the word "reasonably" is necessary in the last clause.

Mr. Broches - That is to furnish a basis for arbitration. Members should, I think, have the right to query whether the Association has been reasonable in determining the value of one currency in terms of another.

The meeting adjourned at 5:10 p.m.

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SLC/M/61-16

Rough Notes of Staff Loan Committee Meeting held on
Monday, April 17, 1961 at 11:00 a.m. in Room 1006

IDA Development Credit Regulations

Mr. Broches - The Credit Regulations follow Loan Regulations of the Bank except for one major deletion, the Article on bonds; as was discussed with the staff. We can always later get bonds by agreement but we would not have the right under the Regulations to ask for bonds.

Section 2.04

Mr. Rosen - Why is the last clause necessary? I think any type of prepayment would be satisfactory.

Mr. Broches - This is only for purposes of determining where we would allocate a partial prepayment in absence of other agreement.

Mr. Demuth - I don't see why this is needed. It is not conceivable that there would be prepayment on IDA credits. If the inconceivable happened, we could do what they wanted.

Mr. Cope - We have to state that they have the right to prepay even though it is not probable.

Mr. Demuth - Then we could let them say to which maturity to apply the prepayment.

Mr. Broches - We could provide that, unless otherwise notified, prepayment would be allocated on a pro rata basis. It would be simpler to change the sentence to read "(ii) all or part of the principal amount of one or more of such maturities as specified by the Borrower."

Section 4.01

Mr. Broches - This is the same as Loan Regulations. Mr. Cope has suggested more general language to cover the credits disbursed on a percentage of total expenditure basis as well.

Mr. Rosen - 4.01 (c) would require approval of the Board while (a) and (b) would not. I question putting these together.

Sir William Iliff - That is just an administrative problem.

Mr. Broches - We could make a change in a proposed credit agreement so that the change, which I agree would have to go to the Board, would go automatically with the papers dealing with the proposed credit. There would be no difficulty about this.

Mr. Demuth - 4.01 (b) gives me trouble because the Board thinks we should be liberal on this point. As drafted, these regulations would permit us to finance expenditures in the currency of the borrower but, presented as they are, as the exception to the norm, it may arouse an unfavorable reaction in the Board.

Sir William - Since the Charter runs up a red flag, this approach seems appropriate.

Mr. Demuth - This wording is too strong and the Board may attack it. I am only talking psychologically. Mechanically it is fine, but it may give the wrong impression.

Mr. Broches - This is a mechanical point and local currency expenditures may be handled very simply by the List of Goods. The argument isn't good because this is all mechanics and not policy. Another suggestion would be to take the whole thing out and merely cover the right of the Borrower to withdraw according to the Credit Agreement.

Sir William - That is all right. Does everybody agree with this.

Mr. Cavanaugh - I am afraid that we then would go back too far on old items and too much into local currency financing.

Mr. Broches - That still can be covered in the Credit Agreement.

Mr. Cavanaugh - But it means that the basic ground rules aren't set down anywhere and we may go too far.

Mr. Rosen - Actually the standard practice in the Bank is not as stated here but to go back and finance items from the date when we really decided to go ahead with the project, not from the effective date. This provision isn't right.

Mr. Cavanaugh - Historically, we were supposed to finance new, and not old, projects. Actually I agree we have not followed that practice but my question is whether we are going to stick to the policy that we have practiced.

Mr. Rosen - The suggestions we are making now would not involve a change in policy and the removal of the section does not involve such a change.

Sir William - Then we agree with Mr. Broches' suggestion.

Section 4.02

Mr. Cavanaugh - We thought of making the same charge as the Bank, 1/2 of 1%.

Mr. Rosen - The situation isn't the same. Here we would not be holding borrowed money so the cost to us would not be the same.

Mr. Broches - Also in the Bank we have a commitment charge in addition.

Mr. Demuth - When we make one of these commitments it is the start of the service of IDA so why not start to charge the service charge of 3/4 of 1%?

Mr. Broches - I agree with 3/4 of 1% but I would like to keep them separate.

Mr. Cope - I question the logic of arguing that this commitment charge should be the same as the service charge since we can invest the funds and therefore the return to IDA is different before disbursement and after.

Mr. Cavanaugh - We cannot invest them. The funds are mostly in the form of non-negotiable notes. When the Borrower gets a commitment he is getting the benefit of the credit right then and I agree the service should start at that time but I did not think I had enough support around here so I didn't suggest it.

Mr. Demuth - I agree. Certainly the benefit would start when the commitment is made.

All - Agreed.

Mr. Demuth - There is a consequent change in Section 2.02.

Mr. Broches - I'll change the last sentence by adding the word "same" before "rate" and deleting the rest of the sentence.

Section 4.03

Mr. Cope - The last sentence does not apply to IDA.

Mr. Broches - It does not apply for the same reason as the Bank. For IDA, we don't want the large undisbursed balance to show up when we try to go and get new money.

Mr. Cavanaugh - Also we don't want the Borrower to hold back on withdrawals for a long time with a view to possibly financing it somewhere else and then coming in and cancelling.

Section 5.02 (c)

Mr. Rosen - This covers the situation where the Bank pre matures a loan but does not cover the situation where suspension under the Bank loan is impossible because disbursements have been completed but there has been default in payment under the Bank loan but the Bank loan has not been pre matured. In such a case I think that IDA should be able to suspend.

Mr. Broches - We could change by adding the Bank to (a) or by adding the thought to (c). We'll change (c).

Mr. Rosen - This does not make any distinction between suspension for 30 days and suspension for 60 days.

Mr. Broches - That will be covered in the Credit Agreement. Also pre maturing of the Credit Agreement is not covered here. We will put it in the Credit Agreement in order to give us more flexibility.

Section 5.02(d)

Mr. Demuth - Could not this be simplified?

Mr. Broches - No. The point is that "borrower" and "Borrower" are not the same.

Section 9.06

Mr. Broches - This is substantive because the Articles give the members the right to exclude Overseas Territories from membership in the Association if the members so desire.

Section 9.07

Sir William - Why is this needed?

Mr. Broches - It is needed to avoid spelling it out in all the Articles of the Credit Agreement and related documents.

Articles III
Currency Provisions

Sir William - Mr. Broches will explain that we have had talks with Executive Directors from four countries: German, Netherlands, French and U.S. We suggested: (a) the amount of the disbursement be related to the dollar value at the time of disbursement of the currency disbursed; (b) the repayment be in convertible currencies in an amount of those currencies related to dollars at the time of repayment.

The Executive Directors contacted did not like it. They agreed that in principle the repayment should be in convertible currencies and that there should be some method of evening out the impact of currency revaluations upon the various borrowers.

Mr. Broches will draft the Articles on the principles for further discussion with the Executive Directors this afternoon.

Mr. Broches - To restate the principle, repayment is to be in any currency convertible in the opinion of IDA. The Borrower and IDA would enter into administrative arrangements at the time of signing to determine the currencies to be repaid. The amount of the currency disbursed would be measured in dollars at the time of disbursement. The repayment would be in terms of gold dollars at the time of repayment with two exceptions: (a) if there is a uniform reduction of all currencies, the amount repayable under the credit would be reduced proportionately; (b) if there is a reduction in the value of one major currency, for instance dollars, in the eyes of IDA then the amount of the repayment will be reduced proportionately, proportionate to the amount of the funds of that currency to the total funds of IDA.

Articles III will also state that IDA determines the equivalent and certain other "border plate" from the Loan Regulations.

Sir William - The problem is that all the Executive Directors will want to go back to their Governments before approving these Credit Regulations. This hold-up will probably extend beyond the signing date for the Honduras credit. Our proposal is to make that one in dollars and give them the right to adjust later if they desire. In this way it will not be necessary to complete the Regulations before the Honduras credit is negotiated and signed.

Mr. Cavanaugh - Since Germany and Italy made their first payments in dollars, the first withdrawals will be in dollars. If Honduras is the first to withdraw, the suggestion to make their agreement in dollars will be all right. But, it isn't a question of the first loan, it is a question of the first withdrawal.

Sir William - After Mr. Broches' revised draft has been discussed informally with the same Executive Directors, we will have another SLC meeting to consider Article III.

The meeting adjourned at 12:10 p.m.

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SLC/M/61-15

Rough Notes of Staff Loan Committee Meeting held on
Wednesday, April 5, 1961 at 10:00 a.m. in Room 1006

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MEXICOCreditworthiness

Mr. Schmidt - Mr. Samuel of Kuhn, Loeb had informed Mr. Black that they had been asked to float a large loan, coordinated with a Bank lending operation, to finance power development in Mexico. Mr. Black had replied that the Bank was not interested in joining this operation as long as Mexico maintained its present stand on rates, but if Mexico took the action on rates requested by the Bank, the Bank would be willing to make power loans or enter into a joint operation with Kuhn, Loeb.

Mr. Knapp - The creditworthiness of Mexico is so good that they could raise a lot of money in the market if they behaved themselves and took the necessary action on rates. While the Bank is preventing Mexico from borrowing at what may be favorable rates, I think we are serving Mexico's best interests in preventing them from doing so. I will discuss this matter with Mr. Ortiz Mena, Minister of Finance and Public Credit, at the meeting of the economic mission for Latin America in Caracas, taking into account what is decided here today.

Sir William Iliff - What is the status of the foreign exchange reserves?

Mr. Dominguez - They amount to \$420 million, the equivalent of 11 months of goods imports or about five months of goods and services.

Appraisal of Action Taken on Power Rates

Mr. Knapp - All agree that the actions taken have not been adequate. Mexico has defaulted on its obligation to raise rates to provide a rate of return of 9% as measured by the Mexican formula. We are now talking of a rate of return of 7% on the total investment in the properties of CFE, whereas the 9% commitment was on the major systems and was designed to offset lower earnings in the smaller systems and produce a rate of return of about 7% on the whole system, so actually there has been no change in our requirement. I am not concerned here as to how they keep their books, but rather that there is a return of 7% calculated on our basis, which means including in the gross income the "2% interco" paid by CFE and the 10% electrification tax on CFE's sales, using as the rate basis the revalued assets in operation and allowing for realistic depreciation of these revalued assets.

Mr. Schmidt - The CFE is now examining the whole accounting system and will probably come up with a revision which takes into account all that you have mentioned. I think we should support this effort, but I don't think that we should make the adoption of the revised procedures a condition for a loan.

Mr. Knapp - That's not my point. I am only talking about the determination of the rate of return on a basis which would permit us to go ahead. I am not talking about how they keep their books.

Mr. Schmidt - We are in somewhat of a strange position in that we are not taking into account all of the 10% tax in calculating the rate of return.

Mr. Knapp - Under our system of determining a rate of return, a part of the tax goes to distribution and part to generation and therefore the tax is taken into account in calculating the rate of return on the investment in CFE's properties.

Mr. Matter - CFE is considering changing their method of calculating the rate of return. The valuation of the assets and the allowance for depreciation will probably not lead to argument but the question of the tax being included in revenue will probably cause trouble since this item makes the most difference.

Mr. Knapp - It is possible to divide the tax on the basis of the relative investment in the assets of the two systems and, as counting the tax at all is a concession, I should not think it would be difficult to get their agreement. We do not have to agree with them as to the method of dividing the tax as long as we are satisfied with the rate of return calculated on the basis of our system. This does not mean that they have to adopt our calculation for purposes of keeping their books.

In answer to Sir William's question, we are concerned with these problems of calculation of the rate of return in order to get CFE on a sound basis and to avoid future Government contributions to new investment.

Mr. Squire - Over a period of years CFE will develop into a very large operation and should rightfully be able to borrow on the local market. Our purpose is to make them operate on a sound commercial basis which will enable them to borrow.

Mr. Rucinski - Why didn't they live up to their obligation under their last loan?

Mr. Knapp - Mostly political reasons.

Mr. Cancio - The rate covenant in the last loan was not in the form of our usual rate covenant. It was based on performance according to Mexican law and we received a letter to explain the covenant. The problem is one of interpretation of the Mexican law.

Mr. Schmidt - I agree that they did not act as they should have in fulfilling their obligations under the 1958 loan but, on the other hand, they have not been as bad as we are inclined to state. It's true that the Government which signed the letter did not act before the elections, which followed six months after the signing of the loan. However, the new Government, admittedly slowly, has now started to do something about the rate question.

Mr. Broches - We certainly have grounds to believe that there will be some lag in the raising of rates but there certainly has been a substantial increase in earnings.

Mr. Rucinski - How do we avoid the same trouble we are now in?

Mr. Knapp - We simply won't make any moves until we are satisfied with their actions. We will have to rely on their word to increase rates to cover increased costs for fuel and labor and thus maintain the 7% rate of return.

Mr. Rucinski - Is there any possibility that we may be asking for more than is attainable. The 7% figure seems high compared with other countries and perhaps it is more than Mexico will be able to achieve.

Mr. Knapp - The 7% seems reasonable to all who have considered this problem and has already been agreed. The Mexicans have not raised any objection to our position on this in the past, and as pointed out earlier, our position has not changed.

Mr. Spottswood - The 7% figure was arrived at by calculating the CFE's cash needs and working back to the rate of return required to meet these needs.

Mr. Knapp - On that calculation I have some question about para. 76. Sub-para. 3, on the generation of cash toward new investment, does not include the 10% tax and therefore it does them injustice.

Mr. Matter - I agree that including the tax would increase the percentage generated from earnings, and that they may object. Therefore we should recalculate this.

Mr. Knapp - While we want a 7% return of investment calculated on our basis, I think we might consider some concession during the first few years when they are building up the plant. Otherwise rates have to be increased from year to year and then lowered at the end of the building period.

Mr. Squire - We must remember that they have a serious cash problem during the five years of construction and, therefore, I don't think we should make any concession. They can always reduce the rates later if they prove to be excessive.

Sir William - If a 7% rate of return is agreed, what would happen to retail power rates?

Mr. Knapp - Our position is that no increase in the wholesale return is any good if it is made at the expense of the retailers. The increased wholesale power rates must be passed on to the consumers. The increase in the consumers' rate would be a much smaller percentage. But, of course, the consumers' rates should be increased to cover the increased cost of the distribution companies as well as the increased costs of wholesale power.

Mr. Matter - The recent increase of 54% in the CFE rates would require a 10% increase in Mexlight rates to pass this increase cost on to the consumers. An additional 15% increase would be required in the Mexlight rates to cover the increase in its own costs and to put the company in good financial shape.

Sir William - If all of this were done, what amount would be added to the consumers' bill? Isn't this the practical problem for the Mexican Government?

Mr. Schmidt - That's hard to determine.

Mr. Cope - We should really start from the retail end and determine the amount of revenue necessary to provide an adequate rate of return for the whole system on a consolidated basis.

Mr. Matter - We have calculated that 7% return for both the investment of generation and distribution would mean raising revenues about 10% per annum for CFE and 3% for Mexlight.

Mr. Knapp - Mr. Cope's comment relates to a point I was about to bring up. In the past we said that we would not make any loans to CFE unless adequate rates were installed for both CFE and Mexlight. We had dealt with them as separate systems and our interests were different for each. After nationalization of the Mexlight company the issue came up again and we sort of backed away a little bit from our previous position. Now we have the question again. Should we require adjustments of the retail rates, over and above the question of passing the increased CFE rate to the consumers, before going ahead with a CFE loan?

Mr. Schmidt - I am still worried that part of the 10% tax doesn't go over to Mexlight.

Mr. de Wilde and others - That I don't understand as it was said earlier that we would allocate part of the tax to Mexlight.

Mr. Knapp - I should explain that CFE collects the 10% tax, but in calculating the rate of return on investment for CFE, we have included only one-third of the 10% tax. However, as the proceeds of this tax are not actually given to Mexlight, we have not included the other two-thirds in calculating the rate on the investment of the distribution system. Two-thirds of the tax has not been taken into account anywhere.

Mr. Cope - That's exactly why I suggest a consolidation.

Mr. Knapp - I agree but we do have different systems to contend with. Certainly we should regard the two-thirds of the tax as part of the revenues for Mexlight, now that it has been nationalized and incorporated in the Government's own system.

Mr. Broches - All of this is not an answer to your earlier question, although it has to be taken into consideration in reaching an answer to your question. While we did have a special objective in the past for looking at the various systems separately, I agree now with Mr. Cope that there is no reason not to look at the system as whole.

Mr. Schmidt - I suggest that we ask for a 7% return on all assets of the entire system, taking into account the 10% tax.

Mr. Matter - We should also take a look at the cash needs on a consolidated basis since the cash problem is very important.

Mr. Knapp - All right, but this means a major recalculation on our part before we can do any talking to the Mexicans about anything.

Mr. Schmidt - I suggest that a rate lower than 7% on the investment be allowed during the first few years, as you mentioned earlier.

Mr. Knapp - As I understand it, TOD wants a 7% return on the entire system each year and the Area questions whether it should not be calculated over a longer time period to take into account the lag in the building up of the load level. If the return will eventually come up to the required level and stay there, I see no reason to raise rates to achieve this in each year and to lower them again to maintain the return at 7%.

Mr. Squire - The cash problem is one that they have now, so the rates must go up to meet that problem. They can be dropped later if the rate of return exceeds the required amount.

Mr. Knapp - The performance today has not been adequate because the rate increases have not been passed on to the retail level. We will soon be asked what rate we would agree to. Therefore, we should make our calculations now in order to be ready to answer this question. The return should be 7% on the whole system calculated by our formula but not necessarily a 7% return each year as long as they have a program for building up to the satisfactory level over a short period of time. However, we would want to see the figures before deciding on any reduction from the 7% rate.

Mr. Rucinski - Why 7%?

Mr. de Wilde - There is a question on the justification of 7% as it has been stated that it was arrived at on the basis of the cash requirements. It might be different if there were no expansion program.

Mr. Knapp - I don't really know why 7%, but this figure has been worked out over a period of time and accepted by all and I don't think we want to get into a long argument over the question you are raising.

I think that 7% is a satisfactory figure but that we should be prepared to consider a proposal which falls short of 7% during an interim period to smooth out the curve of rate change while the system is growing. However, I can't say how much the shortfall should be;

Mr. Squire - There are two questions: first, the amount of return we require as a starting point and secondly, the problem of maintaining that rate of return. I think the latter requires an automatic adjustment in rates with the possibility of later review to cover increased fuel and wage costs. This should be covered by a covenant in the Loan Agreement. While it is something that we have not ever insisted on before it would be very desirable in this case.

Mr. Knapp - I agree that a covenant is needed on the maintenance of the 7% rate of return, but I question the wisdom of requiring that the rate of return be maintained in a particular way. I agree that the automatic adjustments in rates that you suggest without the necessity for an application is a desirable solution, but I don't think it's something we can insist upon.

Mr. Squire - If the Government wants to play ball with us they will have no difficulty on this requirement and would agree. If they do not want to play ball, we should not be doing business.

Mr. Knapp - I can't agree that their refusal to agree to an automatic adjustment means that they are not playing ball. They may have other satisfactory reasons for not wanting an automatic adjustment.

Mr. Broches - They never said that an automatic rate of adjustment was not legally possible. This has been done in the U.S. for gas rates. What objection do they have to this?

Mr. Cargill - My objection is that it is too inflexible.

Mr. Broches - I agree that there should not be a covenant but it is a desirable recommendation.

Mr. Demuth - I think we should press as far as possible for satisfaction but this is not a point on which we would be willing to break.

Mr. Squire - We did the same, I think, in Brazil.

Mr. Knapp - We all agree that this is a fine idea, but we did not press for it in Brazil. It's an arrangement that they have already; it wasn't done at our insistence. By insisting on your self-enforcing device, you are indicating that you do not trust the borrower to take the necessary steps to live up to the covenant to maintain rates at the level required. I don't think that this is a position that we can possibly take.

Actually, I hope that they will do away with the tariff commission. In that way you would achieve a solution to your problem. Perhaps that should be your condition.

Mr. Broches and Mr. Cope - They still have to have a review of the rate increases by the Central Government.

Mr. Matter - That would be provided through the membership of the Board of the Power Authority. Since the other Ministers sit on the Board, the Government would be in a position to review rate increases of the Power Authority.

Mr. de Wilde - An automatic increase in rates to cover wage increases raises the question of improper wage increases being passed on to the ultimate consumer without proper consideration.

Mr. Spottswood - If there is no covenant on this point, do we get a side letter?

Mr. Knapp - The next step is for us to get their proposals.

Contract Bidding

Mr. Knapp - It may be too early to discuss all this as the whole situation may change before we reach the question, but it will probably come up in one form or another so we might as well review it. The suggestion of TOD is, I take it, that a loan to CFE might be made in the amount of \$60 to \$80 million to cover the foreign exchange and the foreign exchange component for the procurement on the basis of international bidding of goods not yet contracted for.

However, there may not be \$60-\$80 million of procurement by the time we get in the picture. I suggest that we go to local currency purchases as we did in the case of the last power loan in order to offset that part of the \$60-\$80 million which has been contracted for by the time we lend. This would mean picking up local supplies or make the best competitive bid.

Mr. Cope - This problem is complicated by the import tax.

Mr. Matter - I agree we should watch the situation to be sure that the goods purchased locally are competitive without excessive tax protection but my main point is that the TOD position is too strong. We should include the purchases locally which meet our requirements. These are acceptable to the Mexicans and I understand that the purchases have been competitive. Also, I don't see why we should exclude those items where a line of credit has been opened but purchases have not yet been made.

Mr. Squire - There is only one of those cases, a French credit of \$72 million. We have omitted that one in order to avoid offending the French.

Mr. Cavanaugh - If we finance the goods to be purchased out of the French line of credit, wouldn't we be violating the Bank's Articles of Agreement, given that this is a 14-year credit?

Mr. Cope - We would not be taking business from the private market since the suppliers' credits are guaranteed by the Government and the price for the goods is higher because of the credit. The Mexicans would get a better price if we financed the purchase.

Mr. Rist - We should note that the rules of the Berne committee meeting are leaning toward much longer terms and the five-year suppliers' credit may be a thing of the past. Therefore, we may expect more and more of this type of thing.

Action

Mr. Schmidt - On the question of timing, it may be six months or so before we can go ahead in which time we will rerun our figures.

Mr. Matter - Perhaps we are over-estimating the effect of consolidating the figures and may, after doing all the calculating, come up with the same requirements we have now as to rates, and will have lost a lot of time.

Mr. Knapp - That's what I meant earlier when I said that we should hurry in order to be ready to answer their questions. We agreed that we wouldn't be satisfied unless the whole system were cleared up. We don't have the figures now to say what would be needed to give the 7% return on the total investment. I am not worried about delay because the Mexicans should make the next move. They have not done anything about the rates.

Mr. Schmidt - If they pass the rates to the distribution system, which they may do presently and accept a 7% return then could we start to make a study?

Mr. Knapp - I say we should wait and hear their proposal.

Mr. Squire - We could make a suggestion and see whether they could meet it.

Mr. Schmidt - We have sent a mission down there to look at the situation following the recent rate increases and they expect some sort of comment following the report of that mission.

Mr. Knapp - All right. We could tell them the basis on which we are prepared to consider the whole question.

The meeting adjourned at 1:00 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Friday, March 31, 1961 at 3:00 p.m. in Room 1006

ICELAND

Mr. Knapp - The economic report was an interesting one. The Committee would first review Iceland's creditworthiness. A persuasive case had been made in the report and the SEC had agreed with its conclusions with some questions about the way they were expressed.

The hot water project would probably be self-liquidating and make a net contribution to the balance of payments. However, it had to be remembered that Iceland was a small country with a limited population and that the amount of lending proposed was fairly substantial in relation to Iceland's GNP, etc.

He would like to repeat that the Economic Report was a clear and effective presentation.

Mr. Diamond - He questioned the statement in para. 102 of the report that it was a blemish on their record that they had been reluctant to subordinate the desire for rapid economic progress to the requirements of monetary stability.

Mr. Cope - The report would be edited before it went to Iceland.

Mr. Knapp - He suggested that this statement should be removed in the revision as it might be lifted out of context and misquoted.

Mr. Cavanaugh - He questioned the increased consumer subsidies and the family allowances in para. 72.

Mr. Cope - In their inflationary position there had been a link between the trade unions demands for increased wages and the rises in the cost of living and they had had to cover subsidies for food prices to prevent rises in wages.

This statement could easily be expanded to cover Mr. Cavanaugh's point.

Mr. Knapp - He suggested that the explanation should be put in parenthesis.

Mr. Stevenson - He was not clear about their income taxes, see para. 59.

Miss Zafiriou - They had a direct personal tax somewhat like the rates in England.

Mr. Knapp - The Committee passed a \$2 million vote of confidence in Iceland.

Review of Projects

Mr. Knapp - The Committee was only asked to look at the hot water project today.

Mr. Lefort - They needed heat all the year round for factories as well as for residential buildings.

Mr. Knapp - It was an unorthodox project. Did anyone feel that it should be opposed?

Mr. Cavanaugh - He could live with this proposal as a foreign exchange component was present in the project. He agreed with it.

Mr. Knapp - The foreign exchange aspect was an important consideration on the plus side.

The project might be considered similar to mining a fuel.

He had no insuperable difficulty in accepting it.

Mr. Cavanaugh - He had some question about para. 30. Was the report referring to the impact of the foreign exchange component?

Mr. Knapp - They would have to import finished products (pipes, etc.) and raw materials for fabrication.

The report was not referring to the impact of the propensity of wage earners to buy imported consumer goods.

Mr. Cavanaugh - He did not understand the reference to 50%.

Mr. Knapp - This meant 30% direct and 30% of 70% which gave a total of 51%.

Mr. Cope - These figures were guesses at this stage.

Mr. Knapp - Yes, but it was to be a foreign exchange loan and not a local currency one.

Mr. Diamond - Why would we only finance 40% when 60% was required in foreign currency?

Would the rest of the funds be forthcoming?

Mr. Lefort - There was a gap but Iceland expected to be able to fill it and it was desirable that they should make an effort to get the money. Iceland had seemed satisfied with this proposal. They would obtain some financing from retained earnings and some from counterpart funds.

Mr. Squire - They would still need 40 million kronurs after using the internal funds.

Mr. Lefort - The project would take four years. 60 million kronur would come from earnings in the system, 25 million kronur from PL 480 counterpart in 1961 and 80 million kronur from the Bank. This gave a total of 165 million kronur leaving a 35 to 40 million gap.

The gap might possibly, if necessary, be covered by the use of more funds from PL 480 counterpart. They were not sure they would get this counterpart in 1962-63.

Mr. Knapp - The covering of the gap should be left for the negotiations and he felt that the negotiators could feel free to go up to \$2.5 million.

Mr. Cavanaugh - Where would the goods come from?

Mr. Lefort - The pipes would come from Germany and maybe from the U.K.

Mr. Cavanaugh - Would the goods come from member countries?

Mr. Lefort - We expected so.

Mr. Stevenson - What sort of List of Goods would we have? How would we know where they were bought?

Mr. Cope - We would have the same problem that we often had and it would not be particular to this project.

Mr. Rosen - Re the foreign exchange savings of the project, were the people who were getting hot water already getting a service involving the use of coal?

Mr. Lefort - They now heated with fuel oil. The amount of fuel imported cost approximately \$14 million a year. They would save about 8% of this amount.

Mr. Armstrong - We could not say what proportion would be in savings and what would go in expansion.

Miss Zafiriou - They would connect 30,000 more people to the system and there would also be new construction to be connected.

Mr. Knapp - In any case it was a fairly sound assumption that household heating would be fairly high in their family budgets.

Mr. Rosen - He thought perhaps there might be an overstatement of the actual savings.

Mr. Armstrong - We did not have information on the cost to the householder of making use of this system. There would be some additional import component if they converted from hot air heating.

Miss Zafiriou - We had been told that the project would make a big saving in its installation in existing construction.

Mr. Knapp - Re the covering Memorandum, para. 8 (ii), the question of the priority of the project in Bank lending was not covered.

Mr. Cope - (i), (ii) and (iii) could be rearranged in a different order.

Mr. Knapp - We had been over (i) and (ii) and could pass (iii) with a vote of confidence in the Area Department to keep in touch.

Mr. Cope - The mission had not had a chance to investigate figures and amounts but wanted to get the approval of the Committee to the general idea and would get more exact figures later.

Mr. Knapp - He agreed and proposed that the recommendations should be left as they were for the present.

The meeting adjourned at 3:35 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Wednesday, March 22, 1961 at 11:00 a.m. in Room 927

JOINT LENDING DISBURSEMENT PROBLEMS

Mr. Cavanaugh - Before starting, I merely want to say that the Memorandum we are considering is not intended to cover all of the problems involved but, I think it does help to point out the need for discussion on this problem in order that the Bank's policy can be established before the operations start and the Loan Officers concerned will have the proper guidance to negotiate. While we can, I think, establish some general policies, I feel that the arrangements made for each operation will have to depend upon the circumstances of the particular operation.

Perhaps the most important question raised by the Memorandum is that of basing disbursement on a List of Goods. When disbursements are affected on the basis of a percentage of expenditures as reported by the borrower in an over-all statement of expenditure, I do not think that the Bank can adequately control that the money disbursed is used for the purchase of proper goods. However, if we do decide to base disbursements on a List of Goods, the decision raises several administrative problems which might be avoided if the disbursements were made on the basis of a percentage of total expenditures assuming everything entirely on a reimbursement basis.

Sir William Iliff - How would the system work, as you see it, in the case of the Volta River project where the DLF, Eximbank, the British, and possibly the Germans will be involved along with the Bank? I take it that first there would have to be agreement among the various lenders on the project to be financed and on the List of Goods required for the project.

Mr. Cavanaugh - That's correct.

Mr. Nurick - It would also require agreement on the division of the List of Goods among the various lenders.

Mr. Broches - This raises a question which I would like to bring up now, if I may. The Memorandum under consideration was prepared by the Treasurer and not by a working party made up of representatives from other Departments of the Bank. We must remember, therefore, that the paper bears the stamp of the Treasurer who is interested, and rightly so, primarily in the problem of the administrative work load and risks to the Bank. However, there are other factors which should be taken into consideration. My question is whether we can depart from the technical approach of this Memorandum in our discussion today.

Sir William - Yes.

Let us continue with the practical application of the system. We have earmarked a part of the List of Goods to each lender. What are the problems?

Mr. Cavanaugh - Under that arrangement there aren't any real problems, but the question is whether we want to follow the procedures you have assumed. If we use a List of Goods with sections of the list earmarked for different lenders, each lender would go its own way and we would be avoiding consideration of certain issues; such as whether every lender should put its funds into the project at an equal rate.

Mr. Nurick - I don't see how you can apply the idea of a List of Goods earmarked among lenders in the Volta operation where there would probably be one big contract.

Mr. Rosen - It's certainly possible to divide a hydroelectric project into its component parts: dams, power stations, transmission lines, distribution lines, thermal lines, and irrigation facilities. All may be handled individually with different lenders financing the different parts. This is the actual situation in Thailand where the Bank is financing the Yanhee Dam, the Export-Import Bank is financing the power station and DLF is financing the distribution facilities.

Mr. Aldewereld - That example is not comparable as the various units are not being done at the same time. Where there are separate components of that nature and the Bank agreement only covers one, we don't have any problem. In the Volta operation the loan of no one lender fits any particular unit of the project and the lenders may not wish to identify themselves with a particular part.

Sir William - Is the DLF lending tied?

Mr. Cope - The U.S. will probably tie the U.S. loans to U.S. goods. This is not certain as yet and it would not necessarily mean that the loans would be tied to procurement of goods for the project. The U.S. loans may be tied to purchase of general imports in the U.S. which purchases would free funds for purchase of goods required for the project.

Sir William - Is there any merit in the idea that we take the Volta operation and set up a working party to consider the problems it presents and recommend a procedure to meet the requirements of that situation?

All - That would be a good idea.

Mr. Nurick - The Volta project would be a good test as it probably will include all the various possibilities of joint operations. I have had difficulty trying to fit the principles set forth in this Memorandum to the Volta situation; therefore, I agree that the problem should be approached by working out procedures which could be suitable for the Volta project.

Mr. Cavanaugh - The fact that there is one large contract does not prohibit the use of a List of Goods approach for the Volta project. It's possible to break down the contract into different parts, something we have often done. The existence of a big contract does not exclude the earmarking of the List of Goods among the various lenders.

Sir William - I am afraid we will have to tailor the disbursement procedure to fit the particular project rather than the project to fit the procedure.

Mr. Cavanaugh - I agree with that.

Mr. Aldewereld - The Volta project is further complicated because we don't know the whole story from the beginning. It will not be possible to determine the 'what' and 'where' of some purchases until long after others are made. Division among the lenders is difficult where we don't know what is being divided and various lenders have preferences.

Mr. Stevenson - While I agree with the approach that the procedure should be suitable for the Volta project, I would not want the Volta factors to fix a procedure to be used for Roseires, which I do not think will be particularly complicated, at least compared with Volta. For Roseires we thought we could do it on a straight percentage basis although we could have a List of Goods consisting of three items: the contract, the consultants' fee, and the interest rate section.

Mr. Cavanaugh - I should have made it clear in the Memorandum what I meant in the List of Goods procedure. What I am calling List of Goods, I mean a procedure whereby we pay for the contract payments in contrast to the procedure where we would make payments to the borrower for reimbursement of a percentage of expenditures already made by the borrower, and that our documentation would consist of the documents arising from a particular purchase action for the List of Goods procedure as against a statement of the borrower summing up expenditures for a period of time for the percentage of expenditure system.

Mr. Demuth - I think the working party should be seized with the Roseires problem as well as the Volta in making its recommendations as to disbursement procedures. We all recognize that each may have different problems.

Sir William - Yes, I agree.

Mr. Nurick - I think there is a problem involved here over and above the practical one of how to do it. Many lenders are, or may be, in these joint operations because the Bank is in them. They have looked to the Bank to take the lead in appraising the project and making satisfactory financial arrangements. Therefore, I think that it's right that we should take the lead in the supervision of disbursement, that we should do the job with the other lenders following our instructions for payment. Such a procedure would not be inconsistent with the whole spirit of the Volta operation.

Mr. Stevenson - This point actually came up in the discussions with the Germans on the Roseires Dam project much as you describe it.

Mr. Broches - I agree and see no objection on their part to the Bank taking the lead unless it doesn't fit with the other lenders' own requirements. The U.S. Government, for instance, may not be in a position to pass the disbursement supervision role to the Bank.

Mr. Cavanaugh - This suggestion runs up against the whole problem of whether the borrower can prefinance the expenditures so that disbursement can be made on a reimbursement basis. If not, the complication of making payments to third parties for individual purchases from the funds of several lenders arises.

Mr. Rosen - This whole paper seems to me to be geared to questions of a voiding duplication and commitments the Bank should not make.

Sir William - Would we let someone else make disbursements for us if we were a very small contributor to a project?

Mr. Cavanaugh - Yes, I think we should if they have disbursements procedures we consider satisfactory.

Mr. Aldewereld - We should really require supervision of the total project on a complete accounting basis to avoid any duplication. The borrower could always submit duplicated invoices to different lenders.

Mr. Rosen - What do we really care as long as the total expenditures on the project run ahead of the total payments made by the lenders? We should be looking at the over-all picture, not the individual payments.

Mr. Cavanaugh - I am afraid that that approach does not give us the control we should have. A situation has arisen in Ecuador which illustrates ~~my~~ point. There, DLF has been making payments on the basis of a statement presented by the borrower and now it has been disclosed that the money went astray. What was paid by DLF never went into the project. The Government, the contractor, and everybody else was involved.

Mr. Rosen - With forged documents, no system of supervision will work.

Mr. Cavanaugh - That may be, but with the Government in between the Bank and the suppliers, I think the risk of trouble increases, particularly in these small countries.

Sir William - Based on my experience with the Indus Basin, my feeling is that the other Government lenders would welcome the Bank's supervision and aid in the making of disbursements. Except perhaps in the U.S. where the Administration feels that Congressional approval is necessary.

Mr. Clark - That's right. While there may not be any legal prohibition against turning the supervision over to another party, the U.S. authorities are reluctant to do so unless they have the previous blessing of the Congress. The Administration is afraid of later Congressional criticism unless the expenditures have been approved by the GAO. In some cases the Congressional approval to turn the job over to someone else was included in the enabling legislation.

Mr. Broches - The suggestion made in the Memorandum regarding the deposit of funds with us would encounter this problem, I am sure.

Mr. Cavanaugh - I am told that the U.S. can do it.

Mr. Demuth - Legislation is going to the U.S. Congress this session on the whole question of U.S. aid. It should not be too difficult to get this point covered in the new legislation.

Mr. Rosen - I question whether we should be the ones to propose that we take the lead. I have no trouble when the other lenders suggest it, but I am not sure about whether we should go around asking that we be put in charge of all the disbursements.

Sir William - We put it to the Germans in the case of the Roseires Dam and they welcomed the idea.

Mr. Aldewereld - In the Volta project, the other friendly governments rely on us for appraisal and supervision of the construction of the project, so probably they will be willing to rely on the Bank to do the disbursement supervision.

Mr. Stevenson - I don't think there would be any problem with the Germans on this point for the Roseires Dam project. After the Germans have been in the business a little longer and have developed their own organizations and ideas on supervision, they may object to turning the job over to the Bank but at the present time I do not think so. As now contemplated, we would do the supervision for the Roseires Dam disbursements and merely instruct the Germans to make a payment.

Sir William - On the question raised by Mr. Rosen, it seems to me to be a matter of presentation. As long as the suggestion is in accord with their regulations, I think the various countries will welcome the suggestion.

Mr. Stevenson - The Germans were certainly glad to have us do it. They are not set up to do the job at the present time and they also save some money.

Mr. Aldewereld - They also save embarrassment. We are international and can therefore say certain things to the borrower which another sovereign country might not be able to say.

Mr. Cavanaugh - Could we consider paras. 6, 7 and 8?

Mr. Broches - I have a question whether the suggestion made in para. 6 whether the fund managed by the Bank is really necessary. If there are only a few disbursements, it would be possible to call for the money from the other lenders as the occasion arises. If payments are frequent and numerous, wouldn't it be possible to make the division by periods of time? For instance, disbursements from the Bank loan would cover payments for the first six months and the next six months would be covered by another lender so that everybody moves forward in steps.

Mr. Cavanaugh - The question is whether there will be trouble with the other lenders when their time comes up after we have made payments for our six-month period. Perhaps the trouble we are now having on delays in payment to the Indus fund colors my views. We have not received today money requested from the U.S. and Canada back in January for the Indus fund and we may never receive the Pakistani rupees that we have requested from the U.S. While it's true that part of this trouble arises from the difficulties of starting the operation and later calls for funds should be easier, I think we have to remember that other lenders operate a lot slower than we do and will not be able to make payments on the day we want them to. If we are obligated, I think we have to get the money from the other lenders first in order to avoid a failure to make payment when due.

Mr. Broches - But we would not be obligated. We would merely be agents for the other lenders and the blame for nonpayment would fall on the other lenders, not on us.

Mr. Cavanaugh - I am afraid that some of the blame would rub off on us and we certainly can't refuse to pay third parties where we have commitments to them or where they have taken action on their reliance that we will continue our business in accordance with commercial practices and our established habit.

Mr. Broches - On the question of guaranteeing letters of credit which comes up in para. 7, I agree we would have to make payment. I see no reason why the Bank could not make commitments to commercial banks or suppliers over and above the amount of the loan provided we have an obligation from the other lenders. We certainly cannot assume that the other lenders are not going to meet the obligation to pay us. If they are late in meeting their obligation, then we can charge them interest on the period that we were out of funds just as any other commercial bank does. This is the normal confirmation process of commercial banks.

Mr. Cavanaugh - I agree that we should take the risk of going over the amount of the loan.

On the question on the timing of the disbursement raised in para. 8, what do we do in the simplest cases where there is only the Bank and IDA?

Mr. Stevenson - For the Roseires project we suggested that the disbursement be made pro rata. The Sudanese raised no objection, but I would be interested to hear Mr. Cavanaugh's argument if they had raised an objection.

Mr. Cavanaugh - I think the argument has already been made before this morning and that is that all funds are part of a single pot for the purpose of the whole project and its disbursement should be from the pot, not some sections of the pot.

Mr. Nurick - The Ghana paper accepted that argument.

Mr. de Wilde - If the loans are tied, it is not possible to have pro rata disbursement.

Mr. Nurick - That's generally true, but not necessarily. It might be possible to arrange the other disbursements to fit the rate of the Bank.

Sir William - We should just say that this is how it is if there is any argument. I think all of these points should be considered by the working party. Who will be represented on the party?

There was considerable discussion in which the Far East and the Western Hemisphere Departments asked to be excused as they had no pending joint lending operations. It was suggested that representatives from the European and South Asian Area Departments, Treasurer's Department and Technical Operations Department and the Assistant General Counsels should be on the committee.

The meeting adjourned at 12:50 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Monday, March 13, 1961 at 3:00 p.m. in Room 1006

KENYA

Creditworthiness

Sir William Iliff - I understand the situation on creditworthiness is that if the political situation is all right, we think the creditworthiness of Kenya would be satisfactory. If the political situation is not all right, we are pushed back on the U.K. guarantee.

Mr. Lejeune - As with other emerging countries, there are many imponderables and we cannot say much more than that. We think it's certain that the quality of the administration would run down seriously if the political situation should go to pot and that there would be an exodus of Europeans from Kenya which would hurt the economic situation.

Sir William - Is there any dissent against making an investment under the creditworthiness situation we have here?

(No comment.)

Project

I take it that in principle we have decided that the general type of approach suggested here is appropriate for Bank lending in Kenya and that the question is whether this particular project fits the approach. Does anyone have any question about the project?

Mr. Reid - In this case the project report must be considered with the economic report since the project is only all right if we accept the political risk.

Mr. Cavanaugh - How long is the period of disbursement and isn't a 20-year term the longest we have ever had for agricultural loans? I wonder whether this long term is necessary.

Mr. Motheral - The disbursement period would be four years. The term of the loan is based on the economic facts of the case. The farmers will obtain a favorable financial condition in about 12 to 15 years and as they are to repay the loan, the payment would not be possible before that time. This is the arrangement that Kenya wants.

Mr. Cavanaugh - If the project is for two and a half years, why does disbursement run for four years?

Mr. Reid - The purchase of land and settlement on the land will end after two and a half years but farm development expenditures on the land purchased and settled will continue for another 12 months, so the disbursement period is really two and a half plus one, or three and a half years.

Sir William - Does the four-year grace period start from the date of approval of each sub-project?

Mr. Reid - No, it starts from the loan signing.

This would not be the longest agricultural loan. I believe the Mexican irrigation and the Dez project in Iran were as long, or longer. But here the farmers are going to pay 85% of the cost of the project. With this heavy burden, they need time to finance the payments.

Mr. Schmidt - I thought the loans to the farmers were to be for four or five years.

Mr. Motheral - The bulk of the loans are for 15 years plus five years of grace. A small amount will be lent to contractors on a four to five-year basis.

Mr. Schmidt - What is the meaning of the project in this case?

Mr. Reid - The sub-projects are multiples of 5,000-acre blocks of land which can be handled in six months. We expect to receive information in Washington regarding the blocks of land which will be processed in each six-month period and the documents would show the land, the staff requirements to do the job and the details as to the settlers. The project is the work to be performed in two and a half years rather than a fixed amount of acreage to be developed, because of the political risk. We don't want to get in a position where an indefinite number of acres required by the project could not be completed for political reasons. By tying the project to work to be performed in a period of time, we avoid this difficulty.

Mr. Stevenson - Is it only the political risk that you are concerned about?

Mr. Reid - Other things come into the picture. We have listed four different possible problems in the conclusion of the report, but they depend upon the political situation.

Mr. Rist - What does the Bank approve on a sub-project? The acreage, the price, the settlers or what?

Mr. Reid - We want to be satisfied as to the quality of the land and the price paid for it. If this is not in line with the forecast, the whole scheme could be jeopardized. We expect to get all the information we would require from the Government and make our decision in Washington on approval of the sub-project.

Mr. Motheral - We have a pretty good idea now of the land that would be settled and we have made up a rather detailed questionnaire. From the answers we think we will get all the information necessary to base a decision to proceed with the next six-month period.

Mr. Lejeune - The whole background of this arrangement is that the political situation may change radically between the signing of the loan and the completion of the project. The staff necessary for the execution of the project may leave Kenya due to political reasons. We have to know that the project can get the right land at the right price, that adequate staff will be available, that the settlers will be properly trained to take over the land; in short, that all of the many varied actions necessary for proper execution of the project can and will be taken. In view of the uncertain situation, we cannot get any assurance on the whole project at this time. The sub-project approach should give us a means of establishing that all is in train for each sub-project before we take each successive sub-project step.

Mr. Rist - Cannot this be called end-use supervision before the fact?

Sir William - It seems to be a sensible arrangement to take care of the special circumstances.

Mr. Cavanaugh - Why do we have to go back to pick up expenditures from January 1, 1961? Have they actually purchased any land yet?

Mr. Reid - No land has been purchased but expenditures for basic planning have commenced. The Bank would pay the foreign exchange cost of the basic skeletal planning project expenditures since January 1, 1961. The foreign exchange component for these expenditures was calculated in the same way as was the foreign exchange cost of the previous project the Bank financed in Kenya. The formula is explained in the Report.

Mr. Cavanaugh - If we are to operate on the basis of approving sub-projects and have not as yet approved any sub-projects, why do we go back and pick up old items from January 1?

Mr. Reid - The Bank would pick up from January 1 the foreign expenditure component of the expenditures from January 1 for the first sub-projects covering the period January through June 1961, if this sub-project were approved.

Mr. Demuth - Why don't we approve the first project when we sign the loan?

Mr. Lejeune - Because the sub-project may not be ready. We will ask whether this is possible, however.

Mr. Cope - There is no reason really why we could not approve the first sub-project with the signing of the loan. But the fact is that we don't know whether they will have the first sub-project ready for presentation so we have to provide for the possibility of approving the first sub-project after the signing of the loan.

Mr. Schmidt - What organization will make loans to the settlers? The report says that the Board will have a very small staff, but that they will handle the loan. How is this possible?

Mr. Reid - There will be a credit subcommittee of the Board and the Board will have a representative on each 5,000-acre block of land supervising the project. These representatives will make recommendations to the Board as to loans to farmers. Also the Board has district agents to collect the loans.

Mr. Schmidt - I thought there were many many small loans which would make a very difficult administrative task.

Mr. Motheral - The administrative bodies dealing with this project are many and their relationship is a very complicated organization of several Government departments. We have not tried to describe this set-up. We have satisfied ourselves that all the interested parties give the highest priority to this project and we think that all the various organizations will pull together to see that it's carried out. In fact, we have seen them work satisfactorily on the previous Bank loan to Kenya.

Mr. Reid - There are only two types of loans per farmers. Most of the loans to the farmers will be to pay Government departments for work they have done for the farmers, the other loans will be made to enable the farmer to improve his property himself. No loans will be made to the farmers for operations. These are for the farmers' own account and explain the working capital requirements for each farmer.

Sir William - What will the Bank loan be for?

Mr. Reid - The foreign exchange cost of general development, on the farm development, contractors' machinery, Government services, overhead and completion cost. In other words, it is the foreign exchange cost of expenditures for everything except land. This includes foreign exchange cost of tools for the farmers, farm costs during the project period and interest on the Bank loan.

Mr. Schmidt - Who bears the exchange risk?

Mr. Reid - The Government will bear that risk. As the farmers are bearing 85% of the total cost of the project which is unusually high for this type of project, we think it is reasonable for the Government to assume the exchange risk.

Financing Plan

Sir William - Can someone explain to me the problem of the short-fall of funds?

Mr. Motheral - The amounts required exceed the available sources of finance by about \$2.3 million. However, inevitably the scheduled expenditures of funds will not be achieved so the gap will probably not be this great, or may not even occur. However, this is not a very good answer, and we have to make some provision for the shortfall.

Sir William - I see that para. 6 of the Area Memorandum recommends the Bank obtain assurances about covering the shortfall while in para. 7 it says that the Bank should consider finding other sources of finance, including an increase in the Bank loan.

Mr. Lejeune - This problem stems from the high target estimate. If they do not reach the target, they will not need the money. We can either assume right now that they will not need the money in which case there is no problem of a gap and merely get general assurances, or we can get together with the other interested parties and notionally close the gap. It would be neater if we offered to put in a little more in the latter case.

Sir William - With the sub-project approval approach, is it necessary to close the gap at this time? We can discuss this question if it arises before approval of a sub-project.

Mr. Lejeune - That's correct. Also the project will be all right even if they do not get the targets completely.

Sir William - My thought would be to stick to a 2 1/2-year period for the project and \$8.4 million for the amount of the loan.

Mr. Rist - Does the Bank loan go in first, which would make periodical appraisal of this gap problem impossible?

Mr. Calika - No, the U.K. loan would go in first for the purchase of the land. The Bank, CDC and the Kenya Government funds would then follow together. Our tentative agreement is that we would disburse 49% of expenditures on the project excluding expenditures for the purchase of land.

Mr. Cavanaugh - I agree that disbursement based on expenditures would be the most practical way to handle it if the Government can furnish us with adequate reports of expenditures.

Mr. Calika - We think the Government can give us all the documentation that we would require. We expect to reimburse them for expenditures made with funds temporarily obtained from commercial banks on overdraft facilities. But we do not rule out the possibility of advances from the loan account for a working fund.

Mr. Cope - Para. 63 of the technical report shows that, of the proposed Bank loan, \$6.5 million represents 37% of the foreign exchange cost. This 37% might be termed the direct foreign exchange cost. The balance of the loan, up to 49% of the total cost excluding the purchase of land, represents also the indirect foreign exchange cost. I have no question about financing these indirect foreign exchange costs but merely wish to point out that this is the point that caused comment by the Executive Directors on the Mexican irrigation loan.

Commitment Charge

Sir William - The proposal is that since the loan has been divided into sub-projects, the Bank would only be committed to provide finance for a sub-project as it is approved, the loan account would only be credited as the sub-project is approved and that the commitment charge should run only from the date of approval.

Mr. Cavanaugh - The Bank attempts to treat all borrowers alike. We have often in the past qualified the borrowers' right to withdraw, but have maintained the commitment charge where we have thought that the project would go through. If we didn't think it would go through, we have not charged. We have used the commitment charge in Italy, in the Dez project in Iran and in Brazil. The one exception has been in the case of industrial development banks where we have not made a commitment charge as a special measure to foster private investment. I agree that conditions should be put on disbursement, in this case by approving sub-projects, but I don't see why this means that we have to drop the commitment charge, contrary to our practice in other loans.

Sir William - What about the Indus loan?

Mr. Cavanaugh - There were many extenuating circumstances and we did a lot of things which we have never done before.

Mr. Demuth - We were worried about the development bank loans and these worries led us to depart from our normal pattern. I am concerned now that if we follow the suggested path and don't charge the commitment fee, any smart borrower can avoid the commitment charge by presenting a loan in the form we are considering here for Kenya. I agree that the Indus loan was so different that it cannot be taken as a precedent for general Bank operations. If we do have an obligation to make payment, we should charge a commitment charge.

Mr. Cope - I don't see that we have a commitment because we have not approved the project.

Mr. Demuth - Then why do we fix the interest rate?

Mr. Cope - Logically, I agree there is a very good case for a flexible interest rate. I would suggest that we either fix the interest and charge a commitment or make the interest rate flexible and not make a commitment charge. We should leave the choice up to the Kenyans.

Mr. Broches - The word commitment has been used differently by various people. The Treasurer's Department has been using it as meaning exposure to risks, which meaning has nothing to do with the legal obligations which depend in each case on the particular Loan Agreement. In the development bank type of loan the Bank is only legally obligated to look at a project. The present case appears to fit that pattern. In the list of goods type loans the Bank still has to approve the expenditure but the Bank is much more narrowly committed.

Here we could make a case either way, but if we do not make a commitment charge, then the interest should be flexible.

In the first Austrian loan all projects were agreed so we charged the commitment. In the usual development bank loan there is less certainty that things will go forward; so, we do not apply the commitment charge. In this case we ourselves do not want to go forward except by single steps. Therefore, we should not require a commitment charge.

Mr. Reid - The purpose of this loan is to lower tensions. If the political situation remains bad and the westerners leave, we would look bad pulling out from under the Africans.

Mr. Schmidt - My question is whether we could get out if the political situation disintegrated, but the project was all right. If we could, then I can see making a distinction in this case from similar cases in Latin America where we have charged the commitment charge.

Mr. Motheral - I should emphasize that the review of the sub-projects will be very strict. This would be a serious matter. If the Europeans should leave, the project would be seriously affected and we could not approve the next sub-project. The Kenyans understand this and have accepted it, particularly as they see the savings in the commitment charge.

Mr. Stevenson - Here there seem to be strong reasons why we are not being committed and we do not wish to be committed so I agree with Mr. Broches that there is no reason for the commitment charge.

Mr. Cargill - The facts are that we will be committed to make the payment of \$8.4 million. I wonder, if the political situation goes to pot, whether we will take the decision to step out. I say we won't.

Mr. Lejeune - That's not true. The whole idea of the thing was to enable the Bank to be able to step out if the situation goes bad. The Kenyans are aware of this.

Mr. Cargill - Which Kenyans?

Mr. Lejeune - The Government.

Sir William - As I see it, this differs from development bank loans. In the latter, the Bank has a much wider latitude of project choice and therefore possibilities that the loan will be absorbed are much greater. Here, it is more likely that the loan will not be used and therefore less reasonable to make a commitment charge.

Mr. Cavanaugh - Are there any reasons other than technical to refuse to approve the sub-projects?

Mr. Reid - We have listed four points in the technical report but they all depend upon the political situation.

Mr. Cavanaugh - Can we turn down approval on creditworthiness?

Sir William - I don't see that that is relevant. If the political situation remains stable and they keep to their targets, we will disburse. The Area is merely saying that we want to stop getting into a commitment if there is political chaos. What would be the situation if we did charge a commitment charge and political chaos should develop?

Mr. Cavanaugh - We would collect the commitment charge up until the time we cancel the loan. In Brazil we collected commitment charge on a loan that was never disbursed.

Sir William - I think we would have more trouble in refusing to finance in the event of trouble if we had been charging a commitment charge.

Mr. Cavanaugh - I don't seriously disagree, I only want to find a justification for actions in the future.

Sir William - What is the justification in the case of the development bank loans?

Mr. Cavanaugh - There I feel that the justification is that we were fostering the development of private industry and we bent backwards to make this effort. Here it's not private industry but the Government that's involved.

Mr. Cargill - I think the reasons that have been given for holding back on the commitment and for the use of the sub-projects approval approach are good ones, but they are also good reasons for not making the loan at all.

Mr. Broches - It's not a question of not making a loan but of not making a series of loans. Politically it is better to make one loan, but the suggested procedure gives us the advantage of making a series. Also, question of size is involved.

Mr. Cope - Also, the U.K. guarantee would be involved, if they should become independent.

Sir William - What about a flexible rate of interest?

Mr. Cope - I agree it is a logical position to take.

Mr. Cavanaugh - I agree that is logical, but it would mean that we could not sell any participation until after disbursement as no purchaser would buy without knowing the rate of interest.

Mr. Lejeune - There wouldn't be any sale here until the interest rate had been fixed for a sub-project because we could not sell any participation until we were sure we had a loan to sell.

Mr. Demuth - The decision to start a commitment charge at the time of approval of the sub-project bothers me, not for this project, but for the next one where we want to be committed. We might want to make a commitment but the country submits the project in tranches to avoid the commitment charge. This sub-project approval procedure should not be a precedent except where we do not want to make a commitment.

Mr. Cope - The Kenyans may not want flexibility of interest. Why don't we leave it open for their choice, as I suggested earlier?

Sir William - If we charge a commitment, I am afraid it ties our hands later.

Mr. Rist - Leaving it to their choice makes this whole matter of commitment a small point of negotiations rather than a point of substance and raises the question as to our whole position not to charge a commitment because we are not committed.

Mr. Lejeune - Why not agree to no commitment charge and then leave the question of flexibility of interest up to them?

Mr. Cavanaugh - As Mr. Rist said, this whole matter is one of substance. If we are not committed, the interest rate should be flexible. If there is no loan, how can we fix interest rate for future loans?

Mr. Lejeune - Does it do any harm to fix the rate if the borrower so desires?

Sir William - It may hurt us if the rate should go up. I question not charging a commitment charge and fixing the rate of interest. Are we all agreed on this?

(No comment.)

Mr. Cope - I would like to point out that the Board may raise questions over increasing coffee production.

Mr. Reid - The execution of this project would increase production of coffee in Kenya by about 9.7% in ten years which would increase world exports of coffee by about 0.8%. However, whether these figures may be twice as high as they should be because there is the alternative of producing pyrethrum and other things rather than coffee.

Mr. Rist - This alternative is very important. Previously the Executive Directors were faced with accepting an increase in coffee production. Here it is a matter of increased land which may be used for coffee, among other things.

Cooperation with the Colonial Development Corporation

Mr. Lejeune - We don't have anything to add on this point. We don't really know how it will work out in detail, but propose to discuss the question with the CDC.

Mr. Rist - Why does CDC wish to restrict the amount? What are the difficulties with raising their participation?

Mr. Lejeune - There are no real difficulties. The point is that the increase of \$640,000 which we have suggested could be done easily because it is within the approval already given by their Board. Something above this would require Board action.

The meeting adjourned at 4:30 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Tuesday, March 7, 1961 at 3:00 p.m. in Room 1006

HONDURAS

Sir William Iliff - Do you intend that the port project, referred to in para. 12 of the memorandum, should be financed by the Bank?

Mr. Diamond - We are thinking of a Bank loan. They may be thinking in terms of IDA. Since the country is creditworthy for small amounts of conventional lending we don't think it would be proper that IDA should finance the port in addition to the \$9 million highway.

Sir William - Are they creditworthy enough for a conventional loan for the highways?

Mr. Diamond - If IDA had not come into existence, it is probably true that the highway would have come up as a Bank loan.

Sir William - If we go to the Executive Directors with an IDA loan now and six months later go with a Bank loan, doesn't that create a problem?

Mr. Demuth - I think the approach should be that Honduras is creditworthy but its creditworthiness is limited in relation to the financing needed for the projects which they can and should do and therefore both IDA and Bank financing are appropriate. We have decided to do IDA now and Bank later since it is obvious that we cannot do the whole program on the basis of Bank financing.

Mr. Diamond - That is the approach we have tried to give in the economic section of the paper.

Mr. Aldewereld - We must prove to the Directors that all the lending cannot be done on the basis of Bank loans.

Mr. Diamond - In para. 7 we tried to give a picture of a blend of IDA and Bank financing as now suggest

Mr. de Wilde - The financing of an economic program would certainly raise the debt service requirements but the figures are not given here so I cannot say whether the debt service would be raised high enough to justify shifting to an IDA operation.

Mr. Alter - If we consider only the projects now in sight, this project would not have to be financed by IDA, but, taking a longer point of view, the situation is such that we should consider using both IDA and the Bank. The full program would increase debt service to the extent that it equalled about 10% of annual exports. But we do not feel that we would be prudent in using this figure as a basis for a decision because the economy is unstable and the prospects for coffee and bananas on which the economy is based are uncertain; although one cannot tell for sure at the present time. Therefore we decided to move to IDA for this operation.

Sir William - Is there any dissent from the thought that this is an "IDable" project?

Mr. Cavanaugh - If we use ratios of debt service to export earnings that we have been using in the past, we would have to consider this project as ineligible for IDA financing.

Mr. Alter - If we wish to take the risks, we could make a Bank loan for this project but we have never argued that the economy of Honduras was good. In fact, we have been very cautious in the past and careful to point out that the situation was unsatisfactory.

Sir William - It bothers me that we would have made a Bank loan for this project if IDA were not in existence.

Mr. de Wilde - At the present time we do not appear to be pushing against the creditworthiness limit of Honduras and could make another Bank loan unless it were thought that the export earnings would decline drastically. My question is, "How far do we look ahead to the point where we would be pushing against the ceilings of creditworthiness?"

Mr. Lejeune - I don't think that we should be bound by ratios but Honduras does not appear, by measurements of per capita income, to be as poor as some other countries and the debt service to export earnings is not very high so I don't think that this is an outstanding IDA case.

Mr. Rist - If we had the whole program for a future period which could and should be carried out, then we could split the whole program between the Bank and IDA on the basis of the ability of Honduras to support the Bank-financed section but where we are told about only two projects then the question is, "What is the program over-all?"

Mr. Havlik - That was in a previous report. Including the necessary expenditures for social development, the program should give them considerable difficulty.

Mr. Alter - The program that is currently contemplated of about \$75 million calls for a modest rate of expenditures but that program will probably have to be expanded.

Mr. Havlik - There is no doubt that annual expenditures will go up. The cost estimates are on the low side and with the addition of other projects which they are talking about, the annual expenditures would begin to mount up rapidly.

Sir William - Does Honduras know we are thinking of using IDA for this project?

Mr. Diamond - The Executive Directors know because Mr. Black included it in his progress report so I assume that Honduras knows. Also Mr. Schmidt told them that IDA would finance 60% of the cost of the project. This came about because the Finance Minister had earlier said that he could only supply 10% of the cost and in answer Mr. Schmidt mentioned the 60% figure. The Finance Minister is now pleading that IDA put up 75% because he ~~says~~ ^{claims} that he cannot produce more than 25%.

Sir William - As the per capita income of a country is low, that does not give me any trouble, but I do have misgivings on the debt service to export earnings ratio in considering this project for IDA financing.

Mr. Demuth - Mr. Black said this morning at the Board meeting that there would be borderline cases and that we would give them the benefit of the doubt. The first case to come up will probably benefit more than later ones until we get shaken down a bit. Therefore, this case would not be out of line with that statement. However, I am concerned about the tactical question of putting this project up on the first IDA project. It would be much less noticeable if it were somewhat later along the line.

Mr. Aldewereld - I am not worried about the percentage of the total cost that we would have to put up since studies indicate that they would have difficulty putting up very much. However, I do not think, first, that we have put forward a very good case for a blend in Honduras and, second, I question whether Honduras should be No. 1 if it is not very well documented.

Mr. Cavanaugh - We have said many times that there is a shortage of IDA-type funds so how can we give IDA funds to a country which is creditworthy and would qualify for Bank funds which are not in short supply?

Sir William - It is a pity this first case presents this character. I would prefer if we could present a mix of Bank and IDA.

Mr. Rist - Do you mean a mixed package of Bank and IDA, one covering the port and one the highway, made at the same time?

Sir William - Or we could divide the highway project between the Bank and IDA.

Mr. Diamond - Perhaps the case has not been put properly to the SLC. The fact is that the information we have leads us to doubt that Honduras can carry out projects and, therefore, whether they would be able to get the Bank-type credit.

Mr. Demuth - The trouble is non-availability of local currency so why does an IDA loan help?

Mr. Havlik - The debt service and foreign export earnings picture are not particularly good considering their prospects so it affects their future payments position. An IDA loan should also aim to help the local currency situation somewhat.

Sir William - Is there anything to the argument that the economy is very small and vulnerable so that we should therefore go ahead with IDA in this case?

Mr. Aldewereld - There is something but the question is whether we have reached that point yet.

Mr. de Wilde - There is nothing in the argument of smallness but there may be something in the question of vulnerability, but we have gone ahead on other countries with vulnerable economies.

Mr. Alter - Honduras is at a very primitive level so that they will need external capital for some time.

Mr. Demuth - The low level of debt reflects the low level of economic development. If and when they move, or begin to move, the debt service to earnings ratio would move very fast and they may quickly get themselves into an unsound position if all borrowing is done on a conventional basis.

Mr. Havlik - They are at a low level. The power loan the Bank made last year was the first real step made in power development. The same may be said for the highway loan. Investment in the economic and social overhead is generally very low. Therefore the projections of \$10 million borrowing a year are extremely modest. If we double this figure, which should be aimed at, we get up to a ratio of 12-13% on debt service to earnings. For undeveloped Honduras with a vulnerable economy, lending on conventional terms with this magnitude of debt service is not very prudent.

Mr. Rosen - I don't think it is a question of Honduras' creditworthiness to service debt but a question of how much debt they can service in relation to the investment requirements for a development program. This case does not seem to have been made. There is nothing in the paper about investment requirements for an economic program and we have to look at the entire program.

Mr. Broches - This morning Mr. Larre urged that we wait until a country exhausts its creditworthiness before using IDA financing. That seems to me to be too extreme a position to take and I assume that we agree that we should not wait that long before shifting to IDA but here in Honduras we seem to be going too far the other way. In this case, we think there will be pressure later for IDA financing but we cannot see the need now so there is really no justification for now moving into IDA financing.

Mr. Aldewerold - Since the Bank is, in effect, over-capitalized at the moment and IDA under-capitalized this move would give grounds for criticism.

Mr. Rosen - Why don't we make a Bank loan?

Mr. Rist - Because the Finance Minister was told it would be IDA.

Sir William - Is it possible to inform the Board that this is not an ideal IDA case but to develop the argument that Honduras has an ambitious worthwhile development program which could not be covered entirely by Bank financing?

Mr. Diamond - I agree we must fill out the economic story.

Mr. Cavanaugh - Will other poor countries approve of this action?

Sir William - Yes, I think they will because they want to see IDA get started. Possibly the richer countries may object.

Why cannot the \$200,000 for the highway planning survey be financed by the UN Special Fund?

Mr. Diamond - We considered that and dropped the idea because of the time needed to get UN Special Fund projects approved and the danger of delay to this project.

Mr. Demuth - I am concerned that we are getting into elaborate transportation surveys for every small country.

Mr. van Helden - This would not be a real survey. Here highway planning is required to stop them from building roads without any plan. It is more in the nature of engineering than a transportation survey.

Mr. Aldewereld - This is not a transportation study.

Mr. Demuth - This survey then would certainly fall within the range of UN Special Fund projects.

Sir William - So why don't we use them to save IDA funds?

Mr. Havlik - We were concerned about the timing and also we did not want the complications of the UN operation. If we are going to think in terms of a Bank or IDA mix, this is something the Bank could do. The amount is small.

Mr. Diamond - On the amount of the financing, the rationale for \$9 million is that in Jordan the SLC said that we could go to 70% of a project's cost. We arrived at the \$9 million by taking two-thirds of the total cost. The Finance Minister, in replying to the offer of not more than 60%, asked for financing for 75% to 80% on the plea that he could not cover the local currency cost. He was talking about a lower set of figures. He does not know that we have added something for contingencies. I don't know what he'll do when he comes up here to Washington but he may be able to raise some money out of the existing DLF loan as I understand this will not be fully utilized.

Mr. Demuth - In the case of Jordan, we said that the IDA investment should be limited to 70% in order to get a government interest in the project. There is certainly no sense in bringing in other funds from other organizations in order to reduce the Government's investment.

Mr. Diamond - In Jordan, the Government contribution came from the U.S. really. And here we would consider doing much the same thing - some sort of windowdressing to cover the Government's investment.

Mr. Rosen - Is the two-thirds figure open for discussion? If this were a Bank operation, we would not invest up to two-thirds of the cost of the project without some justification, which is not made here.

Mr. Demuth - If they cannot put up one-third of the cost of this project, how are they going to carry out any program we were talking about?

Mr. Diamond - This we really don't know. The Finance Minister merely has said he cannot cut expenditures elsewhere to contribute to this project, but perhaps he can. This we would have to discuss.

Mr. Alter - We should be clear that we have emphasized in the past that Honduras has trouble getting local currency for its very modest program. And actually we considered financing local currency expenditures by the Bank. I think the record on this question is very clear.

Mr. Rosen - Do you agree with their monetary and fiscal policies, that they were doing all that they possibly can?

Mr. Alter - Yes. We think that they are taking proper steps to improve a very weak situation.

Mr. Demuth - The UN Special Fund action would not come until December but it certainly would take time to mount the project and we could probably get agreement in principle with the UN before December.

Sir William - Why not have the Bank finance the maintenance and the highway planning survey and have IDA do the highway extension and feeder roads program, dropping the idea of the UN financing the survey because of the timing factor? How does everyone feel on that?

Mr. Lejeune - I would say that it is not an overwhelming case for IDA.

Mr. Stevenson - I would be happier if we could say that the whole program were too much for Bank financing and therefore we were using IDA financing for this project. I don't think the split between Bank and IDA helps very much.

Mr. Broches - Why not add the maintenance program to increase the amount to be covered?

Mr. Diamond - It is not a real maintenance program but a part of a program. We thought we had a bigger maintenance program but we could not get good cost estimates so we only have this rather special part of the maintenance program.

Mr. van Helden - It is a little more than that. The extension to include the entire maintenance program would get us into financing recurrent operating expenses which we do not think are suitable for long-term financing. The maintenance items that are included in the project are special one-time expenditures rather than the annual recurrent type.

Mr. Diamond - I did not mean that we should finance the recurrent expenditures but merely that we did not have the figures on the total maintenance program to present to justify the need for IDA financing now.

Mr. Aldewereld - I don't see why we have to break down the project and the parts to be financed by Bank and IDA. In the Roseires Dam project we are not allocating the section to be financed by the Bank and the section to be financed by IDA. There we are allocating all expenditures pro rata. We could if we wanted put all local currency into IDA and divide the rest pro rata between the Bank and Germany.

Mr. Demuth - The solution of dividing up very small projects would look strange. Why not take the highway project for the Bank and then do the port with IDA.

Mr. van Helden - It will take quite a while to bring the port project to the SLC - at least 6 to 8 months.

Mr. Diamond - It will be the end of the year for the port at the best.

Mr. Rosen - What's the next project?

Mr. Havlik - They are talking with other agencies about other projects including other roads, but they hinge on this loan. There is a water supply project for the capital city. The IDB has recently had a mission down there which may produce something. The agricultural reform law and an agricultural bank law, recently passed, may lead to some IDB loans but we don't know what types. In total, these various projects may add up to \$25 million.

Sir William - There are three ways to handle this highway project:

- (a) to have IDA do it. That leads to certain dissent around the table.
- (b) to have the Bank do it. I think there might be some support for that.
- (c) to do a combination. The merit of this suggestion is that we have told them that there would be IDA financing.

Whether we make the combination on the basis of portions of the project or percentages of the total cost does not seem to matter.

Mr. Broches - That leaves the problem of the 75% to be settled. On the question you raised, I would feel more comfortable if there were a blend.

Mr. Lejeune - I favor a blend.

Mr. Rosen - The blend is better than IDA but I favor the Bank over a blend.

Mr. Stevenson - In the absence of evidence of a substantial borrowing program, I have to accept the mix but I would much rather put forward a story of an investment program which indicates the necessity for both Bank and IDA financing and justified going ahead with IDA now on this project. However, it may not be possible to put forward this story.

Mr. Aldewereld - I am for the blend.

Mr. Demuth - I don't want to vote at the moment. I think we need more facts. If we looked at the entire program for this year and the reasonable prospects for the next two years, then we may be able to make a case for IDA now. If we cannot get these additional facts, I would be for a blend.

Mr. Rist - I like Mr. Demuth's position. I don't know what the difficulty is with the bigger program.

Mr. Cavanaugh - I think IDA would be wrong for such a rich borrower.

Sir William - What negotiating difficulties would you have if we got ahead on this basis?

Mr. Diamond - None, I think, subject to the question of the percentage we are willing to finance.

Mr. Graves - From a publicity standpoint, I think that it is wrong if the IDA financing were mixed with the Bank. It would be better if the first one were all on its own. However, I realize this is not a prime consideration.

Sir William - How long will this operation take?

Mr. Diamond - Our only problem is local currency and as they are in a hurry, I don't see a long negotiation.

Mr. Broches - We do not have Loan Regulations for IDA yet. They are supposed to go to the Staff Loan Committee tomorrow (March 8).

Mr. Aldewereld - The work will not start on the project until December, so we might delay.

Mr. Rosen - If the Honduras project comes up first, we are likely to have this morning's discussion all over again. It might be better to have a different operation as the first IDA operation.

Mr. Aldewereld - The big road program in India of \$40 million will be ready in about five weeks.

Mr. Rosen - Why not put both to the Executive Directors at the same time?

Mr. Diamond - It is true that the work will start in the fall but the decisions must be taken now. Moreover, we have a Parliament problem. If we don't go ahead now, Parliament will adjourn and a later operation will require a special session.

Mr. Aldewereld - The Indian road project will probably be ready for SLC in about five weeks. It won't go to the Board probably until after the Consortium so that means early in May.

Sir William - On the local currency, will Honduras be able to find it or not?

Mr. Diamond - We think that contributing two-thirds of the total cost is reasonable. This would mean we would be financing a very small amount of the local currency cost.

Mr. Rist - I get the impression that the Government would get local currency for this project by cutting investment in other projects, which seems to be an unsatisfactory arrangement.

Mr. Diamond - If the other projects are all very low priority, is that too bad?

Mr. Broches - What does the \$9 million cover?

Mr. Aldewereld - The \$9 million represents 68% of the total cost of the project and would cover all of the foreign exchange cost and 10% to 15% of the local currency costs.

Mr. Demuth - Is this project defined; or part of a road program? If the latter is the case, would it be possible to make the loan a percentage of the larger program?

Mr. van Helden - No, this is a self-contained project. They have other projects under way but not a part of a single road program. It would be very difficult to pick up the other small scattered projects they have.

Mr. Diamond - The higher percentage would be hard to justify. We may have trouble satisfying them with our offer to finance two-thirds of the cost of the program and there is another question as to whether they can satisfy us that they will be able to get the funds to cover the local currency cost.

Mr. Broches - That raises the question of whether we should go ahead at all.

Mr. Demuth - Why should they be unwilling to supply the local currency? Is it because they can find the money only by cutting back on other projects which they think have higher priority?

Mr. Alter - Or they think that they can get the money we are talking about somewhere else without giving in?

Mr. Diamond - The Finance Minister said he cannot increase the revenues and he cannot reduce the project. It is impossible to stretch out this little road in time.

Mr. Rist - It is disturbing that they have already cut down and can't find the local currency. Why don't we send them across the street?

Mr. Broches - If they can't cut down other projects, can they do a program?

Mr. Rosen - That is the trouble. I think we are lost without information about the entire program and the resources available to carry it out.

Mr. Diamond - I suggest we go ahead on the basis of two-thirds of the cost. If the Finance Minister sticks, we will just have to come back to the SLC.

Sir William - What percentage of the budget would this amount to?

Mr. Diamond - The cost is about \$1.5 million a year out of a budget of \$4.1 million. It is about the biggest item in the budget.

Sir William - Do we think the project is too big perhaps and should be reduced to what they can handle?

Mr. van Helden - The standards have been reduced down to a minimum and they have to build the scheduled distance in order to get anywhere.

Mr. Diamond - Honduras is going to be very suspicious about the cost figures because we have added to the figures since they saw them. It may be that about \$2.1 million will turn out to be an over-estimate if the contingencies are not needed, in which case the picture would be brighter for them.

Mr. Aldewereld - The amount we have added for contingencies is part of the price we have had to pay for speed on this project. We don't have all the information that we need to make more accurate cost estimates and in order to be on the conservative side we have to cover the worst possibilities.

Mr. Demuth - On the technical report, I have a question about the need for a covenant on the priority of the project. How can we say this if we do not even know whether they have a program?

Mr. Aldewereld - We don't know that this is the highest priority but we only want to avoid having them abandon it after they have started it. This is merely a practical policing measure.

Mr. Demuth - I see the practical value of this but what happens if they make another loan for an equally high priority project? How do we enforce this covenant?

Mr. Diamond - We have no doubt that this is near the top of the priority list.

Sir William - Does anybody have any ideas as to what size the IDA loan should be in the Bank/IDA mix? Mr. Black, in reporting to the Board, mentioned \$6 to \$8 million for the IDA investment in the project. Perhaps we should say IDA \$7 million and the Bank \$2 million.

Mr. Aldewereld - That is not a very good mix. If we don't use 50/50, a mix raises more questions than it solves. The statement Mr. Black made was not very definite. It was very qualified and we could deviate from that without any trouble.

Sir William - I think that this should not be the first IDA project, if there is any way of avoiding it.

Mr. Black told me a moment ago that we should not go to 75% of the cost.

Mr. Diamond - We will just come back to SLC if we get stuck on 68%.

Sir William - I will advise Mr. Black that we should have a split of IDA and Bank financing, saying to the Executive Directors that after looking further into the creditworthiness of Honduras we have decided that IDA financing should not be used for the entire project.

Mr. Rist - Can we bring in the port and split this also?

Mr. Diamond - No, it would not be ready in time.

The meeting adjourned at 5:05 p.m.

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Rough Notes of Staff Loan Committee Meeting held on Monday, February 20, 1961 at 3:00 p.m. in Room 1006

CEYLON

Mr. Cargill - The Government has been running a heavy cash deficit for some time and borrowing from the Central Bank which has resulted in running down the foreign exchange reserves. No corrective action was taken until the new Government came in in July and the caretaker Government increased the problem by increasing rice subsidies. So far the action of the new Government has been peripheral. They have applied some custom duties and embargoes, which have got them in trouble with GATT, and they have attempted to reduce private credit. If these measures were to be successful in cutting down imports and Government expenditures were not reduced, the result would be serious domestic inflation.

The Fund had discussed this problem with the Finance Minister and has calculated that Ceylon might be able to bring the budget back into balance with these measures taken and certain others; but I don't agree. The Fund did not ask for an elimination of the rice subsidy but did push for the imposition of a sales tax.

In November and December the reserves continued to fall and are now down to about five weeks of imports at the 1960 level. The only favorable thing in the picture is that the Government now in power has a majority which it could use to take the necessary corrective action, if it so desires.

Sir William Iliff - Do I understand correctly that they have maintained price levels by drawing on their reserves but that that cushion is now gone so that in order to avoid inflation they will now have to reduce expenditures? This means cutting subsidies which is probably politically difficult or cutting down on the development program. I take it that raising revenues is not a real possibility.

Are we all quite happy about lending, given this situation?

Mr. Schmidt - Could we strengthen the hands of the person who might be in a position to take corrective action by refusing to make this loan?

Sir William Iliff - Have we ever taken the line that we might not lend any more?

Mr. Cargill - Yes I did with the Finance Minister last fall when I told him that there would be no further lending after this loan until the financial situation had been straightened out.

Mr. Basch - In 1954 - 1955 the situation was almost as bad. The Bank then warned them that no further Bank action would be taken until they took steps to correct matters. Strong action of the Finance Minister then reversed the unfavorable situation. The reserve situation was not quite as bad then and the political situation is probably more difficult now.

Mr. Cargill - The political situation is one thing we are sure of now. The present Finance Minister is a real tough character and would not hesitate to take action, I believe.

Sir William Iliff - Does anyone say "no" to a loan now?

Mr. Lejeune - We cannot say "no" on the basis of the creditworthiness. The real question is one of timing. How do we best use our association to make them take the necessary corrective action?

Sir William Iliff - Assuming we do make a loan, what representation do we make? Would Mr. Black write a letter saying what we think ought to be done?

Mr. Cargill - The trouble with that is that we should have done that after the economic report was prepared in March 1959. Right now we don't have the facts on which to base a detailed criticism. We could speak with more conviction if we had an economic report. I think we should tell the negotiators how we feel and then Mr. Black should write.

Sir William Iliff - I don't want them to think we are not concerned.

Mr. Bachem - We do intend to tell them that we won't do any more loans before an economic mission has had a chance to look at the economy.

Mr. de Wilde - That is not enough. We should point to the troubles and outline the actions necessary to correct them. The situation appears to me to have gone beyond the stage where we can merely say we want to take a look at the situation.

Mr. Cargill - I think we should inform them that (1) we are alarmed, (2) no further operations will be possible until we have made a study and then only after we have reached an understanding on the necessary action to correct the situation.

Mr. Lejeune - Is it too late for a mission to go back and gather a bill of particulars on the economy?

Sir William Iliff - I don't think that is necessary as now we only want to sound a note of warning.

Mr. Cargill - Actually the leverage this loan might provide is limited. Ceylon could be creditworthy with proper management for quite an increase of debt and, if they straighten out, they may be borrowing a good deal more. This loan is small in relation to their potential program.

Mr. Aldewereld - Mr. Wheeler has written that the Ceylonese are thinking of a \$250 million multipurpose project. He sent a newspaper clipping which reported the Bank's plans to finance this big project.

Sir William Iliff - What is the timing for the present operation?

Mr. Cargill - We propose to invite negotiators right away. They will arrive here in two or three weeks and we might have a loan in a couple of months perhaps.

The Permanent Under Secretary of the Ministry of Finance will probably head up the mission, but we are not sure of this.

Mr. Nurick - We think generally that it's better to make loans to the executing agency, in this case, the proposed Board rather than the Government. If we make a loan in this case to the Government because the Board won't be ready and the Board later takes over the execution of the project, what will happen to the project agreement?

Mr. Cargill - We would lend to the Government under any circumstances whether there was a Board or not. The Government will not let any of the autonomous boards borrow directly. We are going ahead now simply because they need power badly. If we knew the Board were coming along shortly, it would be possible to tie everything up before making a loan to the Government, but we know that the Board isn't coming along soon. The trouble arises with the transfer of personnel from Civil Service status, which will have to be settled by another law. There is no difficulty about the bill to set up the power authority but the bill regarding the transfer of Civil Servants has not been cleared by the Cabinet and difficulties are expected. Both laws are expected to go through eventually, but we do not know how soon this will be.

Mr. Schmidt - The Area paper points out that, in connection with the last loan we made to Ceylon, they agreed to set up a power authority. What happened? Why wouldn't they do this?

Mr. Cargill - They did, in a wide letter, and they presented a first draft of the bill for the power authority for our approval about 18 months ago. About the time we looked at it the Premier was assassinated and no action has been taken since because of the unsettled political situation.

Sir William Iliff - Also the question of the take-over of municipal power authorities has caused a problem, I believe.

Mr. Cargill - That is not too serious now. Last November the Bank dropped its insistence on that and the law as now drafted does not make the take-over of municipal operations mandatory except in those cases of faulty management.

Sir William Iliff - In the best of conditions this problem of setting up autonomous agencies is politically difficult for the central Government. They have had a lot of other things to consider in Ceylon in recent months so we cannot expect snap action on this matter.

Mr. Bachem - The Government has pleaded with the Bank some years ago not to make the creation of a Board a condition of a loan. I don't think that it would advance the creation of the Board to make it now a condition of the loan. The Ceylonese just don't want to be bullied by the Bank and probably would balk if we should insist.

Mr. Nurick - I don't understand because the technical report recommends that we should insist on this point.

Mr. Cargill - That is a point for discussion. I don't think that we would get it if we insist.

Sir William Iliff - If the Board is not set up, what would happen as far as the production of power is concerned?

Mr. Cargill - The Board will not make much difference. There would be the usual delays and difficulties but they would get the power. The important thing about the Board is that they would be getting their own commercial accounting system and their own procurement. At present, the power operation is under the federal budget which is bad but the creation of a Board is not going to bring about a fine situation overnight. They will be a long time working up to the proper shape.

Mr. Aldewereld - Mr. Cargill has just expressed very accurately the views of the Technical Operations Department as to the results of creating an independent Board. There would not be any quick improvement but, with a separate organization, we might see gradual improvement over a period of time.

Mr. Cargill - I think that we should not make this a condition of the loan but we should ask for assurances that they intend to go ahead with the creation of the autonomous Board. I am probably as upset as anybody else about the troubles and delays that have been encountered over the Board, but the fact is that the one purpose in making a loan now is to get the work started. The Ceylonese under the law cannot place orders for the equipment or work to be done without having the funds assured. If we make the formation of the Board a condition of effectiveness nothing is going to get started.

Mr. Nurick - The report does not say that this should be a condition of effectiveness. The time for the creation of the Board is left for decision.

Mr. Cargill - My objection to that is that if the Bank insists on the creation of a Board, the legislation will never get through the Parliament. We should have a letter giving an expression of intent. The Government can do no more than that.

Mr. Lejeune - Is one project more important than the others? Could we split the loan into two operations?

Mr. Cargill - No. Construction on both must start right now although the construction period differs. Also, tenders for the Norton Bridge project were received some time ago and have twice been extended for a six-month period. The Ceylonese have recently been holding the prices firm on the basis of promises to the suppliers that the Bank was going to finance this project and their initial payment was going to come shortly. If there were further delays this price arrangement would collapse.

Sir William Iliff - As I see it, the purposes of the loan would not be frustrated if there were no autonomous Electricity Board but that agreement to form such a Board is desirable; therefore, the best thing would be to get an undertaking as to the date on which a Board should be set up and if the Ceylonese cannot be persuaded to make this undertaking, we should accept an expression of their intent to form a Board.

Mr. Nurick - I agree there is no magic in having a Board, but the Bank makes a big fuss about boards and is taking strong position on this point with Ghana. Why do we not follow the same course here?

Mr. Aldewereld - I still think we should insist upon a date for the formation of the Board. This whole matter has been an example of bad planning from the very beginning. We have been unhappy about the Board situation since 1953 and I think that there should be a covenant in the Loan Agreement about this.

Sir William Iliff - Do we part with the Ceylonese on this point?

Mr. Nurick - I think that depends on the reasons they may be able to advance for not having a Board. The argument about the Bank bullying does not appear sufficient to me.

Mr. Cargill - It's not just a question of bullying. Technically, we cannot get an agreement from them because it is a matter for Parliament to decide.

Mr. Bachem - The important thing is to get legislation which would allow improvement of the procurement and accounting practices--not so much creation of an autonomous Board. The Board act is, however, a practical way to get this legislation although there may be other ways. Therefore we should not insist on passage of the present act if we can get other assurances that the necessary reorganization will be carried out soon.

Sir William Iliff - Could they get the improved organization without the Board?

Mr. Cargill - Mr. Rosen thinks so. I am not sure I agree, but it's not a clear-cut case. My feeling is that they are all geared up for the new legislation now so why stop them? They have given us assurances in the past and will again in the future. We will do a lot better if they can go to Parliament and say that they have discussed this matter with the Bank and that they have decided to go ahead. If they should decide not to go ahead, then we should break with them.

Mr. Piccagli - Some of the people in the Bank question whether the Ceylonese are sincere in saying that they are all ready to form an autonomous Electricity Board.

Mr. Cargill - I don't understand what they base that thought on. It is true that the Ceylonese have been slow but there have been many good reasons for their slowness. However, now we hear that they are going ahead.

Mr. Squire - But we should realize that they did have a Board at one time and dropped it back in 1947. The question is whether they are now going ahead of their own free will;

Mr. Cargill - That is a matter of judgement. However, they have applied this board mechanism in other fields recently. The Government was very much against autonomous boards earlier, after money was stolen from a board. This has not been true for the last four or five years or so.

Sir William Iliff - Assuming that the Ceylonese will not agree to a covenant but will accept a letter of intent on this point, does anyone think that we should part?

Mr. Nurick - Let's wait until we know the reasons for their objection to agreeing.

Sir William Iliff - For the sake of argument, let's suppose they gave no reasons.

Mr. Nurick - Then I don't know. This would be a matter for management to decide.

Sir William Iliff - All right. That is all the answer I want.

Mr. Lejeune - What is their objection to the Board? I don't understand what the hurdle is.

Mr. Cargill - There is no hurdle for the bill on the Electricity Board. The big question is the transfer of personnel from the Civil Service status which is a separate matter.

Sir William Iliff - There has been political chaos in the country for about two years and the capable Government has been in office for only a few months. They certainly should be allowed some time to commence to take action.

Could we have some expansion on this question of procurement?

Mr. Aldewereld - It is a matter of repeating an order for the equipment purchased for the first unit of the Grandpass thermal plant. The first unit was purchased with international competitive bidding, but the Ceylonese wished to repeat the order with the suppliers for the first unit without additional competitive bidding. Normally we insist upon competitive bidding except where the fact of standardization is important. Here the big question is that of timing. If we were to insist on competitive bidding, it would delay the construction of the project and upset the whole point of the loan. On the other hand, we may have difficulties with the Executive Directors over our lack of consistency. The arguments are valid for going ahead here; but in Thailand, where a similar situation has arisen, we do not propose to agree. The question of standardization and of spare parts is of some concern here, but is not really vital.

Mr. Squire - The Ceylonese will save over a year by going ahead without competitive bidding. If they do not go ahead immediately, the project should not be built at all.

Sir William Iliff - I understand that eventually the physical assets would be transferred to the Electricity Board and that the investment the Government has made in these assets would be converted to equity capital.

Mr. Squire - That is our general understanding. The existing investment we are sure would be transferred to equity. We are not quite sure as to future investments.

The meeting adjourned at 4:00 p.m.

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Rough Notes of Staff Loan Committee Meeting held on
Wednesday, February 15, 1961 at 3:00 p.m. in Room 1006

VENEZUELA

Mr. Schmidt - Since the paper was prepared, the Eximbank has announced a \$50 million seven-year loan to Venezuela to finance imports to be used for many purposes, particularly by enterprises which are Government owned or controlled. The Eximbank loan was to have been in addition to a \$100 million standby with the IMF but the latter is still waiting to look at the Government's financial program before considering a new standby credit.

Mr. Alter - There have been many changes in the political picture since the last meeting of the SLC. The Cabinet was changed last fall and constitutional guarantees were suspended in December. The elimination of the URD Party from the Government three months ago has probably strengthened the prospects for the present Government as the URD Party was not a stable member of the Coalition and was splitting itself. The situation is not clear but there now appears to be a greater probability that Betancourt will stay in power. The Government has moved to the right in the last six months but is still left of center.

Mr. Knapp - As I see it, there are two reasons one might argue for not going ahead with the highway loan: first, concern over the political situation, and second, concern over Venezuela's break with IMF over stabilization.

I cannot see backing out of the highway loan on the basis of the political situation but I don't know about the second point.

Mr. Alter - The Fund is now waiting for the Finance Minister to come up with a budget program for the coming year. The trouble last year over devaluation gave the Fund some concern but now the Fund feels that the Finance Minister is trying to formulate a satisfactory program and the Fund expects to go into the standby arrangement. The big question is whether there will be devaluation. This, I think, will depend upon the program the Government comes up with. If it suggests a big program, much above 5.5 billion Bolivares annually, it is doubtful whether the Government could manage without increased receipts brought about by devaluation. If, however, they stay within the 5.5 billion budget, they may manage without devaluation. It is quite probable that a halfway step will evolve. Until the Fund knows more about this, they are not concerned.

The mission did not urge devaluation unless a decline of petroleum revenues should occur. It suggested that devaluation might be desirable but not immediately. This question is partly one of timing, to get all the various groups concerned to accept the devaluation.

Mr. Knapp - Does anyone think we ought not to go ahead on the highway loan?

(No answer.)

How soon will it be ready?

Mr. Wheelock - It would be six to eight weeks before we have the information necessary to proceed.

Mr. Knapp - What does the Fund think about the Bank going ahead with this loan or about the Eximbank loan?

Mr. Schmidt - Mr. del Canto has informed us that he thinks we should go ahead. They have no quarrel with Venezuela at the moment and do not feel that the Bank loan should be used as a weapon in their relations with Venezuela. I understand that they knew that the Eximbank was going ahead with its loan.

Mr. de Wilde - This appears to me to be a case where credits, no matter where they are received from, might strengthen the move for stabilization.

Mr. Alter - Actually the loan should not make much difference as the amount is relatively small but a loan from the Bank would help, the Venezuelans think, to improve the external reaction. Bank support could be a factor in bolstering external confidence.

Mr. Knapp - Then we approve going ahead with the highway project. I am a little worried about going ahead before the general financial program has been worked out. We previously told the Government that we would go ahead with the highway project only if a sound financial program were worked out. Going ahead now may mean to them that we were no longer interested in the program. We would have to make it very clear to them that our interest in the sound program has not decreased one bit.

Mr. Schmidt - Yes, that is right, but we expect that the program question will be settled before we make the loan.

Mr. Knapp - We said at the last meeting that we could lend \$30 million to Venezuela and that we should go out and find a project for \$30 million. The highway project was found but has subsequently grown to \$40 million. That is not quite the right way to operate. I agree that we cannot contract back to \$30 million now but I just want to throw out a warning on this procedure.

Mr. Squire - The \$40 million highway project is a well-balanced project and needs \$40 million in foreign exchange. We could reduce the loan by agreeing to contribute only a part of the foreign exchange but we do not want to see the project hurt by cutting back on the amount of the foreign exchange.

Mr. Wheelock - Actually the project has not grown. We thought we had a \$30 million project. As more complete information has been received the cost estimates for the project have had to be revised upward.

Mr. Schmidt - The lesson appears to be that we cannot accept cost estimates where we have a limit on the amount we want to lend; or, we must take projects such as a group of roads, from which we could easily cut out physical sections in order to reduce the amount of the loan without hurting the project.

Mr. Stevenson - Is this project something additional or something that the Venezuelans would do anyway under their investment program? If, as you say, it is the latter, why don't we give them \$30 million as previously proposed and let them finance the balance?

Mr. Knapp - They already know that we are thinking in terms of \$40 million. That would be difficult. However, Mr. Squire's idea of financing only part of the foreign exchange cost rather than chopping down the project is certainly proper. In this case, let's go ahead with the \$40 million.

Mr. Nurick - Are the arrangements for tax anticipation payments by the oil companies known?

Mr. Alter - We don't know what method will be used ultimately but we do know the various ideas that were being discussed when the mission was there. The present proposals are only for the purpose of reducing the lag between the date taxes are due and the date of collection. If this process goes on it may become a matter of borrowing in the future.

Mr. Nurick - The latter would give us a negative pledge problem. I think it would be better to find out what the situation actually is.

Mr. Knapp - I agree we will have to clarify this. My understanding is that to meet the budget deficit the Government contemplates taking two actions, both of which are in the nature of one-shot operations. The first is merely that the oil companies would accelerate the time of payment. The second is just a matter of blackmail--the oil companies are asked to contribute a sum of money which will apply against future tax payments.

Mr. Alter - I inferred from what Mr. Collado told me that the oil companies wanted to help the Government although they do not desire to see the satisfactory Government financial condition continue. They did not consider that they were being blackmailed. But, they may have changed their minds since I talked to him. Up until now the Government has been merely advancing the payment date of taxes that were due.

Mr. Knapp - What about the business of oil companies guaranteeing notes?

Mr. Alter - That is the same thing. That has been the system they use to make payment. The oil companies guarantee Government notes which are held by the commercial banks until maturity and are then repurchased by the oil companies and used to meet tax payments.

Mr. Nurick - That is exactly what we objected to in Chile and in Peru. In Peru they stopped after we objected.

Mr. Knapp - Aside from the negative pledge question, these methods of acquiring funds appear to be stopgaps eating up future receipts and not a long-term solution to a real problem. Consequently they should be discouraged by the Bank.

Investment Program

Mr. Alter - The Four-Year Program of the Government is of the same magnitude as that recommended by the mission but the sources of financing it are different. The mission recommended additional taxes and the Government assumed higher receipts than does the mission from existing taxes, but this, of course, has been changed by subsequent developments. There are substantial differences in the composition of the two programs but both recommended large amounts for the

fields of transportation, water supply, industrial credit and agricultural credit. The mission recommended greater amounts for investment in the steel mill while the Government's plan provides for a greater investment in the social sector than did the mission. They are similar in their major emphasis on private investment and investment in transport, particularly in highways over railroads. The differences between the two programs have not been as great in actual practice as they were in conception. Actual expenditures have been closer to the mission's recommendations than the Government's plan was originally, except in regard to the agricultural settlement scheme where the Government has been moving faster by Presidential decree and contrary to the ideas of the Government Planning Board.

Mr. Knapp - What is the connection between our report and the approval of their plan by Parliament? What happens to our report next?

Mr. Alter - We don't really know. It depends on the Finance Minister. We will publish our report and the Finance Minister says he will present a Four-Year Program shortly. We presume that this question is being considered now in Caracas.

Mr. Knapp - I think that during the next four-year period they could cover a \$200-\$300 million deficit by borrowing without much trouble but they certainly would be using up their credit at a fast rate and perhaps they should go more on a pay-as-you-go basis and reserve some of their borrowing power for later.

Mr. Alter - We recommended an increase in taxes of Bs. 200 million a year. This they have not done as yet.

Mr. Knapp - There still is a good argument for increasing taxes, it seems to me. The case made in the report against increasing taxes and of holding them at the present rate for pump-priming purposes seems rather weak to me. My question is whether they may be hurting confidence by increasing inflationary tendencies rather than successfully priming the pump by holding taxes where they are.

Mr. Alter - The Venezuelans feel that the present compensatory fiscal policy is necessary to encourage domestic investment.

This admittedly is a very tricky matter and one where the chances of failure are great but so far the business community has been applauding the Government. This whole element of business confidence is very important in Venezuela. If the Finance Minister gains sufficient confidence of the business community to hold the capital flight, he may be able to carry out his compensatory fiscal policies without disastrous consequences, but on the other hand he may go too far. It is risky but we think that we have to let them try it and that it is not out of place for them to try it.

Mr. de Wilde - I sympathize with Mr. Alter's reasoning. The Bank loan may not be large in relation to the deficit but if it helps confidence of the business community it may have a much greater effect than the amount would indicate.

Mr.

Mr. Knapp - With capital flight already under way I only question whether more deficit financing is the right policy. My impression is that it would increase lack of confidence in the Government and increase the capital flight.

How much effort are we going to make to establish a relationship where we would be exercising leadership? We are prepared to lend and to consult on the rest of the program I take it. How far is this to be a consortium operation?

Mr. Schmidt - We plan to talk to them about just that. We feel that we should be willing to move if we find that we can be effective. From our talks so far we think that they want us to give them help getting other finance and in the execution of their projects. In connection with helping them to find other finance, we have in mind leading them to the point where they might be able to go to the private market.

We cannot say anything definite about relations with Venezuela until we have talked to them but we think we could be of help. There certainly will be a lot of projects and a lot of money invested. As for mechanics, we might have a resident mission consisting of an economist to work on financial plans and external financial arrangements and a technical man to work on the execution of projects. These two might be supplemented from time to time by specialists as the case required. For instance, we might send an expert on agricultural credit, which seems to be a field for advancement in Venezuela.

Mr. Knapp - It seems to me that we have never had very cordial relations with Venezuela. Perhaps there never has been any necessity for this. Certainly a first loan should help to improve that situation and if we can get on a good basis, there is a lot we can do. Certainly we could do something to bring them closer to the private market. They are a prospect for private financing if any country in South America is. Also, I think we should pry loose the 18% on the increase in the capital subscription as part of the highway loan deal.

Mr. Schmidt - I agree but there will be a problem if devaluation is contemplated and part of the 18% is out on loan.

SINGAPORE

Mr. Knapp - I take it that the amount of possible projects in view is not great enough to raise any question about creditworthiness. This report speaks of \$20 or \$30 million being a reasonable amount for the Bank to lend.

Mr. Edelman - \$30 million would cover all that is in mind at the present time and there is no creditworthiness question about that. \$30 million would appear to be in their minds also as this is the figure they gave for loans from "the IBRD or similar sources" in the Development Plan.

Mr. Knapp - What about the U.K. guarantee?

Mr. Cargill - Geoffrey Wilson has a letter from the U.K. saying that they are prepared to guarantee Bank loans to Singapore and I understand he is prepared to put the same in writing to the Bank. No amounts are stated in the letter but discussions in London turned on a figure of \$30 million because that was the figure given in the Plan. There is nothing sacred about the figure, of course.

Mr. Knapp - I would like to ask whether everybody thinks the Bank should make a loan to Singapore, given the uncertainties of Singapore's constitutional status due to the transitional stage of Singapore.

(This led to a lot of irrelevant discussion on the similarity or lack of it of the political status of Singapore to other Overseas Territories.)

Stating the question in another way, does not anyone object to the loan to Singapore with a U.K. guarantee?

Mr. Lejeune - Singapore has unusually large reserves and a very small debt, making its position rather unusual but its population is rising very rapidly and there is a potential unemployment problem. The question is what would happen after 1965. Would the running down of reserves and increasing debt put Singapore in such a position that it would not be able to face successfully a decline in per capita income and employment in the 1960's?

Mr. Bachem - My only answer to that is that we hope the industrialization program will be successful. That is the best answer unless, of course, unification with Malaya works out.

Mr. Schmidt - What are the possibilities for that and what are the alternatives if they don't?

Mr. Bachem - It is conceivable that Malaya may become Chinese-dominated, thus removing the obstacle to unification.

Mr. Cargill - At the present time the Chinese make up about 40% of the population in Malaya and they are not likely to become a dominant group in a short time. It is conceivable that shifts in the representation of the 40% may permit them to bring greater pressure on the Government to relax its position towards Singapore but there is nothing definite that can be forecast about this.

Mr. de Wilde - My impression is that the situation is not quite as stark as Mr. Lejeune has put it. There may be a temporary decline in per capita income but Singapore should be able to take that in its stride considering the level it has now achieved and its other more intangible assets. We are banking on its geographical position and the ingenuity and adaptability of the people. This definitely would be in the nature of a character loan.

Mr. Knapp - Do we send this report to the Government now?

Mr. Cargill - We did not think we would send the report to the Government now. We would write to tell them that we were sending a mission and the mission might hand it to the Finance Minister informally.

Mr. Knapp - I take it then we would give it to the Executive Directors only when a project comes along for financing?

Could you give us a little more about this Israeli tie-up?

Mr. Edelman - At the moment that business is at the stage of discussions with an ex-Dutch businessman, Mr. Kahin, and his company. He has done technical planning in the Netherlands and later in Israel. As far as we know he has not as yet accepted the Israeli offer to head the proposed Economic Development Board.

Mr. Knapp - I understand the Israelis are giving technical assistance around the world and I realize that they probably have a pretty good pool of technical advisers but this is the first case where I have noticed that they have offered general economic advice. From the results of our mission to Israel I concluded that they were not much good on this point.

Mr. Cargill - The Singapore Government has also contacted Mr. Arnon, Director General of Finance of the Israeli Government, so that these discussions they are now having with Mr. Kahin are in the nature of a start and the continuing relationship might be with the Government.

The meeting adjourned at 4:30 p.m.

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STAFF LOAN COMMITTEE

SLC/M/61-4

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Rough Notes of Staff Loan Committee Meeting held on
Monday, January 16, 1961 at 2:45 p.m. in Room 1006

LOAN REGULATIONS

Mr. Knapp - Before considering the drafts I would like to ask whether anyone has any difference of opinion about the policy itself. At the last meeting some of the things said by Mr. Cope and Mr. Rosen led me to believe that they might have some question about the policy.

Mr. Cope - I do not object to the policy but I do not think that it should stand for all time. We should review it from time to time to see whether it is still appropriate. At the present time I have no objection.

Mr. Rist - There is one point I did not get the last time. I thought that we had the premium for prepayment not only because we might want to sell participations in the loans but because it is a logical position for lenders to take and always has been and that the Bank, as a recurrent exception, might waive the premium. My question is whether it should not be left at that, which leaves it on a day-to-day basis. There was some discussion the last time which made me think that some around the table think we would always waive the premium.

Mr. Knapp - No. Your first statement was correct. The policy is to waive, depending upon the circumstances existing at the time as a "recurrent exception" but there is no commitment to waive. Any statement would be merely an expression of intention.

Mr. Rist - All right. I was afraid that our agreement last time might be interpreted as agreement to continue to waive.

Mr. Cope - There are three things involved: the expression of intent in the Loan Regulations, the fact that it is our present policy to waive, and the fact that we have always done so. These three things put together lead to the impression that we would always do so in the future although we did not agree to do so. I am against the inclusion of this expression of intent in the contract because in conjunction with the other two things, the borrowers may believe that it will be our policy to waive the premium always. By removing one of the points I mentioned we might weaken this impression.

Mr. Knapp - Let us discuss the alternative papers now. On the policy statement, I would like to consider this as though it would not be issued by the Executive Directors.

Mr. Cope - I prepared the draft and I did so on the basis that it would be issued by the Executive Directors merely because you had said that it would be issued by the Executive Directors.

Mr. Knapp - The idea of a policy statement by the Executive Directors appears to be an opening for further trouble. They might ask for a review of policy from time to time. I wonder therefore whether the statement could not come from the Management.

Mr. Broches - I am not sure we can make that distinction between the Management and the Executive Directors. This would be a Bank statement. Can the Management make a decision of this type without the Executive Directors' approval? Also, the present policy is a policy of the Bank which was approved by the Executive Directors when they approved the earlier Loan Regulations. If we take the section out of the revised Loan Regulations, the Executive Directors in approving the revised Loan Regulations would be approving the change even though they did not have the opportunity to approve any statement on the policy.

Mr. Schmidt - Would it be possible to use the statement as a guide for loan regulations rather than as a published statement of policy? What I have in mind is that it could be used by the people concerned only when needed.

Mr. Knapp - That argues for not having a statement at all. At the last meeting, the point was made that there have been cases where some sort of a statement was necessary.

Mr. Cope - As this is not an issue in the case of every loan but is something that we have to explain to every borrower going through and explaining the Loan Regulations, I think there is a clear case for omitting this from the Loan Regulations.

Mr. Schmidt - That is also true of many other things in Loan Regulations.

Mr. Rist - The issue we are discussing has been raised because of the change in the Loan Regulations. Couldn't this issue be resolved by changing the Regulations and giving the Executive Directors an explanation of the reason for the change. I think this explanation would be relatively easy to draft. I don't particularly care which of the suggested alternatives for Section 2.05(c) is included.

Mr. Knapp - That would leave the Bank's policy unannounced to the borrower as none of the three alternatives cover the policy adequately. However, it is referred to indirectly in Alternatives II and III.

If we do have a statement of policy, I would suggest some changes. I dislike the reference to the Executive Directors and think the statement should be changed to make it one of the Bank. Also, I think para. 1 should have an additional statement that it is the Bank's established policy to sell loans out of its portfolio.

I also considered adding something to cover the point that the benefit to the borrower if the Bank waived the premium on prepayment is a privilege and that if this benefit were lost through sale of all or part of the loan to the market the borrowers would not have any reason to object. However, on second thought, I don't think that this should be included.

Mr. Rist - I agree with that but I think that the bit about the Bank's policy to sell should start the statement.

Mr. Cope - I like the suggestion of including a clause about the Bank's policy to sell bonds out of portfolio.

Mr. Knapp - I don't agree with Mr. Rist's suggestion to shift the statement about possible sales to the beginning of the statement. The decision to charge a premium is not based solely on the possibility that a loan might be sold to the market. We might not want to waive the premium for other reasons, therefore it would not be correct to hang the argument solely on the market angle.

Mr. Cope - Let us look at the alternative suggestions for Section 2.05(c).

Mr. Broches - Alternative II is the closest to the policy statement.

Mr. Knapp - The words "subject to the Bank's policy of selling loans or portions thereof to other investors" appears irrelevant to the Section to me, so I have trouble with Alternative II. Alternative III is merely a combination of I and II. I prefer Alternative I but think it could be strengthened by adding the words "and are still held by the Bank." This would be a repetition but for the purpose of emphasizing the distinction.

Mr. Cargill - I suggest we drop the word "sympathetically." Have we ever considered anything unsympathetically?

Mr. Cope - The "notwithstanding" clause at the beginning of Alternative I does appear to me to be a logical link so I think that I is the best but I still prefer the policy statement idea. Having this in the Loan Regulations makes it seem contractual whereas I think it should be handled on an ad hoc basis as the occasion demands.

Mr. Broches - Unfortunately there is a long history behind this Section. Originally it was put in to reassure borrowers on the one hand, and, on the other, to cover us where premiums were payable for prepayment of the Bank's bonds. In 1952, the words "in the light of all circumstances then existing" were substituted for the earlier language specifically to meet the problem of selling bonds from the portfolio. With all the back history, any changes we make now raise the question as to why we are making the change.

Mr. Stevenson - I have never had any trouble with the existing provision. Perhaps we are stirring up more trouble than the whole thing is worth. I realize that a policy statement such as this in Loan Regulations seems a bit odd. I suggest we might go back to the original version.

Mr. Cargill - I do not have much of any opinion. I was not in on the earlier discussions and feel reluctant to express an opinion but I have not had any difficulty with the existing provision.

Mr. Schmidt - We have never had any difficulty, therefore I would suggest to leave ~~it~~ as it is or to make as little change as possible.

Mr. Cavanaugh - I would prefer to leave it alone. Some time back when I was concerned with explaining the premium to borrowers, this was an answer against the borrowers' criticism of the premium but I have not been concerned with that problem lately so I don't have any strong feelings.

Mr. Rist - We have said that a policy statement should not logically be included in the Loan Regulations. Therefore it would not be an improvement in the situation if we retain the existing Section 2.05(c) which includes this policy statement.

Mr. Clark - It is not at all illogical to have a policy statement in the Loan Regulations. Having a statement is logical but the statement of policy which we have is illogical.

Mr. Broches - It is a sly way of referring to the Bank policy to seal bonds.

Mr. Knapp - In the existing wording of 2.05(c), the first sentence is too broad. If we mean it is the policy of the Bank to encourage prepayment of loans held by the Bank I would agree that we should stick with the existing Section, otherwise we would be opening up more trouble.

Mr. Clark - Is the statement as you modified it true? Is it the policy of the Bank to encourage prepayment of loans held by it? What about Pakistan?

Mr. Knapp - Yes, even in Pakistan we are basically interested in seeing them pay up early.

Mr. Broches - I'll change the first sentence to read "prepayment prior to maturity of portions of its loans retained by the Bank for its own account."

The meeting adjourned at 3:30 p.m.

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STAFF LOAN COMMITTEE

SLC/M/61-3

Rough Notes of Staff Loan Committee Meeting held on Tuesday, January 17, 1961, at 3:00 p.m. in Room 1006

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COLOMBIA

Mr. Knapp - Let us look first at the Economic Report. Do you have anything to say about that, Mr. Avramovic?

Mr. Avramovic - I have nothing to add really. The minutes of the SEC were fairly complete. There was a lot of discussion of what the present situation means for the future, but it is really a little too early to say anything with accuracy.

There is one new development. The world coffee crop in 1962 is expected to be very big compared with this year. By world crop we mean Brazil. This development has been discounted somewhat in the report as the price was assumed to go down slowly. However, in the light of the new report on the coffee crop, one might be more pessimistic about the balance of payments prospects of Colombia.

Mr. Knapp - It seems clear from the report that the Government continues to pursue sound financial policies. They have paid off an impressive amount of debt.

Are there any general comments? Would the Economic Report go to the Board?

Mr. Schmidt - I think we generally send these economic reviews to the Board to keep them informed.

Mr. Cope - With this record of debt retirement, there is a good chance of getting an 18% release.

Mr. Schmidt - We mentioned this the last time we talked to Colombian officials and got a good reaction.

Mr. Knapp - Why do we make loans without getting agreement on 18% release? I think we should put the pressure on now for this.

Mr. Schmidt - I agree to the idea of applying pressure, but I would not want to delay important projects because of disagreement over the release of 18%.

Mr. Knapp - One of the attached charts shows that on January 1, 1960 Bank lending to Colombia had slowed down but that it would pick up fast until 1963. The \$6.3 million of the 18% is rather small in relation to the amount we are considering for loans.

Mr. Schmidt - I agree we should push for this release.

Mr. Knapp - I have one comment on the level of imports in 1959 discussed on p.10.

Mr. Dominguez - P. 10 says that import levels had been high in 1960 and there was a consequent balance of payments deficit. New information indicates that the balance of payments in 1960 was about even. This will require a change in para. 22. Actually what had happened is that balance of payments did not drop but reserves have as debt was paid off.

Mr. Knapp - I suggest that some figures in paras. 22 and 23 would help the reader's understanding of this problem. Table 15 shows that import payments were up \$100 million in 1960 over 1959, which does not check with figures given elsewhere.

Mr. Dominguez - Table 15 is based on fiscal figures rather than physical trade and therefore reflects delays due to suppliers' credits, etc. The physical trade figures are more reliable for the long run.

Mr. Knapp - It seems obvious that the Government has been trying hard and has made a good record in the face of a poor outlook for coffee.

Mr. Dominguez - Further improvement is possible as cotton export forecasts are now up more than we had thought earlier.

Mr. Knapp - Let's reserve discussion on the actual total figure that the Bank might level. But, we are agreed, I take it, that Colombia is creditworthy for substantial additional external loans.

(No dissent).

Have they also been using restraint in borrowing from others?

Mr. de Vries - The ^{IDB} ~~IAD~~ is considering a line of credit of \$1 million for private financieras and some more for water supply projects.

Mr. Knapp - But Colombia is not plunging ahead with suppliers' credits.

Mr. de Vries - Commercial bank credits are up but these are for items which should be financed by that type of credit.

Mr. Aldewereld - And that may indicate improvement in the general economy.

Mr. Cope - There are some interesting figures on bond yields. Colombia appears to be almost within striking distance of a joint market operation. The yield on Japanese bonds is not far from the Colombian bond yield figures.

Mr. Knapp - I distrust these figures on bond prices somewhat.

Mr. Stevenson - Are there to be any changes in the figures on the ratio of debt service to export earnings as a result of the comments of the SEC?

Mr. Avramovic - We could drop the figures after 1962 as they are obviously unrealistic.

Mr. Knapp - The drop from 10% to 6% in these figures may change between now and 1963 but they do show that Colombia now has borrowing room. Certainly these figures, or absolute figures as to the debt level, are important.

Mr. Stevenson - My idea was only that the SEC had commented that there should be less stress on the figures and more on the basic factors; a comment with which I agree. Really, I only wonder whether changes have already been made in line with the SEC comments.

Mr. Dominguez - Yes.

Mr. Knapp - I want to raise the question whether we consider Colombia as an IDA customer on the basis of the level of the living standard and the direction in which the economy is moving. Personally I question whether it should be.

Mr. de Vries - The current balance of payments trend is based on the confidence of external creditors, which could deteriorate rapidly following faulty government action, and on coffee prices, which might slip fast. It's true that the per capita income figure is around \$250 but the figure is unreliable.

Mr. Schmidt - This is something to keep in the back of our mind but I had not considered Colombia as an IDA customer at the present time.

Mr. Basch - Colombia has a problem of managing to maintain the equilibrium of the Government budget. This is important because the budget is the basis for about 40% of the investment program and of course it has a bearing on the consideration of Colombia as an IDA customer.

Mr. de Vries - My big concern is whether the Government has the ability to finance the large investment program, necessary for political and social reasons, without severe inflationary forces developing.

Mr. Knapp - I do not think that is an adequate argument for more financing through IDA. They could go faster with their development if they got more funds, to be sure, but I think Colombia is high on the list of countries which should rely on normal sources for investment funds. With the Bank putting in the money at a good rate, there isn't much justification for more from IDA.

Let's look at the Area paper. Let's check off all the projects.

Highways

This is an old item. The transportation survey and the mention of a soft loan are the only new points.

Steel Mill

This again is another old item. Do we know yet whether this plant is economical and efficiently operated?

Mr. Armstrong - The information we have is indirect and incomplete. We are still waiting for the report being prepared for the Koppers' company. We understand that there have been some strained relations between Koppers and the Colombians which may be greater if their port is delayed further. We do not know whether Koppers is actually operating the plant or merely preparing a report on its operations. However, we have been told that the estimated cost of the project has grown from \$12 million to \$25 million since we first heard about it.

Medellin Power

Mr. Knapp - This one is urgent. The sum is certainly big.

Ra

Railways

Mr. Knapp - We have moved a long way from our previous position. At last report we had questions about the financial administration, the accounting system and pretty nearly everything about the project. Now we are talking of a loan early in 1961. Have all these problems been resolved?

Mr. Aldewereld - The track is not entirely clear, but a four-man mission went down to study these problems of efficiency and has recommended necessary changes. Secondly, they are now talking of a transportation survey. I don't think we need wait for the final report of the transportation survey, but can go ahead when the project is ready, assuming that the motive power and rolling stock investments are justified.

Mr. Schmidt - In preparing the paper we are now considering, we assumed that the Loven report would clear up these matters so that we could go forward. But, we would not go forward any faster than the project justifies.

Mr. Broches - I thought there was so much wrong with the railroad that we wanted to take another full look. We have already made two interim loans. Should we be making another before having our good look?

Mr. Knapp - I thought so too but the Bruce Payne report seems to be favorable, saying that although there was room for further improvement of the financial and statistical records, they provide a satisfactory basis for financial appraisal of loans which could be made earlier in 1961.

Mr. Aldewereld - We are now organizing a large expansive study. But the emergency of the motive power and rolling stock situation might justify going ahead before the survey is complete.

Mr. Schmidt - It's true that we had a question whether the financial picture was accurate. Bruce Payne checked and said it was; thus wiping away one of our big doubts. And then rates have been increased 30%. Consequently, if dieselization is urgent and economically justified, I think we can go ahead. It's now down to a question of technical appraisal of the project.

Mr. Demuth - In Argentina the emergency project put forward by the management of the railroad differed greatly from that which came from the mission after it had had a look at the situation. Is there any danger of the same thing happening here? Are we satisfied with the emergency project put forward by the railroad?

Mr. Aldewereld - The question is whether we trust Madigan-Hyland Corp. But we certainly could consider these projects as an exception to see whether they are sound.

Small Power Plants at Cartagena and Rio Prado

Mr. Knapp - Don't we have enough without these two small projects?

Mr. Schmidt - They need power at these places. The question is whether we can tell the Colombians that we have enough power projects and don't want to take any more. If we feel that way, maybe they would be something for IDA.

Industrial Development Bank

Mr. Knapp - What are the chances for this in 6 to 12 months?

Mr. Schmidt - The chances are very small.

Mr. Demuth - It's a long chance for anything coming out of this at all. We will know a little more in a few weeks but nobody is optimistic. There is a problem of regionalism, distrust between Government and private interests, and between sections of the latter.

Mr. Hoffman - Could the present organization borrow from the Bank?

Mr. Knapp - The Government guarantee problem has prevented that.

Mr. de Vries - The Government legally can guarantee now and the director of one of these institutions has said he would ask for a Government guarantee.

Mr. Demuth - The trouble is that the organizations are small and not satisfactory for Bank operations. Perhaps they are better prospects for the IDB.

Medellin Water Supply

Mr. Schmidt - This is in the list because we thought that if the Bank is going to start doing water supply projects, it could do this one because it is a good one. The IDB says that it's too big for them to do alone. We have been thinking of a joint arrangement, with the IDB lending pesos received from Colombia in payment of their capital subscriptions to the IAB.

Mr. Demuth - I don't think we should encourage that sort of thing.

Mr. Schmidt - There might be other sources of funds. They certainly need long-term financing.

Mr. Armstrong - The figures on foreign vs. local capital requirements are not very accurate. We do not know on what basis they were calculated.

Mr. Knapp - If anybody wants to throw out water projects, now is the time.

Mr. Aldewereld - In the Philippines we threw out water because it was identified with power we were financing. The same policy might be applied here, although in the Philippines it was the same water being used for power generation and water supply. Here it is not the same water but rather the same organization.

Mr. Cavanaugh - We have better things to do with our funds.

Mr. Cargill - We certainly have enough things to do with our funds.

Mr. de Vries - I thought the Bank was going to consider water projects. This one is easy to swallow as the rates are high and can be raised higher, it's industrially important and a generally attractive enterprise run by an organization which we are already financing.

Mr. Cavanaugh - My question is where do we stop and also I think it would hurt the Bank's ability to sell bonds.

Mr. Knapp - Mr. Black says it would not.

Mr. Aldewereld - Could we discuss where we draw the line?

Mr. Knapp - That has always worried me, particularly in Latin America where there are so many water supply projects which might be presented to the Bank if we start on them. However, having decided to go ahead on water supply projects, we just have to pick and choose.

Mr. Demuth - I never understood that position about the danger of being flooded with projects. With a limit on the amount we are willing to lend to a particular country we have to pick the most economical projects within the creditworthiness limit. The argument of too many projects is true of power or anything else.

Mr. Cavanaugh - Where do we put this water project in importance in relation to power.

Mr. de Vries - The water project is very important in this area. There are three important industrial areas in Colombia. The other two have found finance for their water supply and this one has not. I consider this among one of the top priority projects in Colombia. But I would have to put railroads as the most important.

Mr. Knapp - Why are we only considering a joint operation with IDB on this project? Why not on the others?

Mr. de Vries - The Colombians figure that this project had a high percentage of local currency. They know we do not do local currency financing so they thought of the IDB. Also, the amounts involved for some of the other projects are too big for IDB.

Conclusions

Mr. Knapp - The chart shows possible Bank operations in two steps: Step No. 1 is all right, but I think there is too much in Step No. 2 and the figure of \$12 million for the development bank is too high. The total figure of \$100 million seems awfully fast. What does that do to debt service?

Mr. Broches - If the IDB aims to do the development bank without a Government guarantee that might take it away from us.

Mr. de Vries - The second chart shows debt service, assuming loans were made for all the projects we have discussed.

Mr. Knapp - There is an awful lot and it seems too much. Why do we not consider the small power projects for the IDB?

Mr. de Vries - We cannot estimate when any particular project will be ready or what new projects will come along so we have to list all the possibilities. But, that does not mean they will all necessarily mature in the next 12 to 18 months. Also, the small power projects may turn into bigger ones. That has happened before in Colombia.

Mr. Schmidt - These are all good, high-grade, priority projects. We always think we can go faster than we actually do so that it's not necessarily a matter of lending all of this at one time. Moreover, the projects will have to go forward whether we do them or not, and I think it is better that they be done under us.

Mr. Knapp - We don't have to do all the projects in every country. That argument may be used for every project. How about these small power projects?

Mr. Schmidt - The question is whether we decide to stop doing any more power. That decision does not appear to be justified on the basis of the creditworthiness. These small projects have come up and we have to consider them.

Mr. Knapp - How do we justify so much work on these projects with many other demands on our time and manpower? The total amount of money suggested here for Colombia is high and has some important bearing on the question, but the manpower question is important too.

Mr. Aldewereld - The country has made progress. I am not certain, but all these projects appear to be good. This will put a big demand on our staff which already has big demands on it. The two small projects require as much work as big ones. The question is whether it is worth a \$7 million loan.

Mr. Broches - It isn't a creditworthiness problem but rather how thinly we can spread our manpower. It's a pity to give the impression of turning down small projects but on the other hand I don't think a decision here means that we were turning down all small projects.

Mr. Demuth - I agree with Mr. Broches, and would like to say also that this method of presentation gives a useful view of operations for a year or two and we should not penalize a country because two years' operations have been lumped in one package, making it look big, whereas actual loans will probably not reach the total figures.

Mr. Cope - I agree on the point about manpower. Can't we say we envisage a rate of lending of this magnitude over two or three years, leaving projects to be completed depending on the work load.

Mr. Knapp - If projects are all ready, we can't stop now on the basis of creditworthiness. Let's not proceed on the two small projects. We do have to place arbitrary limitations on our load. We will discuss it later.

Mr. Schmidt - If we are not going to do these projects, we have to tell the Colombians so that they can make other plans. They have gone through a good deal of trouble to prepare the projects well.

Mr. Knapp - What if the six others come in? We can't do everything and Cartagena is really nothing.

Mr. de Vries - The Cartagena power company figures on selling a substantial part of the increase in output to fertilizer plant which will not be built unless there is power. The Rio Prado project is in a region where the Government is making a real effort to help people settle on new lands as part of a social improvement program and we would like to contribute to this useful program.

Mr. Knapp - I would not want to approve it now. The problem is two more projects in a rich 'bill of fare'. I am not worried if some of the projects go out because that would get something off of our plate.

As for the amount, I take it that we agreed that we can leave the amount below \$100 million.

Mr. Demuth - \$93 million would not be excessive from a financial standpoint. If Colombia came in with two good projects of \$50 million each, we could not object on a creditworthiness basis. The problem is not the amount, but rather one of manpower and work load.

Mr. Knapp - I agree it is more of a manpower problem.

The meeting adjourned at 4:30 p.m.

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SLC/M/61-2

Rough Notes of Staff Loan Committee Meeting held on
Tuesday, January 31, 1961 at 3:00 p.m. in Room 1006

REVENUE-PRODUCING PROJECTS

Mr. Knapp - This meeting comes about from the fact that this subject was on the agenda of the Lost Weekend but was not discussed for lack of time. The meeting has been postponed once in order to make some revisions in the paper. Just putting the thoughts down on paper has probably been very helpful as a useful exchange of ideas. I understand there has been a good deal of discussion on the paper already. It certainly is an interesting paper.

Mr. Aldewereld - I had two reasons for wanting to undertake the study of this subject. The first stems from our difficulties in preparing the technical report on the Japanese railways project. The second is that we have been applying principles in the past which perhaps may not have been consistent. I hoped the paper would give us a chance to see whether the principles we have been applying have been correct.

Mr. Knapp - I would like to ask Mr. de Wilde about the minutes of the SEC meeting on this paper and to give us an oral report of that meeting.

Mr. de Wilde - Because this paper was changed considerably after the meeting of the SEC on an earlier draft, the minutes of the SEC meeting were not particularly relevant. I will attempt to give an oral report but I may go beyond the SEC in some respects because of my personal predilection for raising revenues.

This personal position is based on three considerations: (1) there is rather a prima facie case that if revenues are low, the cost/benefit ratio may be low; (2) if investment resources are low, it is desirable to examine all possibilities for increasing production of investment resources by higher revenues for self-supporting projects; (3) if prices are low, there is some danger of encouraging investment for production of economically unnecessary consumption of services or goods.

The presumptive yardstick set out in the paper is satisfactory as a guide of operations, but we must examine each application of the yardstick for possible departures either up or down. There is, for instance, a case for charging what the traffic will bear where there are monopoly profits, if investment resources are low in comparison with investment possibilities.

There are, however, limits to the application of this policy in some cases because of competition and, in such cases, other means of raising revenues must be found rather than increasing rates.

Acceptance of lower revenues depends, I think, on whether a project should be subsidized, or stated in another way, whether the subsidy should be countenanced by the Bank. A subsidy may be desirable if the result would be to maximize over-all production. For example, subsidization of fertilizers or water supply might result in an over-all increase of agricultural production. Also it might be advisable to countenance subsidy to offset other subsidies, for example, to subsidize agriculture to offset subsidies given to develop industries in an under-developed country. Finally, subsidies granted to benefit the community as a whole rather than the users might be considered as acceptable; e.g., education and water supply subsidies.

There are, however, two difficulties in applying the yardstick proposed by the paper. The first is that of determining a cost of capital. This is not the cost in terms of borrowing but in terms of the scarcity of capital and its possible use in other areas of development. Much study by the Bank is still required in this field.

Secondly, where a project is the extension of an old project, there is the difficult problem of calculation of asset value on which to determine the rate of return.

This whole matter is one of codifying basic practices of the Bank. The general position of the paper is all right; but the real problem is one of departure from the yardstick set up by the paper and the extent of the departure.

Mr. Knapp - On the problem of measuring the cost of capital, do you think that 7% to 10% is in the right range??

Mr. de Wilde - I think the range should be broader than that, say 5% to 12%. The 5% figure may be considered low but it is a question of supply and demand for capital which may balance out at some point in the range. Capital is generally scarce in underdeveloped countries but opportunities are also rare with a consequent low cost of capital. On the other hand, a very high supply of capital combined with a high demand may result in a high cost, as in Japan. The rate may balance out at any point in the range.

Mr. Cope - The discussions alone on this subject justify the paper.

I agree with what Mr. de Wilde has said as to the difficulties of this problem. It seems to me the paper takes too narrow a point of view. I want to make three points: First, the real question is what is a reasonable rate of return. This question is not covered in the paper. I understand that TOD has been doing some research on this and it would be helpful to know what rate of return had been expected on all the projects we have financed at the time we made the loans.

Secondly, the paper is fairly strong on power projects but gets a little shaky on railway projects where technical changes have begun to cause financial difficulties. I agree with the general idea set out in the paper but the paper is not very useful for railway systems which are going downhill. It leaves out a whole range of projects on which we need guidance. Para. 37 speaks of "prospects of earnings and adequate return on investment on proper valuation of assets." This is not much help. Historical cost is no good and revaluation to present values of assets in a declining industry or project is not very useful because in truth the assets wouldn't even be built today if we were starting fresh. This whole question is one of very complicated economic analysis. I think the paper should pay more attention to economic principles rather than to descriptions of situations we have encountered. I suggest that the Economic Staff set down principles for the guidance of Bank operations.

Thirdly, because of the history of the paper with numerous revisions, it has several ambiguities which should be edited out.

Mr. Aldewereld - The paper was prepared on the cases ~~of~~ seen and the difficulties encountered and not on the basis of general economic principles. I agree para. 37 is not very helpful. This point was discussed in the SEC meeting. The question of the less dynamic industries is admittedly difficult. If we were not examining an old railroad but were asked to finance economic transportation, we might now recommend building a highway instead. But the mere existence of the railway leads to a conclusion to hold the railway, but the question is at what rate of return. What is the value of the old assets? We can capitalize the return we expect to get, but, this is not a very helpful answer.

Mr. de Wilde - In this connection, the paper suggests that in some cases it may be necessary to revalue assets. But often the situation is one of over-valuation and the question arises whether we should seek a return on the old investment. A devaluation may be necessary which would show a much higher rate of return.

Let's assume a situation of inflation and serious price distortion. The question may arise whether it is possible for rates to be put up for the purpose of increasing the return without reducing revenues. Under these circumstances, revaluation of assets may be only a rationalization for a rate increase and not a change to reflect the true value of the assets.

Mr. Knapp - My view is that if a project slips into financial difficulties, this fact alone compounds the unsatisfactory situation because the general efficiency of the project is damaged by a drop in standards. For example: payrolls become inflated; the capital equipment is allowed to run down. This is a good reason for catching the problem before it slips into real financial difficulties.

Mr. Cargill - We all agree to eliminate deficit cases but the correction of the financial difficulties to which you refer may require other means than rate increases.

Mr. Aldewereld - This is a complicated problem. In Australia they added diesels to their equipment to solve railroad difficulties.

Mr. Cargill - A really interesting case would be that where there was a deficit for a whole enterprises but a new addition is justified.

Mr. Knapp - That case is discussed in the paper.

Mr. Broches - There seem to be two problems: first, determining what rate is proper; and, second, on what basis this should be calculated. Could one calculate a renewals fund necessary to keep the project on an existing level?

Mr. Aldewereld - That is exactly what they are doing in all the ex-U.K. countries. Calculations give the present revaluation cost and that is used as a depreciation charge. The Japanese have revalued all assets on present values and so they automatically use replacement cost for their depreciation charge. Other people achieve the same thing by charging the current prices for depreciation. This is why the rate of return figures are not comparable for different projects.

Mr. de Wilde - The chance of insisting on adequate depreciation depends on the monopolistic status of the enterprise. Some projects just couldn't cover adequate depreciation charges with their revenues.

Mr. Aldewereld - That's right. But the question is, if they cannot, whether the railroad should be built at all.

Mr. Cope - If the railroads followed Mr. Broches' suggestion of charging at a renewal rate, they probably would not earn anything on their capital investment.

Mr. Knapp - I think that a project should meet a lowest standard of covering operating cost and depreciation. This would give protection against the internal financial rot I mentioned earlier. Above that, it becomes a fiscal question for the government or agency or company responsible for the project. We cannot generalize except to say that we should get the most we can.

However, we might accept lower standards if we could get agreement on a forward program to achieve the satisfactory level within a reasonable time. Uruguay would be a sample perhaps.

Mr. Aldewereld - The paper tried to cover that. I would go as far as to say that we might accept a railway losing money, assuming an efficient operation, if the cost of providing service by other means would be greater. For example, the construction of a railway extension might result in a loss on investment in the total old and new facilities but the cost of a highway would be much higher.

relative

Mr. de Wilde - Investment in transport is a question of the return on the marginal investment in roads or railroads.

Mr. Knapp - What about a section of the road going off to some isolated area? If they don't need transportation for this area, they shouldn't build either railroads or roads.

Mr. Schmidt - In Latin America the railroads run at an operating deficit and we must insist upon reforms before we can go ahead. Once we have achieved that point then I would agree with the principles in the paper.

I have a question, though. This paper does not say anything about a margin for future expansion. Although the loan covenant does. Are we now saying that rate should only provide an adequate return on investment.

Mr. Aldewereld - The answer is now. The paper says 'return to include enough to cover investment in growing industries.'

Mr. Knapp - We have dropped out the involuntary savings point since there is no experience of a rate high enough to impose their savings.

Mr. Schmidt - But we have had rates which permitted reinvestment.

Mr. Diamond - I do not know of any cases where the return was higher than the cost of capital, but in Costa Rica certainly the 7% figure was arrived at not from calculations of the capital cost but by calculating how much was needed in the way of rate increases to provide 40% of the estimated cost of future expansion.

Mr. Knapp - That is a good persuasive approach; a good argument to meet investment requirements for future needs. We are uncertain as to the exact cost of capital for each case. As a practical matter we worked out what was needed for reinvestment, knowing that the return figure would probably fall within the range of the cost of capital.

Mr. Cope - That is all right as a practical matter but what if there is no expansion program requiring reinvestment?

Mr. Aldewereld - Fortunately we are not faced with that problem as we are dealing with the industry in the usual case. However, Mr. Diamond is right. If the calculation of the amount needed to cover 40% of the cost of expansion had come to a 20% return on investment it would have been all wrong.

Mr. Stevenson - If the application is pragmatic, we certainly cannot say that the general policy is all right. Consequently, I suggest a change in para. 50.

Mr. Knapp - Your suggestion is appropriate.

Mr. de Wilde - One would have to prove that there is no better way to raise money if one objects to this policy. As a practical matter, it is all right. But, don't let's kid ourselves that it's anything else but a practical guide.

Mr. Lejeune - The rate clause in the Costa Rica Loan Agreement provides that rates are to accomplish three things: (1) cover costs, (2) provide a return on investment, and (3) provide funds for future investment. A side letter says the rate of return is to be 7%. Why?

Mr. Cope - The provision of the Loan Agreement should refer to the rate of return on investment and not to what should be done with the return received on the investment.

Mr. Lejeune - The covenant deals with cash generation and disposal. I think that it should not.

Mr. Aldewereld - I agree we will have to have another look at that provision.

Mr. de Wilde - This problem arises if we want a rate of return above the rate of the cost of capital for the project.

Mr. Aldewereld - The amount of ploughback was admittedly determined by various factors. 40% of the cost of future expansion would be good for one project while 25% would be good for another. Therefore, criticism based on that score is justified. However, the criteria as to the rate of return should be uniform.

Mr. Diamond - Often there isn't enough economic guidance on this point for TOD when preparing their technical reports.

Mr. Aldewereld - The reports should have some evaluation of the rate of return on investment for each project that we consider.

Mr. Nurick - How can it be done without any capital market?

Mr. Diamond - I don't think that that problem is any more difficult than determining the justification for providing 40% of the cost of future expansion out of present revenues.

Mr. Aldewereld - The 40% figure is based on technical and financial factors which can be evaluated.

Mr. Diamond - But there are other factors for determining the return on capital which could be considered.

Mr. Aldewereld - I agree we should take these other factors into account. If a project earns a reasonable rate of return we cannot insist upon a rate increase. There is no connection between rates charged to customers and the needs for financing future expansion.

Mr. Knapp - True, there is nothing to justify insistence on providing for future expansion but it is persuasive and practical advice.

Mr. Cope - I agree that it is advice and not something for insistence. In Austria, for instance, we would not have been successful if we had insisted.

Mr. Diamond - Para. 19 speaks of electrification taxes and mentions that such taxes going back into the industry from which they were derived would be all right. I don't see why it makes any difference whether the proceeds go back into the same industry or not provided they go into the over-all investment of the country.

Mr. de Wilde - I agree. There are two questions really: (1) whether the tax should be considered as part of the revenues of the enterprise, and (2) whether all of the proceeds of the return on the enterprise should be devoted to the extension of that enterprise.

Mr. Knapp - If the funds received by the Government go into additional investment such as power, all right. But are there any such cases?

Mr. de Wilde - Many cases in the Middle East.

Mr. Knapp - But the receipts of the governments in the Middle East are just taxes and not part of the return on the enterprise.

Mr. de Wilde - In the cases I am thinking of, the tax is part of the return on the investment in the project.

Mr. Cargill - Whether the proceeds are earmarked for reinvestment or not, the rate of return should certainly be calculated before deducting taxes.

Mr. Knapp - I was talking about additional taxes over and above the return on investment. A tax increase (including excise tax) is not properly included in the return on the project.

Mr. de Wilde - Assuming a country wishes to penalize domestic consumption of power, it can raise the price of power or the tax. In that case it is entirely a question of a return on the investment.

Mr. Knapp - If the proceeds are going to be invested, I would consider that a return on the investment. I gather that others don't agree with this.

Mr. de Wilde - Dividends don't go into investment but they are certainly to be included in the return on the investment.

Mr. Knapp - Throughout the section of the paper on irrigation there appears to be a theme of subsidizing agriculture.

Mr. de Wilde - The facts of the matter are that in underdeveloped countries industry has been subsidized so that most underdeveloped countries have to have a subsidy for agriculture for offsetting this.

Mr. Knapp - I agree with the first sentence of para. 49 and with the first part of para. 50.

Mr. de Wilde - We find that the policy is applicable to ^{the} power field possibly because of the monopoly situation of power.

Mr. Knapp - Also power is a fruitful resource.

I do not believe that this paper should go any further now. It was a very useful paper for discussion and not a holy writ. It has served its purpose.

Mr. Schmidt - Could we follow through by having a discussion on covenants covering earnings and capitalization? This would be helpful.

Mr. Knapp - There was a paper on that some time ago. Perhaps it did not go out.

Mr. Schmidt - I will look at that.

Mr. Diamond - There is one thing to follow through, and that is the consideration of the rate covenant.

Mr. Stevenson - I am still concerned about para. 50 as to whether it is a general policy or the policy which is generally applicable to the power field.

Mr. Knapp - Generally revenues should cover cost and earn an adequate return but exceptions will have to be made in the fields of agriculture and transportation.

Mr. Ripman - A study of the whole question of subsidies would be worthwhile.

Mr. Knapp - I agree. Could the Economic Staff come up with a paper on this subject?

Mr. de Wilde - There are three questions really: (1) the problem of incremental investment; (2) the determination of the cost of capital; and (3) the question of subsidies. All these would be quite a job.

Mr. Knapp - I think the Economic Staff could do a paper on subsidies and it should not be too much of a job to round up figures on the productivity of capital.

Mr. Aldewereld - In the future the TOD reports could indicate the cost of capital for the project under investigation.

Mr. Knapp - That seems something for the economic report.

Mr. de Wilde - Really there should be guidelines set up by the Economic Department to assist in determining this cost.

Mr. Diamond - Why do we not have an economic review of TOD papers made by the Economic Staff?

Mr. Knapp - Such a review should be by the Working Party operation, but we have to remember that the economist cannot come up with a fast figure for each project.

Mr. Lejeune - I assume that the same criteria that we have discussed here would apply to IDA projects.

Mr. Knapp - Normally we would give Bank and IDA projects the same treatment, except in those cases where borrowing from the Bank was not feasible because the project could not service a Bank loan and we would not want to lend to the government. Under ^{such} circumstances we probably would lend to the government and the government would lend to the borrower on conventional terms.

The meeting adjourned at 5:00 p.m.

STAFF LOAN COMMITTEE

SLC/M/61-1

Rough Notes of Staff Loan Committee Meeting held on
Thursday, January 5, 1961 at 11:00 a.m. in Room 1006

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JAPAN - Railways

Mr. Knapp - The main topic for consideration seems to be the project. The amount has been left a little indefinite. The Area paper speaks of \$80-\$100 million, while the Technical Report is based on a project of \$70 million. This will, of course, have to be worked out later. The amount does not make much difference to the railroads as it is small in comparison with the amount of the total program of the railroad.

The outlook for the bond issue now appears rather pessimistic but it has not been finally settled one way or the other. We will review the matter later with the Japanese, bearing in mind that the figure of \$100 million is rather a large, round target for possible criticism. So, we will consider a figure a cut below that.

Mr. Aldewereld - This project is distinctive in many ways. It has been a very long time in preparation. It is probably the best railroad project the Bank has ever had. The utilization of equipment, the efficiency of operation and service speeds are high. The company enjoys very good labor relations. The investigation has been very complete. Perhaps the report is a little optimistic but still if one makes allowances for that, the technical, managerial and economic aspects of the project are very good.

The financial aspects are somewhat peculiar. The assets were revalued in 1955 with the result that the return on the investment for the whole system would range between zero at the start and 3% at the end of the construction period, but the return on the line to be financed by the Bank is estimated at 25%. However, it compares favorably with the Indian railroad which uses historical asset value and depreciation based on historical cost.

Information has been received within the last 24 hours that rates will be increased 15%. This would raise the return on total investment up to about 5%. This changes the financial picture considerably and will aid further by making additional borrowing possible.

Mr. Knapp - Will we have a rate covenant in the agreement?

Mr. Aldewereld - No.

Mr. Rosen - We are dealing with a sophisticated, competent management. We have been talking rates and return on investment with them since the fall of 1958. They know all about this question, our feelings on the question and how to correct the situation. A rate adjustment took place last July which will raise revenues somewhat. A rate increase requires approval of the Diet and, consequently, the Railroads and Government are not able to give a commitment. They have been working slowly on this problem, including several sessions with members of the political parties. They are asking for a 16% increase, knowing that they will not get that, but they think that they will get something satisfactory. I think it's better to let them handle this in their way rather than for the Bank to make demands on rate increases.

Mr. Knapp - I don't question that; in fact, I was ready to accept the financial situation before the 15% rate increase, given the existence of the sophisticated management.

Mr. Broches - What is the usual position of railroads for handling depreciation to calculate the return on investment in the U.S., for instance?

Mr. Aldewereld - In the U.S. the railroads calculate depreciation by using 2% of historical cost.

Mr. Rosen - The U.S. practice is not a fair test without looking into the entire background of the question.

Mr. Broches - I was thinking of South America. Do we have another standard for Latin America? Can we make the necessary adjustments here in order to make a satisfactory comparison?

Mr. Aldewereld - This picture here is obviously strange at first sight. The rate of return of 25% on the line to be financed by the Bank under the proposed loan and the 1% return on all railroad property means that some properties must be losing money and should be written off. The fact is that this railroad would have to go through the financial wringer to get an adequate picture.

Mr. Knapp - Is further revaluation of the assets contemplated by the railroad?

Mr. Wallenius - No further revaluation is being considered at the present time as not much inflation has occurred since 1955 when the last revaluation took place. The railroad is now using a depreciation rate of 2.1% of the book value.

Mr. Knapp - In para. 51 we may be overdoing the argument that the return would be better on the basis of the original cost. The para. might be interpreted as meaning that we think it would have been better if there had been no revaluation. To the extent that depreciation funds are needed to meet the cost of necessary renewals, a revaluation of the assets is desirable.

Mr. Aldewereld - I agree, but the same thing can be accomplished without revaluation of assets if depreciation charges are based on need rather than on historical cost of the assets.

Mr. Stevenson - I have a feeling in reading this report that I don't know for sure exactly what is going on, but I do think that it would be better to say that the return on investment is adequate under the circumstances rather than to say that it is low.

Mr. Rosen - The report writers cannot say that it is adequate if it is not in various parts of the railroad system.

Mr. Broches - We can say that the figures on the rate of return are inconsistent with those of other railroads the Bank has examined and then give an explanation of why we think this railroad is as good or better than the others.

Mr. Rosen - I agree with the idea of giving an explanation as to why we think this is as good as the others.

Mr. Aldewereld - I am afraid that if we were to readjust the figures in an effort to make a comparison with other railroad projects, we might give the Japanese, other than the Railway, the wrong idea. They might use the Bank's revisions for some other entirely different purpose which we might not approve which would be detrimental to the interests of the Japanese railroads. We want to avoid this sort of trouble if we can.

Mr. Rist - Looking at the problem from a broader angle, the situation of the whole railroad system having a low rate of return raises the question of subsidizing of the railroad users.

Mr. Rosen - The simple figures on rate of return that we have been discussing are not meaningful generally. Basing our case on them may cause trouble in connection with other railroad projects. There are many other immeasurable criteria involved here such as the crying need for transportation and the extreme cost in terms of money and time of highway construction in Japan. All of these factors, which are peculiar to Japan, have to be considered; or we will be in serious difficulties when other railroads are considered which have a better rate of return than this, but do not have these general favorable factors and are really not as good.

Mr. B. King - I think that one must separate the project and the railroad enterprise. This report does not concentrate enough on the project and the high rate of return on the project, which is very significant and would have a large bearing on the question of considering other railroad projects. Secondly, I think we should make up our minds whether we think revaluation is good or bad. In this particular case, I think it's good but there may be other railroad projects where revaluation is not justified.

Mr. Aldewereld - Rate of return in railroad projects is a more difficult, or at least a more obvious problem where the growth rate is 3% compared with perhaps 10% for the power industry. In a mature railway system such as this, the problem shows up. In a fast-growing, dynamic situation, such as many of the power projects the Bank has financed, the inequities and inaccuracies of revaluation progressively diminish in the growing picture.

Mr. Knapp - This problem rate of return is to come up in a special paper so I think that we have discussed it enough at this meeting. I agree with Mr. King that a 25% return on the line is good but the enterprise is also important as the railroad would be the borrower and must be able to service the debt. The fact that our project earns an adequate return will not solve the borrower's financial problems.

Mr. King - But they are two different things.

Mr. Knapp - It's not so easy to separate these two things however. In Chile, for instance, the north section of the Railroad was bad. We discussed the possibility of setting up a separate borrower for the southern part of the system but were unable to make any satisfactory arrangement to meet this problem. We have to look to our borrower for repayment.

What is the situation on competitive bidding? Are they just going to go through the motions or will there be real competitive bidding?

Mr. van Helden - The railroad knew about this problem as they were familiar with the Bank's discussions on the Japanese roads and apparently decided to accept the Bank's position without further comment. For most of the goods, it's an academic problem because they know that Japanese producers can compete with producers in other parts of the world.

Mr. Aldewereld - Since the Japanese producers are beating the rest of the world in the world market at the moment, this does not appear to be a problem.

Mr. Knapp - What is our position on security?

Mr. Aldewereld - We would stand pari passu with other borrowers.

Mr. Broches - The railroad follows the usual Japanese practice of medium-term notes which are refunded at maturity. This would mean that we need the usual standby commitment which was worked out for the Aichi loan.

Mr. Knapp - I take it that we accept the railroad project as bankable.

(No dissent.)

The meeting adjourned at 11:⁴⁵~~50~~ a.m.

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STAFF LOAN COMMITTEE

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WBG ARCHIVES

Rough Notes of Staff Loan Committee Meeting held on
Wednesday, January 4, 1961, at 3:00 p.m. in Room 1006

LOAN REGULATIONS

Mr. Knapp - Before proceeding to go over the draft word by word, we will have a comment by the General Counsel.

Mr. Broches - We are sorry about the four-year delay in revising Loan Regulations but we hope for speed from this point forward. First, because the new regulations should be ready for the many new loans coming along, and second, because a schedule of orientation lectures on Bank procedures is coming up shortly.

Several very useful comments on drafting have been received already and probably more are to come. I don't think it is necessary to discuss pure drafting here at this time.

Mr. Knapp - I agree that we should not discuss pure drafting changes but the very nature of this work necessitates a rather detailed review. Are there any general comments before proceeding to go through the paper page by page?

Mr. Rosen - Is there any purpose or general theme to the changes which have been made in the Loan Regulations?

Mr. Broches - No. The purpose of this revision is only to clear up past changes and to achieve uniformity. There is no intention to cover new points although that possibility was given passing thought. There have been no suggestions for new points from the Legal Department or from the clients of the Legal Department. The Loan Regulations have been very useful but the previous issues went about as far as we can go to cover the various points. The danger of not reading carefully a provision because it is included in Loan Regulations must be measured against the ease of using Loan Regulations to cover those points which apply to all agreements.

Mr. Rosen - There still is some boiler plate in the Loan Agreements. I wonder whether some of this could be transferred to the Loan Regulations; for instance, the repayment provisions.

Mr. Broches - Since we have to put dates of repayment in the Loan Agreements the other repayment provisions can go into the loan agreements. Also there is some boiler plate in the loan agreements because we want to discuss these points with the prospective borrower.

Section 2.01

Mr. Stevenson - Does this section cover development banks?

Mr. Broches - No - deliberately. We considered separate regulations for development banks or including them here as exceptions, but have dropped both ideas because each development bank loan would require individual treatment.

Section 2.05 (b)

Mr. Iliff - What is the difference between "part" and "portion"?

Mr. Broches - There is no difference but we have reserved the word "part" to apply to development bank loans and therefore did not want to use it here.

Mr. Iliff - The word "portion" carries the meaning of share as in a widow's portion.

Section 2.05 (c)

Mr. Iliff - The phrase "any request of the borrower to waive..." should be certainly "of the borrower that the Bank waive..."

Mr. Rosen - I would suggest that we take the whole section out since it gives the borrower the wrong impression that he is entitled to this waiver. Under some circumstances the Bank might not wish to waive the premiums and our position may change although circumstances do not change.

Mr. Broches - We have tried to make it clear that the benefit to the borrower could only come about if circumstances warranted it at the time. I agree with Mr. Iliff's suggestion.

Mr. Cope - I have already asked to have this section removed as a change of policy, but agreed after discussion with the lawyer that a revision of Loan Regulations is not the proper place to make such a change of policy.

Mr. Rosen - This is a very important question, particularly when the Bank sells strips which include longer maturities. I think it is better to explain this to individual borrowers and handle it case by case rather than include it in the Loan Regulations.

Mr. Knapp - Nobody thinks we should change now our policy of waiving the premium, do they?

(No dissent.)

A borrower may misunderstand the nature of the benefit. They may receive it but they would not have any argument if we explain that we can sell participations in the loan and that we would not, therefore, be able to waive the premium on the portion of the loan sold.

Mr. Rosen - That is a good argument for not having it in the Loan Regulations. When I explain this provision to prospective borrowers, I always say first that the Bank will try to sell the loan paper and then I mention the possibility that the premium might be waived if the loan is prepaid to the Bank. All of this can be explained better to individual borrowers rather than in a form which would be suitable to all borrowers.

Mr. Knapp - I agree with your method of explaining the provision to borrowers but don't understand why that means that the provision should be removed from Loan Regulations.

Mr. Rosen - It was explained earlier that we agreed to leave out of Loan Regulations those things which we have to explain to and discuss with the borrowers.

Mr. Knapp - By including it in the Regulations we make it a part of the record.

Mr. Broches - If we take out this section, its omission will come up for discussion in the Board. It would be difficult to explain to the Board that the removal does not reflect a change in policy.

Mr. Rist - The Loan Regulations are part of the loan agreements. Under the Loan Regulations the borrower has the right to prepay, but the Bank may waive the premiums. This is not a contractual relationship and therefore need not necessarily be included in the Loan Regulations.

Mr. Broches - That's correct. But it is a statement of policy which puts on record the Bank's answer to a question which borrowers may ask about the premiums.

Mr. Cope - This is the only policy statement in the Loan Regulations; the only place where Bank's policy is mentioned.

Mr. Iliff - I am afraid if we leave it out now and the omission is noticed, we will be in trouble.

Mr. Knapp - I prefer the original language as the wording in the revision; "without prejudice," is pretty weak.

I would like to make a different suggestion. Could the Bank make a policy declaration and refer to this declaration in the Loan Agreement?

Mr. Rosen - It would be better to give them a declaration without the reference, otherwise the borrowers would go away thinking that they had a right to prepay without the premium.

Mr. Broches - Not a right, a privilege.

Mr. Cope - I prefer no reference in the loan documents. Then there is nothing binding.

Mr. Broches - Since this is a policy matter and not a contractual relationship, it is true that it does not have to be in the documents. On the other hand, this question should not be left to an oral explanation. That leads to greater dangers of misunderstanding. I agree we could give them just a standing policy declaration without the footnote.

Mr. Knapp - A footnote in the Loan Agreement would not bind us.

Mr. Iliff - Why not leave it the way it was?

Mr. Cope - We have had trouble about this and may have further misunderstandings if we don't make a change.

Mr. Cavanaugh - Our troubles have arisen from the policy more than from the wording.

Mr. Rosen - Our troubles could be answered by putting both policies in the Loan Regulations, that is, that we will try to sell and we will consider waiving premiums on the portion of the loan we do not sell.

Mr. Aldewereld - My suggestion would be to keep it here but to blow it up along the lines suggested for clarification.

Mr. Broches - I have no objection to putting the Bank's policy of selling bonds in a positive way, but I did not do it here because it would be out of context in a section dealing with premiums.

Mr. Cope - This seems to be a clear case for removing the section from the Loan Regulations.

Mr. Iliff - There would be trouble, I am afraid, if we did.

Mr. Broches - It would be the same if made the subject of a Board statement. I am willing to consider wording in the Loan Regulations to make the Bank's position on selling loans positive.

Mr. Cope - That still does not answer Mr. Rosen's question on "in the light of all circumstances then existing." Some time we may not wish to consider sympathetically waiving the premiums.

Mr. Knapp - Let us consider another draft of this section and a draft policy statement of the Board at a subsequent SLC meeting.

Section 2.06

Mr. Rist - Do we need this section?

Mr. Broches - Yes, to indicate place of payment. The suggested changes are merely to make it conform with the bonds.

Mr. Rosen - Do we have anything anywhere about the five-day period of early payment for service on loans sold as participations?

Mr. Broches - No.

Mr. Cavanaugh - We have never had trouble over the five-day requirement because the borrowers would have to get other paying agents if we did not perform this service. It is always explained to them that they have the alternative of finding other payment agents. They are not forced into this five-day arrangement.

Mr. Rosen - Since we have to explain this to borrowers always, it might be helpful to have it written down in the regulations.

Mr. Broches - Normally we sell our loans by giving participations in the loans. Under this arrangement there is no relationship between our borrower and the purchaser of the participation. We are not really a paying agent but a paying agent would usually require that it be in funds to make payment. We have avoided difficulties by the informal arrangements made by Mr. Cavanaugh.

Mr. Rosen - But we don't have the right to request this early payment.

Mr. Cavanaugh - That is correct, but we do have the right to ask for bonds and could sell the bonds rather than participations, thus avoiding for us the problem of making payment to the participants. That would be much more expensive for the borrower.

Mr. Knapp - If we cover this question of early payment in the Loan Regulations, it would raise the question of why we do not provide for a reduction in the interest payment to cover the same period.

Mr. Broches - I would urge avoidance of public discussion on this issue.

Mr. Knapp - As it now stands, there is no default if borrowers do not pay five days ahead of time since payment is ^{based} ~~made~~ merely on an informal arrangement. If this were made a part of the Loan Regulations, failure to pay would constitute formal default. Let's leave it where it is.

Section 3.02

Mr. Knapp - The wording seems strange to say the "cost of goods payable".

Mr. Broches - The word "goods" here means including services, but if it is ambiguous it should be changed.

Mr. Cope - I would rather see this whole section recast to provide for payment of costs or expenditures on the project rather than for goods but I agree that it is too late to make this change at this point.

Mr. Rosen - Does this wording constitute a change of policy?

Mr. Broches - No. This is wording only.

Mr. Cavanaugh - We have always had this policy. We have always been able to effect withdrawals in the currency in which the goods are paid for or in the currency of denomination. We have charged the loan account in another currency where we have bought the currency in which the goods were paid for with the other currency.

Section 3.05

Mr. Ramm - Should this section cover the currency in which the charge for special commitments is payable? We follow the practice of charging the currency of denomination in every case.

Mr. Knapp - I suggest we change the word "charge" to "charges".

Mr. Broches - I would prefer to have this point written into the special commitments themselves.

Mr. Knapp - Why is the Treasurer's Department anxious to tie their hands on this? Perhaps we might want payment in currencies other than the currency of denomination.

Mr. Cavanaugh - I am not arguing that it should be in the currency of denomination but merely that there should be agreement somewhere as to the currency of the charge. At the present time the individual agreements merely refer to the loan agreement for ruling on this point. The loan agreement does not say anything.

(All agreed to Mr. Knapp's suggestion to change the word "charge" to the plural where it occurred in this section.)

Section 4.03

Mr. Rosen - I suggest that the first clause of the second sentence be deleted.

(Mr. Knapp and others agreed.)

Mr. Cavanaugh - Would that mean that the borrowers would be in default if they did not submit applications promptly?

Mr. Broches - Yes.

Section 5.01

Mr. Broches - This section has been changed to include amounts committed as well as disbursed.

Section 5.02 (e)

Mr. Iliff - This is rather drastic wording.

Mr. Broches - This is a classical definition of insolvency and we want the right to move fast when suspension is necessary.

Section 5.02 (i)

Mr. Broches - This section which has been a part of recent loan agreements provides that any action of omission between the date of signing and the effective date which would violate the negative pledge or other provisions of the Loan Agreement would constitute grounds for suspension.

Section 5.02 (j)

Mr. Knapp - The language seems cumbersome to me and should be revised.

Section 6.11

Mr. Broches - This section attaches to the bonds held by the Bank the same rights the Bank has under the Loan Agreements. Another subsection will be added to cover the cost of the exchanging of bonds.

Article X

Mr. Broches - A paragraph will be added to define "Guarantee Agreement".

Schedule I

Mr. Broches - This Schedule has been changed to conform with the change in the Loan Regulations and to cover the situation where bonds are issued for only a part of a loan.

PERU - AGREEMENT BETWEEN DLF AND BANK

Mr. Knapp - As the proposed agreement between DLF and the Bank on the Peruvian highways loan might be applicable to other loans I thought we ought to discuss the draft of the agreement.

We welcome DLF collaboration and cooperation on projects and we particularly welcome their agreement to let us do the administrative job. But, there is some danger that they may be passing over too much power to us which might conceivably lead to undesirable Congressional queries and investigations of the Bank's activities in the future. We have tried to cover this point in the present draft, in which DLF is not relieved of its agency responsibilities but allows us to do the administrative work.

Mr. Diamond - Before starting the discussion, I wish to mention a recent development. We have found that the proposed DLF loan to Honduras provides that no equipment, no matter who finances it, can be purchased by Honduras from countries listed in the U.S. Code. In effect, this means Iron Curtain countries. This restriction would not cause any trouble now because the Bank is even more restrictive, but the U.S. Code may be changed in the future, putting us into trouble.

DLF has suggested that for the Honduras loan, a side letter would be agreed with the borrower that this provision would not apply to procurement financed by the Bank. For the Peruvian highways loan, DLF has suggested, and we are now considering, the addition of a paragraph to the letter of agreement to cover this point.

Mr. Rosen - That would not be sufficient since the letter of agreement is between the Bank and DLF while Peru and Honduras are the signers of the loan contracts. We certainly cannot agree with DLF on something which affects the borrowers.

Mr. Broches - Legally you are right. We would, of course, show the change to the borrowers.

Mr. Diamond - For future loans, DLF would limit its restriction to the procurement of goods financed by DL^F funds.

Mr. Rosen - Do we need this agreement with DLF? We have financed projects jointly with other groups, the private market for example, without such agreements. Why do we do it for DLF and not for the private investors?

We have refused to enter into undertakings to furnish the private investors with data such as we are now agreeing to give to DLF.

Mr. Broches - There is a difference here. The DLF has the rights under its loan agreement with the borrower to do the things which we would be doing for them under this procedure. We are only simplifying the administration and not giving the DLF anything new. I do not think that the private market has the same rights.

Mr. Rosen - Such rights could be put in the agreements made between the private market and the borrower. My objection to this is that it looks like an agreement between two U.S. agencies.

If this procedure is ever considered for use in connection with another loan, we should ask the borrower whether they have any objections.

Mr. Cope - I have doubts about this arrangement and share Mr. Rosen's objection. This seems to be much too far-reaching in putting us in a position of having to consult with DLF before taking action.

Mr. Stevenson - What would happen if we were the minority?

Mr. Broches - The same thing probably, because DLF has asked us to do this.

Mr. Diamond - DLF gave us a draft which said in effect that the Bank undertook to do all this administrative work for them in return for their relinquishing their responsibility for action. This, we thought, went much too far and we have taken it out and tried in this present draft to put the agreement on a friendly basis.

Mr. Rosen - But para. 5 goes further than that.

Mr. Cope - And para. 8 limits the right of independent decision.

Mr. Knapp - I don't agree with that. Para. 8 only says we would consult. The draft only puts down on paper those things which we would do anyway to cooperate with another creditor even if there were no agreement.

Mr. Rosen - It is all right to consult in that way but this draft might be taken as more than just friendly cooperation.

Mr. Knapp - I don't see it that way. Looking back over the background history of this thing, should we not welcome the fact that other agencies accept our leadership? DLF came to us with a proposal for just that. The difficulty was that the proposal was too good. They wanted us to take the whole responsibility. But, the fact that the proposal was too good does not weaken the fact that benefits accrue to us from cooperation with DLF.

Mr. Cope - We had the benefits without any agreement and here we would be binding ourselves to do something affecting the borrowers who have not agreed to this action on our part.

Mr. Knapp - I agree with that part of it. The borrowers would have to agree to this agreement.

Mr. Aldewereld - Three things strike me. First, administratively the preparation of a single report rather than two is certainly better for the borrower. Second, the borrower has to approve the arrangements. Third, there is some danger that para. 5 may cramp the Bank's style if DLF should want something which the Bank did not want.

Mr. Broches - We have agreed with DLF on every point in the draft agreement. Each party has what amounts to veto rights, under its loan agreement with the borrower, which are already in effect and because of this veto, DLF and the Bank both have to approve eventually all questions which way arise. It is better that the Bank and DLF should discuss the questions before giving their respective opinions.

Mr. Rosen - That is perfectly true but a good deal of this type of consultation is done anyway through our normal relations with DLF. Therefore, I don't understand why it is necessary to have this formal agreement.

Mr. Clark - Without a written agreement DLF will blow up way beyond the point reached in the paper in order to protect itself.

Mr. Cope - I am not objecting to having an agreement but rather to what is in the agreement.

Mr. Broches - There are two kinds of clauses in the agreement. The first covers those things which both the Bank and DLF do not want to go beyond a certain point, that is, the degree of responsibility that the Bank undertakes vis-a-vis DLF. The second covers those things which both DLF and the Bank would do anyway, such as to talk over points of mutual interest. Having put the first kind in the agreement we felt we had to record the second kind, when DLF wanted it. However, it is perfectly true that this second group would be taken care of through the normal relationships between the two organizations.

Mr. Knapp - Two points have come out in the discussions which are worthwhile, I think, and could be clarified by adding a preamble to the letter of understanding. One, the agreement has to be approved by the Borrower in each case, and two, anything we agreed to do under the agreement with DLF would not be a restriction on our rights because DLF already has the power under its loan agreement with the borrower to do for itself what we are agreeing to do for it.

Mr. Diamond - If a joint lending operation were contemplated, this type of document would be discussed with the prospective borrowers. However, at the present time we have no intention of using it where another creditor comes into the picture after our loan is signed.

Mr. Knapp - We might use it for Development Bank loans if DLF came into the picture later.

Why couldn't we use this with other lenders?

Mr. Rosen - Since the terms on which various lenders join with us differ, I think that the agreements made with the various lenders should vary. It may be that with some lenders we would be able to make more favorable arrangements without any formal agreement at all.

Mr. Knapp - Perhaps you are right but with an agreement we might be able to prevent heavy-handed action by DLF.

Mr. Rosen - Right, but that does not answer the problem of tying ourselves to them.

Mr. Aldewereld - I see one place where this agreement might give difficulty. We picked the Panel to study Thin Arch Dams. If such circumstances arose again, DLF might disagree with our choice.

Mr. Diamond - The thin arch dam problem is not relevant. It is not the same thing as the Panel was hired by the Bank whereas the agreement with DLF is concerned with contractors hired by the borrower.

Mr. Knapp - To sum up the discussion, I take it we are agreed that this type of agreement should be made if approved by the borrower and that a preamble should be added to note the approval of the borrower and to clarify that this is only a procedure for consultation between the Bank and DLF, both of which must approve borrower actions under the terms of their respective agreements with the borrower, and, therefore, it is not a restriction on the rights of either the Bank or DLF.

Let's hold in abeyance whether this agreement will serve as a model for use with other lending organizations. The question will certainly come up soon again, perhaps in the German case.

Mr. Cope - I don't want to think of this as a model for anything.

Mr. Cavanaugh - The agreement, as I understand it, would require that we explain to DLF if we refused disbursement on a borrower's application for withdrawal.

Mr. Diamond - That is right. I don't understand your objection. The Treasurer's Department has agreed that we would not give information to DLF gratuitously but if Peru asked that we give information to DLF, we should do so.

Mr. Broches - DLF wanted us to say whether they should disburse. We have agreed to do no more than to tell them whether we had decided to disburse. That does not limit our rights.

Mr. Knapp - The spirit of it is that we would tell DLF of the disbursements we made and we would explain any discrepancies between the amounts applied for withdrawal and disbursements made by the Bank, if they asked for it.

The meeting adjourned at 4:55 p.m.

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